SUGGESTIONS FOR EXAMINING "ACCOUNTANCY AND BUSINESS MANAGEMENT"—PART ONE

1. The Preface is the authors' "platform." It discusses the point of view from which the course of study contained in the text and the accompanying Laboratory Unit was written.

2. The "Introduction to Bookkeeping" supplies a topical development of the beginning work, with short exercises which permit of the teaching of one basic principle or bookkeeping procedure at a time. See pages 1 to 47.

3. Observe the skillful teaching procedure in this beginning work, which is characteristic of the entire course. Note the following steps under the topic "Recording Purchases" on page 1:

(a) Information—the statement of a few facts of common knowledge in ¶1.

(b) Illustration—reproduction of a purchases bill and a written-up purchases book.

(c) Interpretation of records illustrated—to disclose content of the bookkeeping record.

(d) Investigation by means of analysis—observe how the analysis questions on page 3 "draw out" information and develop reasoning about the subject being considered.

(e) Application and review—exercise 1, page 4, and accompanying analysis.

4. Pages 47 to 122 provide instruction and exercise matter to correlate with Laboratory Unit One, the text matter furnishing the material for class recitations, and Laboratory Unit One the application of accounting principles in a set of books.

5. Ledger account method. If it is desired to begin the study of bookkeeping by this method, pages 47 to 122—the Elementary Accounting Section of the text—supply the necessary material. Notice how clearly principles are developed, the frequency with which they are restated, and the manner in which their application is stressed.

6. Paragraphs 26, 34, 61 and 100 are examples of the extreme simplicity and clearness of the language of instruction.

7. Observe how the division of the text material under topical headings adapts the book to the class method of teaching.

8. Observe particularly the following features:

(a) Model Set, pages 14–15.

(b) Three short practice sets without vouchers, pages 16–17, 23–24, and 40–42.

(c) The simple and effective way of making the pupil understand the equality of debits and credits, pages 26–28.

(d) The introduction of the journal at the logical time, and the analogy between it and other books of original entry, pages 33–36.

(e) Gradual expansion of the content of cash book entries, pages 37–40.

(f) The journalizing exercise and the comparison of classified and journalized sets, page 46.

(g) The simple yet comprehensive treatment of general ledger accounts, the clear exposition of the principles underlying account classification, and the brief and simple statement of rules.

(h) The manner in which rules are developed as the natural outgrowth of basic principles.

(i) The "Construction and Interpretation of the Income and Profit and Loss Statement," pages 100–103; and the corresponding treatment of the Statement of Assets, Liabilities, and Capital, pages 105–108, with the accompanying treatment of accounts by groups.

(j) Closing the ledger through the Profit and Loss Summary Account, with separate closing ent[illegible] "clearing" individual accounts, pages 110–114.

(k) The "Recapitulation of Principles," pages 119–122.

(l) The Review Exercises, pages 123–127.

9. Finally, observe how the subject is stripped of its traditional mass of complicating detail and minute discussions of routine practices that are not basic. Note how the text on the other hand gets immediately to the heart of the subject in every topic presented.

THE H. M. ROWE COMPANY

CHICAGO BALTIMORE SAN FRANCISCO

ACCOUNTANCY

AND

BUSINESS MANAGEMENT

PART ONE

BY

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THE H. M. ROWE COMPANY

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In keeping with the modern trend in business and in accounting practice, all rulings in books of entry and ledger accounts in the illustrations in this book are in black ink. The author recommends the discontinuance of the use of red ink for bookkeeping purposes in schools in the interest of efficiency and economy.

PREFACE

The course of study provided in "Accountancy and Business Management," and in the laboratory practice units which accompany it, is based to some extent upon the author's previous work, "Rowe's Bookkeeping and Accountancy." However, a number of important changes in the teaching plan and in the selection and arrangement of subject matter make the present course of study substantially a new and original work.

The most important new features are:

(a) An Introduction to Bookkeeping at the beginning of the text, in which the fundamental concepts of accepted accounting principles and business operations are presented in an exceedingly simple and logical manner.

(b) The opportunity provided throughout the course of study for teaching by the class method when this method is preferred. The teaching plan is so elastic, however, as to permit the instructor to exercise his personal preference and judgment as to methods of presentation.

(c) A minimum use of the reference feature contained in the author's former works, with no references to topics other than those under immediate consideration.

(d) The separation of the material of the text into consecutive parts to correspond with the material in the laboratory practice units. Each part of the text and the accompanying practice unit can be completed in one semester in the high school, or in the equivalent of that time in commercial and other schools.

(e) The laboratory units are relatively short and can be completed in about one-half of a semester, or the equivalent of that time in the business school. They contain fewer routine bookkeeping transactions, less detail and repetition in office practice matter, and consequently fewer business papers and forms. Emphasis is placed upon principles and the more constructive features of accounting practice.

(f) The inclusion of lessons in business management based upon the transactions in the laboratory units. These lessons are really brief lectures on business management and administration which emphasize, as does the text, the ultimate aims of the study of accountancy and the more enduring educational benefits to be derived from it.

Throughout the course the principles and practices of the subject and the various steps taken in the entire cycle of accounting procedure have been developed as topics for study and recitation on the lesson unit plan to the extent that the subject permits of this method of treatment. The practice exercises following each topic or principle presented in a lesson are short, and as a rule, can be completed easily within one daily period. Class instruction will be supplemented by individual instruction to correct the deficiencies of students as they develop in the work of the class. Individual instruction may be employed to any extent desired.

This book is intended for use in commercial courses in all types of schools teaching business subjects to beginners. It will prove to be effective and entirely satisfactory both in the private school and in the high school because of the recognition which is more and more being given to the greater efficiency of the class method of teaching. Its material and teaching plan are adapted to the requirements of all students taking up the subject for the first time, regardless of whether it is their purpose to become bookkeepers, to engage in business for themselves, or to pursue advanced courses in accounting and business administration leading to professional degrees. It emphasizes principles and requires what the author believes to be the minimum amount of practice work necessary to provide the training which the student must secure to make him vocationally efficient in his knowledge of the subject, no matter whether he may desire to follow the occupation of bookkeeper, business manager, or accountant.

Unless the principle is conceded that the minimum aim of the bookkeeping course is to qualify young people to start a business career, there can be no justification whatever for teaching utilitarian subjects, and the remarkable growth and development of commercial courses in public and private schools, which has been the outstanding feature of educational progress in recent years, must be pronounced a serious blunder. In face of the insistent and ever-increasing demand for education which fits for commerce and industry, and the esteem in which such practical education is held by educators and the general public, such a conclusion cannot be maintained successfully.

The author's view is that the vocational value of a knowledge of bookkeeping and accounting is merely the *immediate* object to be served in offering the course to students of business subjects. On the other hand, he contends that if the aim of the bookkeeping course were merely to train for bookkeeping positions, that aim could not be realized without at the same time teaching students much of what constitutes an elementary course in business management. Such information will in any case be absorbed unconsciously to a considerable degree by pupils from their study of business transactions and their records in books of account, whether the teacher attempts to emphasize the broader aspects of the subject or not. Since both the educational and vocational interests of students in high schools and private schools can be served by a properly constructed course of study, any attempt to differentiate between their needs in the selection and arrangement of text material is unnecessary and unwarranted, and would discriminate against those whose immediate interests may be of a vocational character. Therefore, while the inclusion of bookkeeping in the curriculum of any school teaching business subjects to beginners is not justified unless it does make them vocationally efficient, its chief value lies in the training it imparts in the principles and methods of conducting business enterprises. No subject in the commercial course is so valuable as the subject of bookkeeping with respect to the opportunities and wealth of material if affords for teaching young people how business is transacted. The ultimate aim, therefore, of a course of study in this subject should be to supply a comprehensive training in the *uses to which accounting records and information are put* by business executives in managing and directing commercial and industrial enterprises, rather than to qualify merely for keeping a set of books. Accounting, accordingly, has been coordinated in this text with business management, and it has been the purpose of the author to emphasize the importance of accounting as an aid to intelligent business administration.

Attention is invited to the method which is consistently followed in presenting a new topic for the student's consideration. Reason has been substituted for rule in preparing the pupil's mind for that which is to be learned. The opening statement of a few simple facts in connection with the topic under consideration is followed by an illustration that is made the basis of an analytical investigation which discloses the principles to be learned. The results of the analysis are then summarized in a statement of principles and recapitulation of facts, from which a brief and simple working rule is deduced. Each rule is essentially a summarization of the instruction on the topic or principle to which it applies.

In arranging the first year course in the high school, teachers will have considerable latitude in the use to be made of Part One of the text and of Laboratory Unit One. The Introduction to Bookkeeping, covering the first forty-six pages of the text, is recommended by the author as the first work to be given to all beginning students. It is estimated that it will require approximately six weeks of the first semester to cover this material. The work of Unit One may then be started and completed by the end of the first semester. If the students are immature or if it seems desirable for any reason not to start work on a practice set until the second semester, the material in Part One of the text devoted to Elementary Accounting, pages 47 to 127 inclusive, may be studied by the class method during the remainder of the first semester. This section presents the subject according to the ledger account method and provides an elementary treatment of trial balances, statements, and the adjustment and closing of accounts.

If the first semester's work is confined to Part One of the text as suggested above, Laboratory Unit One will be started at the beginning of the second semester. In this case sufficient time will be available in the second semester to make an introductory study of Part Two of the text, which treats of wholesale and partnership accounting, as a preparation for Laboratory Unit Two, which will be used in the third semester. In like manner, there will be time in the third semester to make a preliminary study of Part Three, which is devoted to corporation accounting, as a preparation for Laboratory Unit Three. This unit presents corporation and general mercantile accounting, and will be used in the fourth semester. Laboratory Unit Four treats of cost accounting for manufacturers, and provides a fifth semester's work. Of course, if Unit One is used in the first semester, the four units will require four semesters instead of five in which to be completed. Thus the text and four units provide a two year, or a two and a half year course, according to the manner in which the material is used.

The author also recommends that students in private commercial schools be started in the Introduction to Bookkeeping, which should be followed by the four laboratory units referred to in the preceding paragraph. Students may be started immediately, however, with the work of Laboratory Unit One when it is preferred to begin the course with a practice set. The importance of introducing the class method of teaching as it is adapted to the subject matter of this course is suggested to teachers in private commercial schools in order to realize as fully as possible the educational benefits to which all young people who are preparing for business life are justly entitled.

The recognition accorded to my previous works on this subject by teachers, students, accountants, and the business public encourages me to believe that this, my latest and perhaps my last contribution in this form to the young people of the country whose interests have always been paramount and nearest to my heart in all of my educational activities, will be received with the same cordial interest.

H. M. Rowe.

Baltimore, 1922.

PART ONE

INTRODUCTION TO BOOKKEEPING

RECORDING PURCHASES

1. A merchant must buy goods before he can sell them. When goods are purchased, they are usually accompanied by a bill which shows the amount of the purchase. If the goods are not paid for at once, the bill shows the amount the purchaser owes the seller. The following illustration shows a bill received by Mr. Rogers for merchandise he purchased from Mr. Walton.

ILLUSTRATION 1—BILL

BALTIMORE, MD., Jan. 1 19

CARPENTER TOOLS
GARDEN TOOLS
SEEDS

J. R. WALTON
WHOLESALE HARDWARE
219 LOMBARD ST.

CUTLERY
PAINTS
VARNISHES

SOLD TO C. E. Rogers,
1220 N. Charles St.,
City

TERMS: 30 days

		2 Doz. Monarch Hatchets	9.00	18	00		
		3 " " Spades	17.50	52	50		
		10 Gal. Oriole Flat White	2.60	26	00	96	50

2. Notice that the bill gives the *date* of the purchase, the *name and address* of the purchaser, the *terms* of the purchase, the *quantity of each item purchased*, the *price* of each item, and the *total amount* of the bill. "Terms 30 days" means that this bill becomes due and payable thirty days from its date. Bills are prepared by the seller and are received by the buyer. It is from the bills received by the buyer that a record of his purchases is made in the book which is kept for that purpose. It is called the *purchases* book, and only this *one class* of transactions is entered in it.

3. The following illustration shows Mr. Rogers' purchases book containing the entries for five purchases which he made during the month of July. Notice that the total purchases are entered and that the book is ruled to show that all the entries of this class have been made for the month. The first entry is for the bill shown in illustration 1.

ILLUSTRATION 2—PURCHASES BOOK

Purchases Book

Jan	2		J. R. Walton	Jan. 1	30 days	96	50		
			219 Lombard St.						
	6		R. C. Jones & Co.	Jan. 5	10 days	101	20		
			121 W. Pratt St.						
	11		J. R. Walton	Jan. 9	15 days	221	80		
	19		Mason & Weller	Jan. 18	20 days	182	40		
			Camden, N. J.						
	27		R. C. Jones & Co	Jan. 26	30 days	149	70		
			Total Purchases					751	60

Note: The purpose of the column to the right of the date column will be explained later.

HOW TO INTERPRET PURCHASES BOOK ENTRIES

4. Refer to illustration 1. Mr. Rogers' bookkeeper would read this bill as follows: "Mr. Rogers has purchased from J. R. Walton, 219 Lombard St., a bill of goods dated January 1, amounting to $96.50, to be paid for in thirty days." He would pay no attention to the fact that Mr. Walton was a wholesale hardware merchant dealing in tools. Neither is the other information on the bill necessary to the record of *the essential facts of the transaction with Mr. Walton.* If he were asked to write a memorandum of the transaction, he would write it about as follows: "Purchased from J. R. Walton, 219 Lombard St., bill of merchandise dated January 1, terms 30 days, amounting to $96.50."

5. By referring to illustration 2 it will be seen that *all the essential facts* in this statement are included in the entry for this bill, dated January 2, the date on which it was received. The items included in purchase bills are omitted from the entries because such bills are kept on file and can be referred to for the items at any time. If the bookkeeper were asked when this bill would become due, he would say, "Thirty days after the date of the bill, or January 31," which means that it should be paid on or before that date. Bills begin to mature from the date of the bill and *not from the date of their entry.* In the entries for the second and subsequent purchases from the same person, the address is omitted.

Analysis of Purchases Book Record

6. Analyze the transactions recorded in the purchases book shown in illustration 2 by answering the following questions. Write the answers in the form suggested in illustration 3 below. Mr. Rogers is transacting the business and the transactions are to be studied from his viewpoint. In other words, the student is acting as his bookkeeper.

ANALYSIS

1. What were Mr. Rogers' total purchases for the month, and how is the amount found?
2. If at the end of the month he had paid none of these bills, how much would he have owed?
3. According to its terms, the bill for the first purchase from J. R. Walton was due and payable in 30 days. When was it due?
4. What were the due dates of the bills entered on the 6th, 11th, 19th, and 27th?
5. Which one of the bills owed to Mr. Walton became due first?
6. If Mr. Rogers had paid each bill as it fell due, how much cash would have been required to pay those that matured during January?
7. If all bills maturing during the month were paid, how much did he owe at the end of the month, whom did he owe, and how much to each?

Illustration 3

ANSWERS TO ANALYSIS OF PURCHASES BOOK RECORD

1. $751.60. The amount is found by taking the sum of the items entered.
2. $751.60.
3. Jan. 31.
4. Jan. 15; Jan. 24; Feb. 7; Feb. 25.
5. The bill of Jan. 9, due Jan. 24.
6. $ 96.50
   101.20
   221.80
   $419.50 Total cash required.
7. Mason & Weller $182.40
   R. C. Jones & Co. 149.70
   $332.10 Amount owed at the end of the month.

EXERCISE 1

W. H. Clark conducts a butter and egg business. He buys from farmers and poultrymen and sells to grocers and other retailers. He received bills during the month of August for the following purchases:

Aug. 1 John Holmes, Woodlawn, Md., July 30, 15 days, $175.00.
5 W. J. Dixon, Catonsville, Md., Aug. 4, 20 days, $155.40.
14 John Holmes, Aug. 11, 30 days, $211.50.
17 L. N. Wilson & Sons, Catonsville, Md., Aug. 16, 10 days, $98.70.
21 W. J. Dixon, Aug. 20, 15 days, $74.85.
24 John Holmes, Aug. 24, 30 days, $122.80.
27 Walter Crampton, Ellicott City, Md., Aug. 27, 10 days, $74.20.

With the purchases book shown in illustration 2 as a guide, write the entries for the above transactions on a sheet of journal paper. Rule the two additional perpendicular lines shown in the illustration. When the seven items have been entered, find the total purchases and enter the amount in the second column.

In recording these transactions be careful to make the writing neat and uniform in size. Write the figures plainly and distinctly. Do not make the capital letters too high. They must be written within the ruled lines on the paper. When completed, present to the teacher for examination and criticism.

ANALYSIS

On the bottom of the page containing the purchases book, tabulate the answers to the following questions:

1. What were Mr. Clark's total purchases for the month?
2. If on August 31 he had paid none of the bills for goods purchased during August, how much would he have owed?
3. Do the total amount of purchases and the amount he would have owed agree?
4. What bills became due and payable during the month?
5. If Mr. Clark paid these bills as they became due, how much did he owe on unpaid bills on August 31?
6. How much did his purchases from each person amount to during the month?
7. If he had paid the bills as they fell due during the month, whom did he owe on August 31, and how much to each?
8. How much cash was required to pay the bills that matured during the month?

RECORDING SALES

7. After goods have been purchased and placed in stock, they are then ready for sale. As they are sold they are billed by the seller to the buyer. The following illustration shows a bill sent by Mr. Cook to Mr. Hart for goods which were sold to him.

ILLUSTRATION 4—BILL

ALL FRUITS AND VEGETABLES IN SEASON

ROBERT A. COOK
FARM PRODUCE AND PROVISIONS
9 EXCHANGE WAY

FLOUR, FEED, AND GRAINS

PHILADELPHIA, PA., Aug. 1 19

SOLD TO B. F. Hart
145 Walnut St.,
TERMS: 30 days City

		10 Brls. Harvest Apples 3.50			35	00

8. Notice that this bill gives all the details of the sale and is similar in general form to bills for goods purchased. A record of each bill of goods sold is made in a book kept for that purpose, called the *sales book*. *Sales entries* are therefore another *class* of entries in keeping books.

The illustration on the next page shows Mr. Cook's sales book containing entries for seven sales he made during August, with the total sales entered and the book ruled to show that all the entries for the month have been made. The first entry is for the bill shown in illustration 4.

9. The form of the sales book differs little from that of the purchases book. However, since bills for sales are sent to the buyers, the items of each sale are included in the sales book entry so that they may be referred to at any time for quantities, grades, prices, and other information. As already stated, this is not necessary in entering purchase bills because the bills received are kept for such information. Sales are entered *under the date they are billed*, and the due date is determined *from the date of the bill.*

ILLUSTRATION 5—SALES BOOK

Sales Book August 1, 19

B. F. Hart, 145 Walnut St	30 days					
10 brls Harvest Apples	3.50				35	00
3						
Manning & Co. 456 Elm St.	10 days					
20 baskets Peaches	60	12	00			
5 brls Harvest Apples	3.60	18	00		30	00
7						
B. F. Hart	15 days					
20 brls. Early Potatoes, 60 bu.	.70	42	00			
15 " Harvest Apples	3.55	53	25			
5 cases Butter Prints, 150#	.22	33	00		128	25
13						
Belvedere Hotel, Times Square	30 days					
15 brls Early Potatoes, 45 bu.	.70	31	50			
10 " Snowflake Flour	7.90	79	00			
6 baskets Peaches	.60	3	60			
12 brls. Pippin Apples	4.25	51	00		165	10
17						
Archer & Crane, 215 Poplar St	10 days					
50 brls. Snowflake Flour	7.75	387	50			
5 cans Lard, 250#	.14	35	00		422	50
20						
Manning & Co	30 days					
15 tubs Creamery Butter, 850#	.25	212	50			
10 boxes " Cheese, 390#	.14	54	60		267	10
27						
B. F. Hart	30 days					
12 brls. Harvest Apples	3.60	43	20			
6 " Early Potatoes	.72½	4	35			
2 tubs Creamery Butter, 60#	.23½	14	10		61	65
Total Sales					1109	60

ANALYSIS OF TRANSACTIONS

The purpose in analyzing transactions is to develop a thorough understanding of the *relations established* between the parties to them. Such an understanding will greatly simplify the work later on in the course.

In each analysis the questions presented should be considered from the viewpoint of the person whose books are being kept and not from the standpoint of the other parties to the transactions.

ANALYSIS

1. What were Mr. Cook's total sales for the month, and how is the amount found?
2. If none of these bills had been paid, how much would his customers have owed him at the end of the month?
3. Who owes for these sales, Mr. Cook or the purchasers?
4. What were the due dates of the bills for goods sold?
5. What was the sum of the amounts due from Mr. Cook's customers for bills maturing in August?
6. What is the sum of the amounts not due until the following month?
7. If Mr. Hart paid his bills when they became due, how much cash did Mr. Cook receive from him during August?
8. If all bills falling due in August were paid, which customers continued to owe Mr. Cook on August 31, how much did each owe, and what was the total owed to him at the end of the month?
9. Explain the difference between the expressions, "One who is owed" and "One who owes."

EXERCISE 2

J. R. Carter is a wholesale dealer in grain and feed. He buys from farmers and sells to liverymen, users of horse-drawn vehicles, and others who buy grain in small quantities. His sales for the month of April are given below:

April 3 J. C. Warren, 211 Second St., 10 days, 50 bu. Oats @ 90¢.
5 City Livery Co., 12 Market Place, 15 days, 100 bu. Oats @ 90¢; 20 bu. Corn @ $1.05.
9 John H. Horner Co., 472 High St., 20 days, 3 tons Hay @ $21.50.
14 J. C. Warren, 15 days, 5 tons Straw @ $14.25; 10 bu. Corn @ $1.10.
17 John H. Horner Co., 30 days, 100 bu. Oats @ $92\frac{1}{2}$¢.
18 J. C. Warren, 30 days, 3 tons Hay @ $22.50; 25 bu. Wheat @ $1.15.
23 City Livery Co., 30 days, 6 tons Straw @ $14.00; 10 tons Hay @ $22.00.
26 Walker & Sons, 126 Paca St., 30 days, 125 bu. Oats @ 90¢; 50 bu. Corn @ $1.10; 2 tons Hay @ $20.00.
29 John H. Horner Co., 15 days, 50 bu. Oats @ 95¢.

Record these sales in a sales book, using a sheet of journal paper. Foot and rule the book in the manner illustrated.

ANALYSIS

1. What were Mr. Carter's total sales for the month?
2. If on April 30 none of the bills for goods sold had been paid, how much would his customers have owed him on that date?
3. Do the total sales and the amount that would be owed to him agree?
4. What bills became due during the month?
5. If each bill had been paid when due, how much would his customers have owed him on April 30?
6. What were his total sales to each customer during the month?
7. Assuming that bills maturing during the month were paid, how much did each customer owe him on unpaid bills on April 30?
8. If Mr. Warren paid his bills as they became due, how much of his indebtedness to Mr. Carter did he cancel?
9. If all bills falling due in April had been paid, how much cash did he receive from his customers?
10. If the John H. Horner Co. had made no payments during the month except $100.00 to apply on their account, how much of their indebtedness to Mr. Carter would have remained uncanceled on April 30?

CASH RECEIPTS AND PAYMENTS

10. Cash is received and paid in making settlements for goods bought and sold. Recording receipts and payments of cash is therefore another important part of a bookkeeper's work. Cash receipts and payments are recorded in the cash book.

Recording Cash Receipts

11. Cash receipts are entered on the *left-hand side* of the cash book. Each entry includes the *amount* (which should be written first), the *date*, the *name* of the party from whom the cash is received, and a brief *explanation* of the entry. Illustration 6 shows the entries for the cash received by A. S. Parker during the month of January.

ILLUSTRATION 6—CASH BOOK—RECEIPTS

Cash Receipts

19 Jan	2	Walter Brown	Bill Dec. 22	50	00		
	5	F. H. Dixon	Bill Dec. 7	126	19		
	11	J. B. Herrick & Co.	Bill Jan. 3	35	20		
	14	Martel & Sons	a/c Bill Jan. 3	150	00		
	19	Walter Brown	Bill Jan. 6	17	28		
	21	J. B. Herrick & Co	Bill Dec. 23	255	40		
	27	F. H. Dixon	Bill Jan. 3	272	16		
	30	Martel & Sons	In full bill Jan. 3	61	45		
	31	Total Receipts for the month				967	68

ANALYSIS

1. What was the total amount of Mr. Parker's cash receipts for the month?
2. What was the total amount of cash received from Walter Brown and from Herrick & Co. during the month?
3. The last receipt of cash from Martel & Son being in full, what was the total amount of the bill sold to them, if the date of the bill was Jan. 3?
4. How much cash was received for bills sold in December?
5. How much was received for bills sold in January?
6. How much of Mr. Dixon's indebtedness was canceled during the month?
7. If Mr. Parker paid out $500.00 of the total amount of cash received, what was the balance of cash on hand January 31?

EXERCISE 3

Rule the two additional lines shown in illustration 6 on a sheet of journal paper; then enter the following items of cash received by R. F. Emerson during the month of July. Foot the column in pencil and then prove the addition. Next write the total in ink and rule the book as shown in illustration 6.

July 2 F. B. Nelson, bill June 22, $95.40.
6 R. A. Fisher & Co., bill June 12, $125.12.
10 T. E. Young, bill June 12, $57.50.
12 F. B. Nelson, bill June 11, $176.19.
17 Carter & Harris, on a/c bill July 7, $100.00.
20 R. A. Fisher & Co., bill July 3, $117.20.
25 T. E. Young, bill July 9, $67.28.
28 G. E. Emery, bill June 28, $189.45.
31 Carter & Harris, in full bill July 7, $76.20.

ANALYSIS

1. What were the total receipts of cash for the month?
2. What were the amounts of cash received from F. B. Nelson, Fisher & Co., T. E. Young, Carter & Harris, and G. E. Emery?
3. If F. B. Nelson owed R. F. Emerson $345.12 on July 1, how much did he owe on July 31?
4. If T. E. Young owed $124.78 on July 1, how much did he owe on July 31?
5. How much of the cash received from Fisher & Co. canceled their indebtedness on June bills? On July bills?
6. If the cash received from G. E. Emery on July 28 was received on the day the money was due, what were the terms of the bill?
7. How much did Carter & Harris owe on the bill of July 7 after their payment of July 17 was received?
8. How much of the cash received applied on June bills? On July bills?
9. What is the difference in the meaning of "on a/c" and "in full of a/c"?
10. If Mr. Emerson had paid out $425.50 of the cash received during the month, what was the balance left on hand July 31?

Recording Cash Payments

12. Cash payments are entered on the *right-hand side* of the cash book. The entries include the *amount* (which should be written first), the *date*, the *name* of the party to whom the cash is paid, and a brief *explanation* of the entry. Illustration 7 shows the cash payments made by Brown & Co. for the month of February.

Illustration 7—Cash Book Payments

Cash Payments

19 Feb.	1		James S. Allen	Bill Jan. 22	75	00		
	5		Hill & Myers	a/c Bill Jan. 26	50	00		
	12		H. B. Thompson	Bill Jan. 14	126	83		
	15		Hill & Myers	a/c Bill Jan. 26	75	00		
	17		James S. Allen	Bill Feb. 3	103	20		
	20		H. B. Thompson	Bill Feb. 12	62	19		
	25		Hill & Myers	In full bill Jan. 26	48	75		
	28		A. J. Bates & Co.	Bill Feb. 2	225	40		
	28		Total Payments for the month				766	37

ANALYSIS

1. What was the total of Brown & Co.'s cash payments for the month?
2. What was the total amount paid to each party?
3. The last payment to Hill & Myers being in full, what was the amount of the bill purchased from them?
4. How much cash was paid for bills purchased in January?
5. How much was paid for bills purchased in February?
6. How much of Brown & Co.'s indebtedness to Mr. Allen was canceled during the month?
7. If the cash receipts for the month were $1,892.75, what was the cash balance on February 28?

EXERCISE 4

The following are the cash payments of John C. Watson for the month of July. Enter them in a cash book in the manner shown in illustration 7, ruling on a sheet of journal paper the two additional lines required. Then foot and rule the book.

July	1	Henry Miller, bill June 5, $27.80.
	3	A. M. Gordon, bill June 16, $36.25.
	7	Barnes & Co., to apply on June bills, $100.00.
	12	Henry Miller, bill June 14, $52.28.
	16	G. W. Richards & Co., on a/c bill July 1, $125.00.
	19	Barnes & Co., in full of a/c, $89.23.
	25	Blake Bros. Co., bill July 7, $142.82.
	27	A. M. Gordon, bill June 22, $59.20.
	28	G. W. Richards & Co., in full bill July 1, $69.90.
	29	Henry Miller, bill July 12, $97.50.
	30	L. O. Cummins, bill June 30, $105.60.

ANALYSIS

1. What were the total payments for the month?
2. What were the total payments to Henry Miller, A. M. Gordon, Barnes & Co., G. W. Richards & Co., Blake Bros. Co., and L. O. Cummins?
3. If Mr. Watson owed A. M. Gordon $95.45 on July 1, what did he owe on July 31?
4. If Mr. Watson owed Henry Miller $211.85 on July 1, how much of this indebtedness remained uncanceled on July 31?
5. How much did Mr. Watson owe Barnes & Co. on July 15?

6. If L. O. Cummins was paid on the day his bill became due, what were the terms of the bill?
7. How much did Mr. Watson owe G. W. Richards & Co. on the bill of July 1 on July 31? On July 20?
8. How much of the cash paid canceled June bills? July bills?
9. If Mr. Watson's cash receipts during the month were $972.66, what was the balance on hand July 31?

REVIEW QUESTIONS

1. Who prepares bills for goods purchased and who receives them?
2. Who prepares bills for goods sold and who receives them?
3. What does "terms 30 days" mean?
4. What is the purpose of the purchases book? Of the sales book?
5. Why are the items omitted in purchases book entries?
6. Why are they included in sales book entries?
7. From what date is the due date of a bill of goods purchased determined?
8. From what date is the due date of a bill of goods sold determined?
9. What is the purpose of the cash book?
10. Where are cash receipts entered? Cash payments?
11. What data does a cash book entry include?
12. What does "he canceled his indebtedness to me" mean?

CLASSIFICATION OF TRANSACTIONS

13. The transactions presented up to this point have been grouped in four classes, namely: purchases, sales, cash receipts, and cash payments. These four classes include by far the larger number of transactions met with in lines of business in which profits are derived from the *buying and selling* of merchandise.

14. Grouping or classifying transactions is a part of the work of the bookkeeper. The transactions which follow are listed in the order in which they occurred without regard to their classification. They are classified and recorded properly in the purchases, sales, and cash books in the model set on pages 14 and 15. The transactions are those of J. M. Fuller for the month of January. He is a dealer in farm products.

Transactions—Model Set

Jan. 2 Bought of Samuel Howe, Greenfield, Pa., per his bill of December 31, terms 30 days, $125.00.

3 Sold to W. C. Archer, 12 Penn St., terms 10 days, 40 brls. Winter Apples @ \$3.40; total \$136.00.

5 Bought of J. K. Todd, Columbia, Pa., per his bill of Jan. 4, terms 30 days, \$100.00.

8 Sold to Harry Carter, 219 Central Ave., terms 10 days, 15 brls. Winter Apples @ \$3.45, \$51.75; 40 bu. Potatoes @ \$1.25, \$50.00; total \$101.75.

10 Received cash from W. C. Archer to cancel bill of Jan. 3, \$136.00.

11 Sold to W. C. Archer, terms 30 days, 10 brls. Winter Apples @ \$3.50, \$35.00; 25 bu. Potatoes @ \$1.25, \$31.25; total \$66.25.

16 Bought of Samuel Howe per his bill of Jan. 15, terms 20 days, \$156.00.

17 Received cash from Harry Carter in part payment of bill sold him Jan. 8, \$75.00.

21 Sold Wm. Martin, 925 Elm St., terms 15 days, 50 bu. Potatoes @ \$1.22½; total \$61.25.

22 Sold to Harry Carter, terms 20 days, 15 bu. Potatoes @ \$1.30, \$19.50; 30 brls. Winter Apples @ \$3.50, \$105.00; total \$124.50.

24 Paid J. K. Todd to cancel bill of Jan. 4, \$100.00.

27 Received cash from Wm. Martin in partial cancelation of his bill of Jan. 21, \$35.00.

28 Paid Samuel Howe in full to cancel bill of Dec. 31, \$125.00.

31 Sold to W. C. Archer, terms 30 days, all of the stock remaining on hand, 5 brls. Winter Apples @ \$3.40; total \$17.00.

FOOTING AND RULING BOOKS IN MODEL SET

15. Notice that the purchases and sales books are footed and ruled in the same manner as formerly. In footing and ruling the cash book, however, the *cash balance,* which is found by taking the difference between the total receipts and total payments, is entered on the payments side and added to the total payments, as illustrated in the model cash book. This is done in order to show that the sum of the payments and the balance is equal to the total receipts. This process is called "balancing" the cash book. The footings showing this equality should always be entered on the corresponding line on the two sides of the book, even if several lines on one side or the other must be left blank in order to do so. The balance is then brought down to the receipts side under the footing.

ILLUSTRATION 8—PURCHASES BOOK—MODEL SET

Purchases Book 1

19 Jan	2	1	Samuel Howe Greenfield, Pa.	Dec. 31	30 days	125	00		
	5	1	J. K. Todd Columbia, Pa.	Jan. 4	30 days	100	00		
	16	1	Samuel Howe	Jan. 15	20 days	156	00		
			Total Purchases					381	00

ANALYSIS OF MODEL SET ENTRIES

By following the analysis below, trace each transaction on pages 12 and 13 to the corresponding entry in the books.

Jan. 2 In this transaction merchandise is purchased; therefore the entry is made in the purchases book, where such transactions are recorded.

3 In this transaction merchandise is sold; therefore the entry is made in the sales book, where such transactions are recorded.

5 Merchandise is purchased—purchases book.

8 Merchandise is sold—sales book.

10 In this transaction cash is received; therefore the entry is made on the receipts side of the cash book, where such transactions are recorded.

11 Merchandise is sold—sales book.

16 Merchandise is purchased—purchases book.

17 Cash is received—cash book, receipts side.

21 Merchandise is sold—sales book.

22 Merchandise is sold—sales book.

24 In this transaction cash is paid; therefore the entry is made on the payments side of the cash book, where such transactions are recorded.

27 Cash is received—cash book, receipts side.

28 Cash is paid—cash book, payments side.

31 Merchandise is sold—sales book.

ILLUSTRATION 9—CASH BOOK—RECEIPTS—MODEL SET

2 Cash Receipts

19 Jan.	9	1	W. C. Archer	Bill Jan. 3	136	00		
	17	1	Harry Carter	Bill Jan. 8	101	75		
	27	1	William Martin	Bill Jan. 21	35	00		
	31		Total Receipts for the month				272	75
							272	75
19 Feb	1		Balance		47	75		

ILLUSTRATION 11—SALES BOOK—MODEL SET

4 *Sales Book January 3, 19*

	1	W. C. Archer, 12 Penn St.	10 days				
		40 brls. Winter Apples	3.40			136	00
8							
	1	Harry Carter, 219 Central Ave	10 days				
		15 brls. Winter Apples	3.45	51	75		
		40 bu. Potatoes	1.25	50	00	101	75
11							
	1	W. C. Archer	30 days				
		10 brls. Winter Apples	3.50	35	00		
		25 bu. Potatoes	1.25	31	25	66	25
21							
	1	William Martin, 925 Elm St.	15 days				
		50 bu. Potatoes	1.22½			61	25
22							
	1	Harry Carter	20 days				
		15 bu. Potatoes	1.30	19	50		
		30 brls. Winter Apples	3.50	105	00	124	50
31							
	1	W. C. Archer	30 days				
		5 brls. Winter Apples	3.40			17	00
		Total Sales				506	75

ANALYSIS QUESTIONS

1. What were Mr. Fuller's total purchases from Mr. Howe for the month? What were the total payments to him? How much did Mr. Fuller owe Mr. Howe on January 31?

2. What were Mr. Fuller's total sales to Mr. Archer? How much cash was received from him? How much did Mr. Archer owe Mr. Fuller on January 31?

3. Which bill was canceled by the cash receipt entered on January 17?

ILLUSTRATION 10—CASH BOOK—PAYMENTS—MODEL SET

Cash Payments 3

19 Jan.	24	1	J. K. Todd	Bill Jan. 4	100	00		
	28	1	Samuel Howe	Bill Dec. 31	125	00		
	31		Total Payments for the month.				225	00
	31		Balance				47	75
							272	75

4. Which bill was canceled by the payment entered on January 24?

5. Who received the money for the cash payment entered on January 28? Who paid it?

6. Who received the money for the cash receipt entered on January 27? Who paid it?

SET 1

COUNTRY PRODUCE AND PROVISION BUSINESS

R. L. Clark began business in Springfield, Mass., on January 1, as a dealer in country produce and provisions. He entered into a contract with John Reed, a farmer of Fairview, Mass., to supply him with fruits and vegetables for which Mr. Clark is to pay as soon as he receives returns from sales of these goods. Although he has no ready money to invest in his business, he hopes soon to accumulate out of his profits a sufficient cash capital with which to finance it.

While Mr. Clark is beginning business without any *capital*, such as *money, property*, etc., which is the *accumulated profits of previous industry*, he has the advantage of a good *credit*. Credit consists of a good name—*a reputation for honesty, ability, and trustworthiness*. A good credit is essential in successfully operating most business enterprises because a large part of the world's commerce is conducted on a credit basis. In this instance, Mr. Clark's good reputation enables him to start in business for himself. If he is successful in his venture and through his industry earns profits and saves them, he will thus accumulate capital, or wealth.

The following is a memorandum of the business Mr. Clark transacted in January. Record these transactions properly in a set of books. Using a double sheet of journal paper, open the purchases book on the front outside page (page 1), the cash book on the two inside pages (pages 2 and 3), and the sales book on the back outside page (page 4). Rule the additional perpendicular lines required as instructed in previous exercises.

TRANSACTIONS—SET 1

Jan. 2 Bought first bill of fruits and vegetables from John Reed, Fairview, Mass., dated Dec. 30, terms 30 days, $180.00.

3 Sold W. B. Morgan, 240 Second Ave., terms 10 days, 25 brls. Baldwin Apples @ $3.30.

5 Bought of John Reed, bill of Jan. 4, terms 30 days, $95.00.

8 Sold Heald & Co., 9 Exchange Way, terms 10 days, 50 bu. Potatoes @ $1.20; 30 brls. Baldwin Apples @ $3.50.

13 Received cash from W. B. Morgan to cancel bill of Jan. 3, $82.50.

14 Sold W. B. Morgan, terms 20 days, 10 brls. Baldwin Apples @ $3.35; 20 bu. potatoes at 95¢.
17 Bought of John Reed, bill of Jan. 16, terms 30 days, $167.50.
17 Received cash from Heald & Co. to cancel bill of Jan. 8, $165.00.
20 Sold Walter Williams, 316 Washington St., terms 10 days, 45 brls. Baldwin Apples @ $3.30; 60 bu. Potatoes @ 97¢.
23 Bought of J. H. Cooper, Merrick, Mass., bill of January 16, terms 10 days, $27.00.
25 Received cash from Walter Williams to cancel bill of January 20, $206.70.
26 Paid cash to J. H. Cooper to cancel bill of Jan. 21, $27.00.
30 Paid John Reed cash to cancel bill of Dec. 30, $180.00.
30 Sold remainder of goods on hand to Walter Williams, terms 30 days, 50 bu. Potatoes @ 95¢; 15 brls. Baldwin Apples @ $2.42.
31 Paid cash to John Reed to cancel bill of Jan. 4, $95.00.

FOOTING AND RULING BOOKS

Foot and rule the purchases and sales books as instructed previously. In the cash book enter the total receipts and total payments in the right hand money columns as formerly. Subtract the payments from the receipts to find the "balance" of cash on hand, enter it on the payments side, write the footings, rule the book, and bring down the balance in the manner shown in the cash book of the model set.

ANALYSIS OF SET 1

1. What were the total purchases from John Reed during the month? What were the total payments to him? How much did Mr. Clark owe him on Jan. 31?

2 What were the total purchases from Mr. Cooper? What were the total payments to him? How much did Mr. Clark owe him on January 31?

3. What were the total sales to Mr. Morgan? What were the total receipts of cash from him? How much did he owe Mr. Clark on January 31?

4. What were the total sales to Heald & Co? What were the cash receipts from them? How much did they owe Mr. Clark on January 31?

5. What were the total sales to Walter Williams? What were the cash receipts from him? How much did he owe Mr. Clark on January 31?

6. What bill was canceled by the cash payment entered on January 30?

7. What bill was canceled by the cash receipt entered on January 25?

8. For what amount did Mr. Clark become indebted to Mr. Reed and how much of this indebtedness did he cancel during the month?

Note: The teacher should retain all papers handed in by students for this and succeeding sets because they must be returned to the pupils later on when additional work on the sets is called for.

GROUPING TRANSACTIONS WITH PERSONS

16. In making the analysis of the transactions for the model set and set 1, called for on pages 14 and 17, it was necessary to refer to the purchases, sales, and cash books for the different items of merchandise bought and sold and of cash received and paid, and to make separate calculations to determine the final result of the transactions with each party. This work would have been greatly simplified if a separate record grouping all of the transactions with each party had been kept. Such a record is provided in bookkeeping by keeping an *account* with each party with whom business is transacted in a book called the *ledger*. Accounts show similar items arranged in the most convenient form for arithmetical solution and analysis. The ledger is the book of accounts.

PERSONAL ACCOUNTS

17. Personal accounts are records kept in the ledger with parties with whom business is transacted. The *object* in keeping personal accounts is to ascertain the amounts *others owe to us* on account, and the amounts *we owe to others* on account at any given time. All accounts with *individuals, firms,* or *corporations* showing amounts owed to or by them are classed as personal accounts for bookkeeping purposes.

18. Personal accounts are divided into two classes: (a) those showing what others *owe to us,* which are known as *accounts receivable;* and (b) those showing what we *owe to others,* which are known as *accounts payable.*

POSTING

19. Any book which receives the *first entry* of a transaction, such as the purchases, sales, and cash books, is a *book of original entry.* The entries in books of original entry are transferred to the accounts in the ledger by a process called *posting.* The ledger is the book of *final entry.*

POSTING FROM THE PURCHASES AND SALES BOOKS

20. Illustration 12 shows the postings to the personal accounts in the ledger of the entries contained in the purchases book (illustration 8) and sales book (illustration 11) of the model set on pages 14 and 15. Notice that all entries in the purchases book are posted to the *right-hand* side of the ledger accounts of the persons from whom goods were purchased, and that all entries in the sales book are posted to the *left-hand* side of the accounts of the persons to whom goods were sold.

ILLUSTRATION 12—LEDGER—MODEL SET

					Samuel Howe			Greenfield, Pa.			
						19 Jan.	2	Dec. 31, 30 ds	P	1	125 00
							16	Jan. 15, 20 ds	P	1	156 00
					J. K. Todd			Columbia, Pa.			
						19 Jan.	5	Jan. 4, 30 ds.	P	1	100 00
					W. C. Archer			12 Penn St.			
19 Jan	3	10 ds	S	4	136 00						
	11	20 ds	S	4	66 25						
	31	30 ds	S	4	17 00						
					Harry Carter			219 Central Ave.			
19 Jan.	8	10 ds.	S	4	101 75						
	22	20 ds.	S	4	124 50						
					William Martin			925 Elm St.			
19 Jan.	21	15 ds	S	4	61 25						

21. As each entry is posted the initial and page number of the book of original entry are entered in the ledger account as shown above. The page number of the ledger account to which the item is posted is entered in the page column of the book of original entry. See illustrations 8 and 11.

ANALYSIS OF POSTINGS FROM PURCHASES AND SALES BOOKS

1. From what book is the credit of $125.00 to Mr. Howe's account posted?
2. What book contains the original entry for the posting to Mr. Howe's account dated January 16?
3. Where is the purchase item of January 5 posted?
4. From what book are the debit items to Mr. Archer's account posted?
5. What book contains the original entries for the items posted to the debit side of Mr. Carter's account?
6. From what book is the posting to Mr. Martin's account dated January 21 made?
7. What do "S 4" and "P 1" in the above accounts mean?

DEBITING AND CREDITING PERSONAL ACCOUNTS FROM THE PURCHASES AND SALES BOOKS

22. Parties from whom goods are purchased on account are *creditors* of the buyer because he owes them until the goods are paid for. The buyer therefore *credits* the parties from whom he buys on account, and the entries for such transactions in the accounts which he keeps with his creditors are *credit entries*. These credits record the buyer's indebtedness to his creditors. It is the universal custom to record credits on the *right-hand side* of ledger accounts.

23. Parties to whom goods are sold on account are *debtors* of the seller because they owe him until the goods are paid for. The seller therefore *debits* the parties to whom he sells on account, and the entries for such transactions in the accounts which he keeps with his debtors are *debit entries*. These debits record the debtor's indebtedness to the seller. It is the universal custom to record debits on the *left-hand side* of ledger accounts.

Posting from the Cash Book

24. The model ledger on the next page shows the postings of the entries from the cash book in the model set (illustrations 9 and 10) in addition to the postings from the purchases and sales books shown in illustration 12. Note that all entries on the *receipts* side of the cash book are posted to the *right-hand* side of the accounts in the ledger of the persons from whom the cash was received, and that all entries on the *payments* side are posted to the *left-hand* side of the accounts of the persons to whom payments were made.

Analysis of Postings from Cash Book

1. Where is the original entry for the debit of $125.00 to Samuel Howe's account?
2. Where is the original entry for the credit of January 9 in Mr. Archer's account?
3. To what account and which side is the cash payment of January 24 posted?
4. To what account and which side is the cash receipt of January 17 posted?
5. Where is the original entry for the credit of $35.00 to William Martin's account?

DEBITING AND CREDITING PERSONAL ACCOUNTS FROM THE CASH BOOK

25. When cash is received from a debtor in full for a sum owed by him, the payment *cancels* the indebtedness, the party who makes payment ceases to be a debtor, and the parties stand in the same financial relation to each other as they

ILLUSTRATION 13—LEDGER—MODEL SET

1		Samuel Howe, Greenfield, Pa.									
19 Jan.	28		C	3	125	00	19 Jan.	2	Dec. 31, 30 ds P	1	125	00
								16	Jan. 15, 20 ds. P	1	156	00
		J. K. Todd, Columbia, Pa.									
19 Jan.	24		C	3	100	00	19 Jan.	5	Jan. 4, 30 ds. P	1	100	00
		W^m C. Archer, 12 Penn St.									
19 Jan.	3	10 ds	S	4	136	00	19 Jan.	9	C	2	136	00
	11	20 ds.	S	4	66	25						
	31	30 ds. 83.25	S	4	17	00						
		Harry Carter, 219 Central Ave.									
19 Jan.	8	10 ds.	S	4	101	75	19 Jan.	17	C	2	101	75
	22	20 ds.	S	4	124	50						
		William Martin, 925 Elm St									
19 Jan.	21	15 ds 26.25	S	4	61	25	19 Jan.	27	C	2	35	00

did before they transacted business. The amount of the payment is entered in the cash receipts book and is posted to the debtor's account in the ledger on the side *opposite* the debit entry to show that the indebtedness has been canceled and that the item has been closed out of the account.

26. When cash is paid to a creditor in full for a sum owed to him, the payment *cancels* the indebtedness, the party who receives payment ceases to be a creditor, and both parties stand in the same financial relation to each other as they did before they transacted business. The amount of the payment is entered in the cash payments book and posted to the creditor's account in the ledger on the side *opposite* the credit entry to show that the indebtedness has been canceled and that the item has been closed out of the account.

27. If a partial payment of an amount previously debited or credited to a personal account is made, such payment *partially* cancels the original debt, and the difference between the two amounts shows the balance still due on the original debt. This is illustrated in the account of William Martin.

Ruling Out Canceling Items in Personal Accounts

28. Notice how the canceling items in the accounts in illustration 13 are ruled out. Such items could be canceled by erasing the original debit or credit, writing "Paid" alongside of it, or ruling a line through it. The first method would destroy the record entirely, and the second and third methods would invite errors and confusion because one debit or credit might be canceled by two or more items. The method of entering canceling items on the opposite side of an account and ruling them out has therefore been adopted to provide a convenient and permanent record.

Balancing Personal Accounts

29. The balance of an account is found by taking the difference between the sum of the debits and the sum of the credits. When there are two or more unpaid items on either side of an account, as in Mr. Archer's account, the items are added and the total is written in small pencil figures directly underneath the last item. The balance is entered in the explanation column of the larger side on the line on which the last entry is made. If the debit side is the larger, the party owes the proprietor the amount of the balance. If the credit side is the larger, the proprietor owes the party the amount of the balance.

SET 1—CONTINUED

On a single sheet of ledger paper open the personal accounts required for set 1, allowing six lines for each account, and post the entries from the purchases, sales, and cash books in the order named.

Procedure in Posting

The following procedure should invariably be followed in posting:

1. Post the amount first.
2. Next post the date, and explanation if any. Make it a rule upon opening an account to write immediately the year date in the date columns.
3. Enter in the ledger account the initial and page number of the book of original entry from which the item is posted.
4. Write in the folio column of the book of original entry the ledger page number of the account to which the item is posted.
5. Rule out canceling items as they are posted.

When the posting is completed, present the books of original entry and the ledger to the teacher for approval. This completes the work of set 1.

SET 2

GRAIN AND FEED BUSINESS

Adam Richards, of Marshalltown, Iowa, has made an arrangement with his friends among the farmers in his community to coöperate with them in securing satisfactory prices for their crops. As he does not have any capital, they agreed to send him their grain, fruits, and vegetables on open account at prices sufficient to cover the cost of production and a fair profit. Mr. Richards on his part agreed to devote all of his time to finding a market for the crops at prices which will enable him to make a profit over and above the cost to him and the value of his time and labor. He has further agreed to pay the farmers as soon as he receives returns from the products sold.

His transactions for the month are given below. Record them in the proper books, using a double sheet of journal paper as in set 1. After all entries are made, total and rule the books of original entry. Then post the items from the books of original entry to the ledger in the following order—purchases book, sales book, and cash book. Use a single sheet of ledger paper, allowing six lines for each account. Rule out balancing items as they are posted; then enter the balances of the open accounts in pencil figures on the proper side. When completed, present the work to the teacher for approval.

Transactions—Set 2

Oct. 1 Received shipment of wheat, corn, and oats from J. H. Burch, Albion, Iowa, per his bill of Sept. 28, on account, $232.50.

2 Sold Frank J. Darling, 12 Main St., on account ten days, 25 bu. wheat @ $1.60; 50 bu. oats @ 75 ¢.

3 Sold Muscatine Flour Mills, Muscatine, Iowa, on account 15 days, 125 bu. wheat @ $1.58; 20 bu. corn @ $1.25.

6 Received shipment from John Roberts, Marietta, Iowa, per his bill of Oct. 5, on account, $249.00.

10 Sold Henry Miller, Melbourne, Iowa, on account 15 days, 5 tons baled hay @ $21.50; 50 bu. rye @ $1.85; 40 bu. corn @ $1.27½.

11 Received from Frank J. Darling cash for bill of Oct. 2, $77.50.

17 Received cash from Muscatine Flour Mills in full of account, $222.50.

18 Paid J. H. Burch on account, $100.00.

20 Sold Frank J. Darling, on account 15 days, 50 bu. oats @ 77½¢; 3 tons baled hay @ $21.50.

21 Bought from Evan Douglas, Three Hills, Iowa, per his bill of Oct. 9, on account, $47.50.

22 Received cash from Henry Miller to apply on bill of October 10, $200.00.

23 Sold Henry Miller, terms 15 days, 30 bu. wheat @ $1.61; 15 bu. corn @ $1.25.

25 Paid John Roberts on account, $150.00.

26 Sold Muscatine Flour Mills, on account 30 days, 50 bu. corn @ $1.20.

27 Paid J. H. Burch on account, $75.00.

28 Received cash from Henry Miller on account, $100.00.

29 Paid Evan Douglas in full for bill of October 19, $47.50.

31 Paid John Roberts on account, $50.00.

IMPERSONAL ACCOUNTS

30. So far the only ledger accounts considered have been accounts with persons; that is, *personal accounts*. In modern bookkeeping, records of the cost of merchandise purchased, the income from merchandise sold, the receipts of cash, the payments of cash, and of the expenses of doing business are also kept in the ledger. These records are kept in the purchases, sales, cash, and expense accounts. Such accounts are *impersonal accounts*. Taken together, they show on one side the costs and receipts, and on the other the incomes and expenditures resulting from conducting a business. It is from their results that the final profit or loss is determined. Illustration 14 shows, in addition to the personal accounts previously illustrated, the impersonal accounts required in the ledger for the model set on pages 14 and 15.

31. The item on the debit side of the purchases account is the posting of the total purchases from the purchases book. The item on the credit side of the sales account is the posting of the total sales from the sales book. The debit item in the cash account is the posting of the total receipts from the cash book, and the credit item is the posting of the total payments. As no expenses are recorded in the model set, no expense account is required in the ledger.

DEBITING AND CREDITING IMPERSONAL ACCOUNTS

32. Purchases are invariably debited to purchases account. Sales are always credited to sales account. The merchandise for which these accounts are debited and credited respectively consists exclusively of the commodities dealt in. Merchandise is the name given to commodities which are purchased for the purpose of selling them at a profit.

ILLUSTRATION 14—LEDGER—MODEL SET

Samuel Howe Greenfield, Pa.

19 Jan.	28		C 3	125 00	19 Jan.	2	Dec. 31, 30 ds.	P 1	125 00
						16	Jan. 15, 20 ds.	P 1	156 00

J. K. Todd Columbia, Pa.

19 Jan.	24		C 3	100 00	19 Jan.	5	Jan. 4, 30 ds.	P 1	100 00

W. C. Archer 12 Penn St.

19 Jan.	3	10 ds.	S 4	136 00	19 Jan.	9		C 2	136 00
	11	20 ds	S 4	66 25					
	31	30 ds. 83.25	S 4	17 00					

Harry Carter 219 Central Ave.

19 Jan.	8	10 ds.	S 4	101 75	19 Jan.	17		C 2	101 75
	22	20 ds.	S 4	124 50					

William Martin 925 Elm St.

19 Jan.	21	15 ds. 26.25	S 4	61 25	19 Jan.	27		C 2	35 00

Purchases

19 Jan.	31	Pchs. Book Total	P 1	381 00					

Sales

					19 Jan.	31	Sales Book Total	S 4	506 75

Cash

19 Jan.	31	Receipts. 47.75	C 2	272 75	19 Jan.	31	Payments	C 3	225 00

33. The total receipts of cash are invariably debited to cash account, and the total payments are always credited to that account.

34. We have learned that we debit persons when they owe us, and we credit them when we owe them. It should be clearly understood that the terms debit and credit are used in connection with *impersonal accounts* only as *convenient terms* to indicate which side of such accounts is referred to. Only persons can owe or be owed. The purchases and sales accounts represent inanimate things which have no power to owe or be owed, and therefore cannot be debited or credited for the reasons that personal accounts are debited and credited. The same is true of the cash and expense accounts. The student should understand at once that receipts, costs, and expenses are *merely listed* on the debit side of impersonal accounts, and that expenditures, returns, and incomes are listed on the credit side.

SET 2—CONTINUED

Open the purchases, sales, and cash accounts in the ledger for set 2 and post to them the totals of the purchases, sales, and cash books. As the totals are posted, enter in the folio column of the ledger the page number of the book of original entry from which the items were posted. Then enter in the book of original entry the page number of the ledger to which the postings were made. When completed, present the books of original entry and the ledger to the teacher for approval.

EQUALITY OF DEBITS AND CREDITS

35. Refer to the purchases book (illustration 8) and the ledger (illustration 14) of the model set, and notice that the sum of the three items posted to the credit of personal accounts from the purchases book is equal to the debit to the purchases account for the posting of the total purchases. The entries in the purchases book, as posted to the ledger, expressed in itemized ledger form are therefore equivalent to the third illustration below:

Purchases Book

Samuel Howe	125.00	
J. K. Todd	100.00	
Samuel Howe	156.00	
Total Purchases		381.00

Ledger as posted		Which is equivalent to	
Samuel Howe		**Samuel Howe**	
	125.00		125.00
	156.00		156.00
J. K. Todd		**J. K. Todd**	
	100.00		100.00
Purchases		**Purchases**	
381.00		125.00	
		100.00	
		156.00	
Total debits 381.00	Total credits 381.00	Total debits 381.00	Total credits 381.00

36. Posting the *total* of the purchases book to the purchases account, instead of posting *each item separately*, saved two postings. If there had been one hundred purchases during the month instead of three, ninety-nine postings would have been saved.

37. In like manner, the sum of the six debits to persons posted from the sales book is equal to or balanced by the total sales posted to the sales account, and five postings are saved by posting the *total* instead of posting each item. Thus:

Sales Book

W. C. Archer	136.00	
Harry Carter	101.75	
W. C. Archer	66.25	
William Martin	61.25	
Harry Carter	124.50	
W. C. Archer	17.00	
Total Sales		506.75

Ledger as posted		Which is equivalent to	
W. C. Archer		**W. C. Archer**	
136.00		136.00	
66.25		66.25	
17.00		17.00	
Harry Carter		**Harry Carter**	
101.75		101.75	
124.50		124.50	
William Martin		**William Martin**	
61.25		61.25	
Sales		**Sales**	
	506.75		136.00
			101.75
			66.25
			61.25
			124.50
			17.00
Total debits 506.75	Total credits 506.75	Total debits 506.75	Total credits 506.75

38. Similarly, the three credits to personal accounts posted from the cash receipts book are balanced by the total receipts posted to the debit of cash account, and the two debits to personal accounts posted from the cash payments book are balanced by the total payments posted to the credit of that account. If each item of cash received and paid had been posted separately to the cash account, five postings would have been required instead of two postings for the totals, or three additional postings as illustrated on the next page:

Cash Receipts

W. C. Archer	136.00	
Harry Carter	101.75	
William Martin	35.00	
Total Receipts		272.75

Cash Payments

J. K. Todd	100.00	
Samuel Howe	125.00	
Total Payments		225.00

Ledger as posted		Which is equivalent to	
Samuel Howe		**Samuel Howe**	
125.00		125.00	
J. K. Todd		**J. K. Todd**	
100.00		100.00	
W. C. Archer		**W. C. Archer**	
	136.00		136.00
Harry Carter		**Harry Carter**	
	101.75		101.75
William Martin		**William Martin**	
	35.00		35.00
Cash		**Cash**	
272.75	225.00	136.00	100.00
		101.75	125.00
		35.00	
Total debits 497.75	Total credits 497.75	Total debits 497.75	Total credits 497.75

39. One of the objects therefore in classifying and recording transactions in the purchases, sales, and cash books is to reduce posting to the minimum, since the totals instead of the individual items can be posted to the purchases, sales, and cash accounts.

40. If all the debit and credit items included in the three center illustrations above are brought together in their respective accounts, the accounts will appear exactly as they are in the model ledger. The three right-hand illustrations show a detailed analysis of the postings in the model ledger.

41. It follows from the above that when all items and totals in the books of original entry have been correctly posted to the ledger accounts, the total debits will equal the total credits. It is for this reason that this method of keeping books is called *double entry bookkeeping;* that is, for each debit entry there are one or more credit entries of equal amount, or vice versa.

THE TRIAL BALANCE

42. Since the debit and credit items posted from each book of original entry are equal, it follows that after all balancing items have been ruled out of the accounts, the sum of the debit balances must equal the sum of the credit balances, as shown by the following list of accounts, with their balances, taken from the model ledger (illustration 14).

Samuel Howe		156.00
W. C. Archer	83 25	
Harry Carter	124.50	
William Martin	26.25	
Purchases	381.00	
Sales		506.75
Cash	47.75	
	662.75	662.75

43. A trial balance is a list of *open* accounts in the ledger, with the balance of each account set opposite its name, showing that the sum of the debit balances is equal to the sum of the credit balances. The above list of balances is in reality a trial balance. Accounts that are in balance are not included in the trial balance. Illustration 15 shows the balances of the accounts in the model ledger set up in the regular form of a trial balance. The figures in the folio column are the ledger page numbers of the accounts.

Illustration 15—Trial Balance—Model Set

Trial Balance January 31, 19 J. M. Fuller

Folio	Account	Debit		Credit	
1	Samuel Howe			156	00
1	W. C. Archer	83	25		
1	Harry Carter	124	50		
1	William Martin	26	25		
1	Purchases	381	00		
1	Sales			506	75
1	Cash	47	75		
		662	75	662	75

Results Shown by Trial Balance

The above trial balance shows the following results:

1. J. M. Fuller, the proprietor, owes Samuel Howe $156.00. Amounts owed by us to others are *liabilities.*
2. Mr. Archer owes Mr. Fuller $83.25. Amounts owed to us by others are *assets.*

3. Mr. Carter owes Mr. Fuller $124.50, which is an asset.
4. Mr. Martin owes Mr. Fuller $26.25, which is an asset.
5. Mr. Fuller's purchases for the month cost him $381.00.
6. His sales for the month were $506.75.
7. His cash balance is $47.75, which is an asset. Assets also include what a person owns or possesses.

STATEMENT OF INCOME

44. Since all the merchandise Mr. Fuller bought during the month was sold, the cost of purchases as shown by the balance of the purchases account, $381.00, is therefore the cost of goods sold. Since the income from goods sold, as shown by the balance of the sales account, is $506.75, the profit is the difference between these two amounts, thus:

Income from Goods Sold	$506.75
Cost of Goods Sold	381.00
Profit	125.75

This statement would be set up in bookkeeping form as follows:

ILLUSTRATION 16—STATEMENT OF INCOME

Statement of Income January 31, 19 J. M. Fuller

		Income				
		Total sales for the month	506	75		
		Costs				
		Less cost of goods sold	381	00		
		Gross Trading Profit			125	75

45. The profit is designated as the *gross trading profit* because it is the profit which results from the buying and selling of or trading in merchandise. Gross trading profit is defined as the difference between the *income from sales* and the *cost of goods sold.* If the cost of goods sold exceeds the income from sales, the difference is the *gross trading loss.*

46. It will now be of interest to ascertain where this profit of $125.75 is. As Mr. Fuller began business without capital and now has a cash balance of $47.75, which is so much capital, that much of his profit is accounted for in his cash account, leaving $78.00 still unaccounted for. The trial balance shows that three of his customers still owe him for goods sold, and that he owes one creditor for goods purchased, the amounts being as follows:

Amounts Owed to Mr. Fuller (Assets)		
W. C. Archer	$83.25	
Harry Carter	124.50	
William Martin	26.25	
Total		234.00
Amount Owed by Mr. Fuller (Liabilities)		
Samuel Howe		156.00
Net Amount Owed to Mr. Fuller		78.00

47. It will thus be seen that the remainder of Mr. Fuller's profit is represented in the difference between what others owe him and what he owes others. This exact amount would have been realized in cash if all sums owed to him and the sums he owed to others had been paid on or before January 31.

STATEMENT OF ASSETS AND LIABILITIES

48. When profits are determined, it is also customary to ascertain one's financial standing by preparing a *statement of assets and liabilities*. This statement is prepared from the accounts in the trial balance which show assets and liabilities. If the cash balance were included, the above tabulation of amounts owed to and by Mr. Fuller would be a statement of his assets and liabilities. A complete statement, arranged in proper bookkeeping form, appears below.

ILLUSTRATION 17—STATEMENT OF ASSETS AND LIABILITIES

Statement of Assets and Liabilities, January 31, 19 J. M. Fuller

		Assets				
		Cash	47	75		
		W. C. Archer	83	25		
		Harry Carter	124	50		
		William Martin	26	25		
		Total assets			281	75
		Liabilities				
		Samuel Howe			156	00
		Net Assets, or J. M. Fuller's Net Capital			125	75

49. The difference between the sum of the assets and the sum of the liabilities is the *net assets*. Capital consists of assets. The net assets constitute the proprietor's *capital investment*, or *net capital*. In this instance the net assets are represented by and are equal to the profit for the month. It will thus be seen that capital is accumulated out of profits. Losses, on the other hand, decrease capital.

50. Profits may be withdrawn, or they may be allowed to remain in a business as a part of its working capital. Could Mr. Fuller draw out his entire profit in cash? Why not? How much of it could he draw out in cash? Under what conditions could he have withdrawn his entire profit in cash?

51. If Mr. Fuller were to collect the debts due him and pay his liabilities, and then withdraw his profit, his business would be left without any assets or capital, which was the condition at the time he began business on January 1. As a working cash capital to meet obligations when they fall due and to pay current expenses will now be necessary in conducting his business, he has decided to allow his profit to remain in the business for the present. In other words he has decided to *invest* his profits in his business. The amount of the profit therefore becomes his capital at the beginning of the next month's business. This capital will become a cash capital as soon as his accounts receivable are converted into cash, out of which, however, his liabilities will have to be paid. It will thus be seen that capital consists of the profit from previous industry which has been invested in an enterprise to promote it and produce additional profits in the future.

Gross Profits and Net Profits

52. If during the month Mr. Clark had paid various expenses, such as rent, fuel, and supplies, out of his personal funds for which he had turned in no report, amounting to $47.60, what would have been his *net profit*, and how would it have been found? The answer would naturally be $73.40, found by taking the difference between the gross trading profit and the total expenses. It should be observed that there is a distinct difference between *gross profits* and *net profits*. The gross profits are the difference between the total sales and the cost of goods sold, while net profits are gross profits *less expenses*. There can be no gross profit unless the goods are sold for more than they cost. There can be no net profit if expenses are greater than gross profit. In such an instance the difference would be a *net loss*.

SET 2—CONTINUED

On a sheet of journal paper prepare a trial balance from the ledger of set 2 and present it to the teacher for approval. Then prepare a statement of income, and a statement of assets and liabilities, and present them for approval. This completes the work of set 2.

REVIEW QUESTIONS

1. What is the object of keeping personal accounts?
2. Define a debtor; a creditor.

3. What are books of original entry? Name those with which you are familiar.
4. How are debit and credit items in the books of original entry transferred to the ledger?
5. On which side of ledger accounts are debit items posted? Credit items?
6. To which side of the personal accounts are the individual entries in the purchases book always posted? Are the personal accounts debited or credited from this book?
7. To what account is the total of the purchases book always posted? Is this total a debit or a credit item?
8. To which side of the personal accounts are the individual entries in the sales book always posted? Are these accounts debited or credited?
9. To what account is the total of the sales book always posted? Is this total a debit or a credit item?
10. To which side of the personal accounts are the individual entries in the cash book always posted? Are these accounts debited or credited?
11. To what account are the totals in the cash book posted? Which total is a debit item and which a credit item?
12. What result does the purchases account show? Sales account? Cash account?
13. How is the amount of profit determined?
14. What is an asset?
15. What is a liability?

THE JOURNAL

53. Three books of original entry—the purchases, sales, and cash books—have been introduced up to this point. In these books purchases, sales, and cash transactions respectively are classified and recorded. Another book of original entry, called the *journal,* is required in which to make entries for transactions which cannot be classified in the above-named books. Examples of entries which are made in the journal are:

(1) Entries for unusual transactions and transactions which do not occur with sufficient frequency to justify the keeping of a special book in which to classify them.
(2) Adjusting entries for goods purchased or goods sold which are returned for credit.
(3) Adjusting entries for rebates and allowances on purchases and sales resulting from errors in pricing, or from shortage and damage claims.

Illustration 18 shows the entries for C. D. Clarkson's unclassified transactions for the month of April requiring adjustment entries in the journal.

Illustration 18—Model Journal

Journal April 5, 19

	Sales	Returned for credit musty flour	32	50		
	F. G. Allen	5 brs. Red Seal @ $6.50			32	50
		6				
	Forbes & Co	Returned for credit musty flour	21	25		
	Purchases	5 brls Red Seal @ 4.25			21	25
		17				
	Sales	Credit for shortage of vinegar	1	50		
	Arthur Wilkins	10 gal. @ 15¢			1	50
		21				
	City Milling Co.	Rebates on April sales	11	60		
	Purchases	116 brls. Snowflake @ 10¢			11	60

54. A journal entry records separately both the debit and the credit items arising out of a transaction, and includes an explanation of the entry. The amounts of debit items are entered in the left-hand money column, and the amounts of credit items in the right-hand column. The names of accounts to be debited are placed just to the right of the second perpendicular line in the journal; that is, to the right of the folio column. The names of accounts to be credited are indented slightly as shown in illustration 18.

The journal entries in this illustration record the following transactions:

April 5 F. G. Allen returned to Mr. Clarkson for credit 5 brls. Red Seal Flour, which were billed to him @ $6.50 per brl., the flour being musty and therefore unsalable, $32.50.

6 Mr. Clarkson returned the musty flour to Forbes & Co., from whom he purchased it, for credit at the cost price, $4.25 per brl., $21.25.

17 Arthur Wilkins claimed a shortage of ten gallons of vinegar in a barrel sold him on April 14. As he was charged 15¢ per gallon Mr. Clarkson allowed him credit for $1.50.

21 Mr. Clarkson received a credit of $11.60 from the City Milling Co., being a rebate of 10¢ per barrel on 116 barrels, for selling over 100 barrels of Snowflake Flour during April.

ANALYSIS OF MODEL JOURNAL ENTRIES

April 5 By returning this flour Mr. Allen has decreased, or partially canceled, his indebtedness to Mr. Clarkson incurred when the flour was sold to him. As Mr. Allen's account was debited at the time the sale was made, his account must now be credited for the flour returned, at the selling price. As Mr. Clarkson credited his sales account for the amount of the original sale, he must now debit that account for the selling price of the flour returned because his income from sales is decreased by that amount.

The original sale amounted to $100.00. After the required sales book entry and above journal entry were made and posted to Mr. Allen's account and the sales account, these accounts would show a debit and a credit balance respectively of $67.50 as far as these two transactions are concerned. Thus:

F. G. Allen		Sales	
100.00	32.50	32.50	100.00

April 6 By returning this flour to Forbes & Co. Mr. Clarkson has decreased, or partially canceled, his indebtedness to them incurred when he bought the flour. As Mr. Clarkson credited them at the time he made the purchase, he now debits them for the flour returned, at its cost price. As he debited his purchases account when he bought it, he now credits that account because his cost of purchases is decreased by that amount.

17 The shortage in the sale decreases or partially cancels Mr. Wilkins' indebtedness to Mr. Clarkson, and therefore his account is credited. Mr. Clarkson's income from sales is decreased, and therefore he debits the sales account.

21 The rebate partially cancels Mr. Clarkson's indebtedness to the City Milling Co., and therefore he debits them. The rebate decreases the cost of his purchases, and therefore purchases account is credited.

55. Each debit and credit item is posted *separately* from the journal to the proper account in the ledger. It is not possible to post totals in a two column journal because the items entered in this book are miscellaneous items affecting various accounts; that is, they are not all of one class such as the transactions grouped in the purchases, sales, and cash books.

EXERCISE 5

Make journal entries for the following transactions of C. B. Aiken:

Aug. 4 He allowed J. M. Rose credit for a shortage of 25 lbs. Creamery Butter @ 30¢, included in a sale to him on July 29, $7.50.

11 Clarke & Co. overcharged him 15¢ per brl. on 25 brls. Winter Flour

he purchased from them July 28. He called their attention to it and has received a credit of $3.75.

15 Melton & Dane returned for credit 10 doz. Canned Corn @ $1.65 per doz., which they ordered by mistake. Mr. Aiken has given them credit for $16.50.

18 H. A. Rollins reports an overcharge of 25¢ per brl. on 20 brls. Harvest Apples sold him on August 15. Mr. Aiken allowed him credit for $5.00.

27 H. B. Knight returned one tub of rancid butter, which was unsalable. Mr. Aiken gave him credit for 50 lbs. @ 37¢, $18.50.

28 Mr. Aiken returned the rancid butter to Fitch & Sons, from whom he purchased it, and received credit at the cost price, 27¢ per lb., $13.50.

Comparison of Classified Entries and Journal Entries

56. Journalizing is determining the accounts to be debited and credited in any transaction. It is closely related to determining the particular classification to which a transaction belongs. For instance, when a purchase is made it is classified as a purchase transaction and consequently is entered in the purchases book. This is *classification.* As a result of this entry the party from whom the purchase is made is *credited* in his ledger account from the purchases book for the amount, and purchases account will be *debited* for the same amount when the footing of the purchases book is posted, since it is included in that footing. This is *journalizing.*

57. It was originally the practice to enter all transactions in the journal. This method required a separate debit for every purchase, a separate credit for every sale, a separate debit for every cash receipt, and a separate credit for every cash payment. It also required separate postings to the ledger for all these entries. This is unnecessary when the purchases, sales, and cash books are used.

58. It has been shown that posting the totals of the purchases, sales, and cash books to the purchases, sales, and cash accounts in the ledger is equivalent to posting each item separately. In other words posting these totals results in an equality of debits and credits in the ledger. See pages 26, 27, and 28. It follows that an entry in the purchases book, sales book, or cash book is equivalent to a journal entry so far as the final result in the ledger is concerned. For this reason these books are frequently referred to as the purchases journal, sales journal, and cash journal. For instance, the entry in the purchases book for the first purchase in the model set (illustration 8) is equivalent to the following journal entry

Purchases	125.00	
Samuel Howe		125.00

The entry for the first sale is equivalent to this entry:

W. C. Archer	136.00	
Sales		136.00

The entry for the first cash receipt is equivalent to this entry:

Cash	136.00	
W. C. Archer		136.00

The entry for the first cash payment is equivalent to this entry:

Samuel Howe	125.00	
Cash		125.00

59. Thus it will be seen that in whatever book of original entry transactions may be recorded, when the items are correctly posted to the ledger the sum of the debits will equal the sum of the credits; consequently an equality of debits and credits will exist, and a trial balance can be taken from the ledger accounts.

CASH RECEIPTS AND PAYMENTS AFFECTING PURCHASES, SALES, AND EXPENSE ACCOUNTS

60. The cash receipts and payments heretofore considered have been confined to cash received or paid in settlement of personal accounts. In many businesses money is also frequently received for merchandise sold for cash. The receipts from cash sales are usually placed in a cash register or drawer, and this money is deposited in bank daily or at frequent intervals. As such deposits are made the total sales represented by the cash deposited are entered as one item in the cash book, sales account being credited.

61. It would be possible to enter cash sales in the sales book in the same manner as sales on account, debiting the person to whom the goods were sold and crediting sales, and then to enter the cash received in the cash book, debiting cash and crediting the person. This method would require the opening of personal accounts in the ledger for every cash sale when the sales book postings were made, and these accounts would be closed immediately by the postings from the cash book. Since the ledger would rapidly become filled with such accounts, cash sales are credited directly to the sales account from the cash book, thus eliminating the personal accounts and saving time and labor. Besides, no indebtedness between the parties to a cash sale similar to the indebtedness between the parties to a sale on account exists except the momentary indebtedness during the time between the delivery of the article to the purchaser and the payment by him in return.

62. Merchandise is also frequently bought for cash. As in the case of cash sales, the personal accounts are eliminated by charging the purchases account and crediting cash directly through a cash book entry. The cash expended for such purchases is usually taken from the supply of cash kept on hand for such purposes.

63. Expenses such as rent, heat, light, insurance, taxes, salaries and wages of employees, office and store supplies and stationery, etc., are always incurred in conducting a business. The bills for such expense items are usually not entered on the books until they are paid, at which time they are charged directly to the expense account. Some business men pay such bills immediately upon their receipt, but in most cases it is the practice to pay them between the first and tenth of each month. The parties from whom expense bills are received, although they are creditors until these bills are paid, should be distinguished from the parties from whom merchandise comprising the stock in trade is bought. Bills from such parties are for supplies and services necessary in the conduct of the business and do not cover commodities purchased for resale to customers. Personal accounts are not opened to record the indebtedness arising out of expense transactions. The bills serve as a record of such indebtedness until paid.

EXERCISE 6

F. J. Ralston & Co.'s cash receipts and payments for November are given on pages 39 and 40. The correct entries for the first six transactions are shown at the top of illustration 19. Classify the transactions mentally under the following classes:

(a) Receipt or payment in settlement of a personal account.
(b) Receipt or payment for merchandise bought or sold.
(c) Payment for an expense item.

Next make the proper entries for them in a cash book. Use a sheet of journal paper.

ILLUSTRATION 19—CASH BOOK

CASH RECEIPTS

Nov.	1		Balance			572.80
	2		Howard Black	Bill of Oct. 23	55.40	
	6		Sales	Cash sales to date	14.25	
....						
	30		Sales	Cash sales to date	10.20	
	30		Total Receipts			876.24
						1449.04
Dec.	1		Balance			466.83

Transactions—Exercise 6

Nov. 1 Balance of cash on hand, $572.80.
1 Paid Miles & Co. in full for bill of Oct. 2, $26.70.
1 Paid the Jones Realty Co. for rent for store for November, $72.50.
2 Received cash from Howard Black for bill of October 23, $55.40.
3 Paid Sam Boggs, a huckster, $8.00 for 3 brls. of apples, which were placed in stock.
5 Paid City Gas & Electric Co. for gas and electric light bill for October, $5.40.
6 Cash sales to date, $14.25.
8 Paid Central Provision Co. on account, $100.00.
9 Paid Chesapeake & Potomac Telephone Co.'s bill for telephone service for October, $6.45.
9 Received cash from Allen & Boyce for bill of Oct. 21, $226.36.
11 Cash sales to date, $9.42.
12 Paid Office Supply Co.'s bill for office stationery and supplies, $13.26.
12 Received cash from Morton & King in full of account to date, $311.78.
17 Paid O. H. Barnes & Co. for bill of November 8, $175.60.
20 Cash sales to date, $27.40.
22 Received cash from Howard Black in full of account, $175.19.
23 Cash purchases to date, $34.80.
25 Paid Enterprise Fuel Co.'s bill for coal, $37.50.

Illustration 19—Cash Book

Cash Payments

Nov.	1		Miles & Co.	Bill Oct. 2	26.70	
	1		Expense	Rent for November	72.50	
	3		Purchases	Cash purchase	8.00	
	5		Expense	Gas and light bill	5.40	
...	...	...	...	...	...	...
	25		Expense	Coal Bill	37.50	
	30		Expense	Salaries office force	372.00	
	30		Expense	Manager's salary	130.00	
	30		Total Payments			982.21
	30		Balance			466.83
						1449.04

28 Received cash from E. Brown & Sons for bill of October 30, $46.24.
30 Paid salaries of clerks and office force, $372.00.
30 Paid manager's salary, $130.00.
30 Cash sales to date, $10.20.

64. The lower part of illustration 19 shows the manner in which the cash book should be balanced. The balance at the beginning of the month is added to the total receipts to get the total footing on the receipts side, just as the balance at the close of the month is added to the total payments to get the total footing on the payments side. After these footings are entered and the book is ruled, the balance at the close of the month should be brought down under date of the first day of the following month. The balance on November 1 is entered in the right-hand column so that the left-hand column will show the total receipts for the month. Compare with illustration 9, page 14.

SET 3

CANNED GOODS BUSINESS

The farmers and truckmen residing in the vicinity of Jamestown, New York, have established a community canning factory in that city under the name of the "Coöperative Canning Company."

H. C. Miller, of Jamestown, has contracted with the canning company to assist in the marketing of the output of the factory. He will establish a trade among the stores in Jamestown and nearby towns and among the summer resort hotels located about Lake Chautauqua. That part of the factory's product which Mr. Miller does not sell will be disposed of to other dealers in canned goods.

Certain stocks of goods will be set aside in the factory for Mr. Miller, for which he will be billed at the time. As he is beginning business without capital, he will be allowed a term of credit of 60 days on his first month's purchases, which will give him time to collect for his sales before his bills for purchases become due. He will deliver orders directly from the factory to his customers at his expense. His profit will be the difference between the price to him at the factory and the price he secures from his customers, less his expense of doing business.

His transactions for the month of September are the following. Record them in the proper books of original entry. Use a double sheet for the purchases, sales, and cash books and a single sheet, numbered page 5, for the journal.

Transactions—Set 3

Sept. 1 Received bill dated Sept. 1, terms 60 days, from Coöperative Canning Co. for the first allotment of 180 cases of canned peas, corn, beans, and tomatoes, $624.50.

Sept. 2 Sold Enos Spencer, Ashville, N. Y., terms 10 days, 10 cases peas, 30 doz., @ \$2.00; 5 cases corn, 15 doz., @ \$1.75.

Note: Canned goods are usually packed at the canning factories in cases containing two or three dozen cans, depending upon the size of the cans. They are always bought and sold by the dozen and should be billed accordingly.

3 Sold for cash one case tomatoes, \$3.30.

4 Paid cash for billheads and postage stamps, \$1.15.

5 Sold Chautauqua Lake Hotel, Bay View, N. Y., terms 20 days, 15 cases beans, 45 doz., @ \$1.85; 20 cases tomatoes, 40 doz., @ \$1.55; 6 cases peas, 18 doz., @ \$2.05.

8 Received cash from Enos Spencer in full for bill of Sept. 2, \$86.25.

9 As Mr. Miller secured an order for canned cherries and the canning company had none in stock, he bought 5 cases for cash, \$18.00.

11 Sold Peter Duff, Bemus Point, N. Y., terms 20 days, 25 cases corn, 75 doz., @ \$1.75; 20 cases tomatoes, 40 doz., @ \$1.57½; 12 cases peaches, 24 doz., @ \$2.65; 5 cases cherries, 10 doz., @ \$2.55.

12 Paid cash for warehouse tools, \$13.60.

13 Received bill dated Sept. 11, terms 60 days, from Coöperative Canning Co. for 50 cases of canned peaches and pears purchased on that date, \$181.00.

16 Sold for cash 2 cases peas, \$12.00, and one case pears, \$4.90; total \$16.90.

17 Sold Chautauqua Lake Hotel, terms 30 days, 8 cases peaches, 16 doz., @ \$2.62½; 8 cases pears, 16 doz., @ \$2.55; 10 cases corn, 30 doz., @ \$1.75.

18 Peter Duff returned for credit 10 cases corn, 30 doz., sold to him on Sept. 11. In placing this order he overlooked a reserve stock he had on hand. Mr. Miller has given him credit for \$52.50.

20 Sold Enos Spencer, terms 30 days, 15 cases peas, 45 doz., @ \$2.00; 20 cases corn. 60 doz., @ \$1.72½; 10 cases beans, 30 doz., @ \$1.85.

22 Chautauqua Lake Hotel claims an overcharge of 15¢ per dozen on the 8 cases of pears sold on Sept. 17. As the price agreed upon was \$2.40, Mr. Miller has allowed a rebate on 24 dozen amounting to \$3.60.

24 Received cash from Chautauqua Lake Hotel in full for bill of Sept. 5, \$182.15.

25 Enos Spencer reported that 1 case of corn sold him on Sept. 2 was spoiled. Investigation showed that it was a case from last year's pack which in some manner was placed with Mr. Miller's stock. He allowed Mr. Spencer a rebate at the selling price, \$5.25.

Sept. 25 Mr. Miller reported the case of spoiled corn to the canning company and was allowed a rebate for the cost price, $4.20.

26 As the canning company's stock of peaches is exhausted, Mr. Miller has purchased a supply from the Dunkirk Cannery, Dunkirk, N. Y., and received their bill dated Sept. 20, terms 30 days, for $38.00.

27 Sold for cash to John Ensor, Ross Mill, N. Y., 8 cases peas and 5 cases beans, total sale $70.65. Mr. Ensor was given reduced prices on this order because he paid cash and called for the goods with his own truck.

29 As Mr. Miller found it difficult to sell pears and the canning company has found a broker who will purchase their entire stock, Mr. Miller has returned 21 cases, 42 doz., to the Coöperative Canning Co. and has received credit for them at the cost price, $1.75, total $73.50.

29 Sold Central Hotel, Hartfield, N. Y., terms 30 days, 9 cases tomatoes, 18 doz., @ $1.55; 10 cases peaches, 20 doz., @ $2.65; 9 cases peas, 27 doz., @ $1.95.

30 Mr. Miller paid the canning company the September rent for the space in their warehouse occupied by his stock, $12.50.

30 Peter Duff's bill of Sept. 11 less the credit of Sept. 18 is due tomorrow. As Mr. Duff cannot pay the balance in full, Mr. Miller has accepted a payment of $150.00 and granted Mr. Duff an extension of 15 days on the balance.

30 Paid Coöperative Canning Co., to apply on account, $250.00.

30 Paid drayage bill of Jamestown Transfer Co. for delivering orders to customers during September, $35.80.

30 Mr. Miller took out as his salary for September, $100.00.

After entering the above transactions, foot and rule the books with the exception of the journal. Balance the cash book in the manner shown in illustration 19. The journal is not ruled and footed because totals are not posted from this book.

Then post from the purchases book, sales book, journal, and cash book in the order named, using a single sheet for the ledger, numbering the pages 1 and 2, and allowing 8 lines for each account. Post the individual items first and then the totals. In posting to the purchases, sales, and expense accounts, write an appropriate explanation of each item such as "Cash purchase," "Cash sale," "Return," "Rebate," "Office supplies," "Tools," "Pchs. Bk. total," or "Sales Bk. total" in the explanation column.

After posting, find the balance of each account as previously instructed. Then take a trial balance, and present all papers to the teacher for approval. Save them carefully for future reference when they are returned.

Statement of Income

65. Mr. Miller sold all the goods purchased during the month. The accounts in the trial balance showing the results from which his profits are to be ascertained are the purchases, sales, and expense accounts. His profit is determined thus:

Income from goods sold	$1099.10
Cost of goods sold	783.80
Gross Trading Profit	315.30
Expenses	163.05
Net profit	152.25

STATEMENT OF INCOME AND PROFIT AND LOSS

66. Such a statement as the above, containing trial balance figures only, does not provide all the essential details of results from operations. It is the custom, therefore, in preparing such statements, to include a detailed analysis of the accounts showing incomes, costs, and expenses so as to show all the units of information, facts, and figures relating to the business transacted. This *statement of income and profit and loss* plays a most important part in the decisions of the management with regard to future operations and business policies, because it demonstrates to what extent past policies and methods of operation have been successful or unsuccessful.

67. The statement on page 44, showing the same final result as the one above, was prepared from the same trial balance and from the data shown by the purchases, sales, and expense accounts in the ledger. It supplies in approved form the information lacking in the first statement.

ANALYSIS OF INCOME AND PROFIT AND LOSS STATEMENT

1. This statement is divided into three sections under the captions "Income from Sales," "Cost of Goods Sold," and "General Expenses."
2. The sales account is analyzed in the "income from sales" section. The *total sales* is the credit footing of the account. The items under *deductions from sales* are the *returned sales* debited to the account on September 18, and the sum of the *rebates on sales* debited on September 22 and 25. The difference between the total sales and the sum of the deductions is the *net income from sales.*
3. The purchases account is analyzed in the "cost of goods sold" section. The debit footing of the account shows the *total purchases.* The items under *deductions from purchases* are the *purchases returned* credited to the account

Illustration 20—Income and Profit and Loss Statement

Statement of Income and Profit and Loss, September 30, 19 . H. C. Miller

	Income from Sales:			
	Total sales		1160.45	
	Deductions from sales:			
	Returns	52.50		
	Rebates and allowances	8.85	61.35	
	Net income from sales			1099.10
	Cost of Goods Sold:			
	Total purchases		861.50	
	Deductions from cost			
	Returns	4.20		
	Rebates and allowances	73.50	77.70	
	Net cost of goods sold			783.80
	Gross Trading Profit			315.30
	General Expenses:			
	Tools and supplies		14.75	
	Rent		12.50	
	Drayage charges		35.80	
	Proprietor's salary		100.00	
	Total expenses			163.05
	Net profit for the period			152.25

on September 29, and the *rebate on purchases* credited on September 25. Since all of the goods purchased have been sold, the difference between the total purchases and the sum of the deductions is the *net cost of goods sold.*

4. The difference between the net income from sales and the net cost of goods sold is the gross profit resulting from the buying and selling, or trading, operations and is therefore designated as the *gross trading profit.*
5. The expense account is analyzed in the "general expenses" section. General expenses are the expenditures for services, materials, and supplies required in conducting the business as a whole. Notice that the first two items in the expense account are grouped in the statement as "tools and supplies."
6. The difference between the gross trading profit and the general expenses is the *net profit* resulting from the conduct of the business.

7. Observe that the net income from sales and the net cost of goods sold are the same amounts respectively as the balances of the sales and purchases accounts in the trial balance.
8. If the general expenses had exceeded the gross trading profit, the difference would have been the *net loss*. If the net cost of goods sold had exceeded the net income from sales, the difference would have been the gross trading loss, in which case the general expenses would have been *added* to the gross trading loss to find the net loss.
9. Observe that the preparation of this statement depends upon an orderly and proper arrangement of the items and correct addition and subtraction. The statement is really a systematically arranged solution of an arithmetical problem containing a proper explanation of each item in the solution.

SET 3—CONTINUED

From the trial balance and ledger for set 3 prepare a statement of income and profit and loss, and a statement of assets and liabilities. Refer to illustrations 20 and 17 if necessary for the proper arrangement of the items. Then submit the statements to the teacher for approval. This completes the work of set 3.

EXERCISE 7

From the following trial balance and ledger accounts, prepare the proper statements and present them to the teacher for approval:

Trial Balance, June 30, 19 .

A. B. Mellon

Browning & Co.		316.28
Frank Ward	176.85	
Lee C. Lang Co.	26.20	
Hudson Grocery Co.		119.76
R. C. Lake	122.17	
Marton & King		59.60
Samuel Balke	38.40	
Butler & Co.	116.22	
Purchases	876 90	
Sales		1182.45
Expense	168.44	
Cash	152.91	
	1678.09	1678.09

Purchases

Cash Purchase	20.00	Rebate	5.25
Cash purchase	5.60	Return	41.80
Pchs. Bk. total	927.51	Rebate	29.16

Sales

Rebate	9.25	Cash sale	5.80
Return	1.60	Cash sale	3.20
Rebate	2.35	Cash sale	8.46
Rebate	5.21	Sales Bk. total	1186.40
Return	3.00		

Expense

Gas and light	7.84		
Drayage charges	24.75		
Rent	30.00		
Sundry repairs	15.85		
Prop. salary	90.00		

EXERCISE 8

Refer to the comparison of classified entries and journal entries on pages 36 and 37 of the text. From this comparison it will be observed that the entry for any transaction can be set up in journal form. For practice in determining the debit and credit items arising out of transactions, make journal entries for all of the transactions in set 3. In other words, work the set again using the journal as the only book of original entry. Omit all explanations. This is a journalizing drill.

After all the entries are made, post them to a new set of ledger accounts just as the items from the journal in the classified or regular set were posted. Allow twelve lines for the sales and cash accounts and eight lines for the other accounts. Then take a trial balance. It should agree with the trial balance of the classified set.

With both sets before you, prepare the answers to the following questions:

Comparison of Classified and Journalized Sets

1. Count the individual debit and credit entries in the classified set. How many are there?
2. How many postings to the ledger were required in this set?
3. Count the individual debit and credit entries in the journalized set. How many are there?
4. How many postings to the ledger were required for this set?
5. Considering each individual entry and its posting to the ledger as two operations, how many operations were required to record and post the transactions in the classified set and how many in the journalized set?
6. With respect to the number of such operations, how much more efficient on a percentage basis is the classified set?
7. Do the accounts in the two ledgers show the same balances respectively? Do they show the same items respectively?
8. Are there any differences between the personal accounts in the two ledgers with respect to the number and amounts of the items entered therein?
9. How do you account for the differences, if any, between the purchases, sales, cash, and expense accounts in the two ledgers with respect to the number and amounts of the items entered therein?

68. From the above comparison it will be observed that while the processes of recording transactions differ, the same final results are shown by the classified and journalized sets; also that the classified set is the more efficient method because of the saving in time and effort in making entries and posting them.

ELEMENTARY ACCOUNTING

In the section of the text devoted to Elementary Accounting, which begins on the next page, there is provided:

(a) The text matter correlating with the material of Laboratory Unit One, to which the student is referred as he proceeds with the work of that unit, after having completed the work in the "Introduction to Bookkeeping" covering the first 46 pages of this text.

(b) The text material, pages 47 to 127, required when it is desired to start the study of the subject by the ledger account method, which when completed is followed by the study of the Introduction to Bookkeeping, or Laboratory Unit One, as the judgment of the teacher dictates and the time available permits.

The following schedule gives a list of the accounts treated in the section of the text devoted to Elementary Accounting and the classification required for Unit One:

ASSET, LIABILITY, AND CAPITAL ACCOUNTS

Current Assets:

- CASH
- MERCHANDISE INVENTORY
- NOTES RECEIVABLE
- DEBTORS' ACCOUNTS RECEIVABLE

Fixed Capital Assets:

- REAL ESTATE INVESTMENT
- FURNITURE AND FIXTURES INVESTMENT

Current Liabilities:

- NOTES PAYABLE
- CREDITORS' ACCOUNTS PAYABLE

Capital:

- PROPRIETOR'S CAPITAL ACCOUNT
- PROPRIETOR'S PERSONAL ACCOUNT

INCOME AND PROFIT AND LOSS ACCOUNTS

Cost of Goods Sold:

- PURCHASES
- FREIGHT IN
- WAREHOUSE EXPENSE

Operating Expenses:

- GENERAL EXPENSE
- REAL ESTATE EXPENSE

Deductions from Income

- INTEREST EXPENSE

Income from Sales:

- SALES

Additions to Income:

- INTEREST INCOME
- REAL ESTATE INCOME

ELEMENTARY ACCOUNTING

PRINCIPLES AND PRACTICE

69. A business transaction is a matter, affair, or item of business completed or in process of completion. A financial transaction is a business transaction which involves an amount to be recorded in the books of account.

70. Transactions result from an agreement, or contract, between two parties. Each party under the terms of an agreement obligates himself to do certain things. For instance, a seller obligates himself to sell certain goods at a certain price and to ship or deliver them to the purchaser. The buyer obligates himself to accept delivery of the goods he purchases and to pay the seller for them.

71. "A contract is an agreement (oral or written) between competent parties upon a legal consideration to do or not to do some lawful act or thing."—*Rowe's Commercial Law.*

72. When both parties to a contract discharge their obligations at the same time, they usually fulfil the terms of their agreement in one transaction. Frequently, however, one party does not perform his part of the agreement until some time after the other party has done so. The first party thus becomes indebted to the other until he does perform his part and thereby discharges his obligation under the agreement. In such cases, two or more transactions are required to carry out the terms of the agreement.

73. Obligations or debts are thus created and discharged by the parties to the transactions which result from agreements between them. Records of the creation and discharge of such obligations or debts are kept in *personal accounts.*

PERSONAL ACCOUNTS

74. Personal Accounts are accounts kept with *debtors* and *creditors.* The object in keeping personal accounts is to ascertain what our debtors owe us on account, and what we owe creditors on account at any time. The book in which accounts are kept is called the *ledger.*

75. A debtor is one who owes or is in debt. The amounts he owes are known as *debit* items in the account kept with him by his creditor.

76. A creditor is one who is owed. The amounts that are owed to him are known as *credit* items in the account kept with him by his debtor.

77. Only persons can be debtors and creditors and the terms *debit* and *credit* in the sense of owing or being owed can be used only in connection with personal accounts. All accounts with individuals, firms, or corporations showing amounts owed to or by them are treated as personal accounts for bookkeeping purposes.

ACCOUNTS WITH DEBTORS

78. **Accounts with debtors** are those kept with parties who owe us and who will later *cancel their indebtedness* by paying us the amounts they owe. They will then cease to be our debtors.

The following transactions with A. J. Cloud are correctly recorded in the account with him which appears below:

Oct. 12 Sold him merchandise, terms 10 days, $375.80.
20 Sold him merchandise, terms 30 days, $162.75.
23 Received cash from him for bill of October 12, $375.80.
31 Sold him merchandise, terms 30 days, $441.20.
Nov. 19 Received cash from him for bill of October 20, $162.75.

Illustration 21—Debtor's Account

A. J. Cloud 796 Market St. San Francisco, Calif.

19 Oct.	12	10 ds. Owed to us	S		375	80	19 Oct.	23	Canceled	C	375	80
	20	30 ds	S		162	75	Nov.	19		C	162	75
	31	30 ds.	S		441	20						

ANALYSIS

1. Is this an account with a debtor or a creditor?
2. For what amounts did Mr. Cloud become indebted to us?
3. How much of this indebtedness has been paid and canceled?
4. How much remains unpaid?
5. Is Mr. Cloud a debtor or creditor for this amount?

79. It is therefore evident that in accounts with debtors there are two classes of items—*debit* items for the amounts for which they have become indebted to us, and *credit* items which wholly or partially cancel such indebtedness. As a matter of custom, debit items are always entered on the left-hand side and credit items on the right-hand side of ledger accounts. Canceling, or balancing, items are ruled out when they are entered, as shown in illustration 21.

Rules for Debiting and Crediting Accounts with Debtors

80. Debit their accounts for all amounts they owe us.

81. Credit their accounts for all items which wholly or partially cancel debit items in their accounts.

EXERCISE 9

Prepare an account from the following transactions with Robert G. Burns, 120 N. Eutaw St., City. Rule out balancing items as they are entered.

Sept. 2 Sold him merchandise, $40.00
4 Sold him merchandise, $126.42.
9 Received cash for bill of Sept. 2, $40.00.
10 He returned goods for credit on bill of Sept. 4, $12.30.
12 Sold him merchandise, $56.20.
14 Received cash for balance due on bill of Sept. 4, $114.12.
15 Sold him merchandise, $125.90.
16 Billed him for undercharge on bill of Sept. 15, $3.68.
23 Sold him merchandise, $176.80.
27 Allowed him credit for defective goods on bill of Sept. 12, $7.50.

EXERCISE 10

Transactions with Bell Bros., 19 Exchange Way, Columbus, Ohio.

Oct. 1 Sold them merchandise, $126.40.
2 Billed them for freight prepaid on goods billed Oct. 1, $5.42.
7 Sold them merchandise, $198.25.
8 Allowed them credit for overcharge on bill of Oct. 1, $9.36.
12 Received cash for balance due on bill of Oct. 1, including freight charged thereon, $122.46.
15 Sold them merchandise, $272.80.
17 They billed us for goods returned for credit on bill of Oct. 7, $17.09.
23 Sold them merchandise, $85.40.
24 Billed them for express charges prepaid on bill of Oct. 23, $4.75.
27 Received cash for bill of Oct. 15, $272.80.
30 Received bill from them for shortage on bill of Oct. 23 and allowed credit, $3.75.

ACCOUNTS WITH CREDITORS

82. Accounts with creditors are those kept with parties whom we owe and to whom we will later *cancel our indebtedness* by paying them the amount we owe. They will then cease to be our creditors.

The following transactions with the John S. Wilson Company are correctly recorded in the account with them which appears on the next page:

Aug. 12 Bought merchandise from them per bill of Aug. 6, terms 30 days, $74.20.

Sept. 3 Bought merchandise from them per bill of Aug. 30, terms 30 days, $316.12.

Sept. 5 Paid them cash for bill of August 6, $74.20.

Illustration 22—Creditor's Account

John S. Wilson Co. Catonsville, Md.

19 Sept.	5	C		74	20	19 Aug.	12	Aug 6, 30 ds. P		74	20
						Sept.	3	Aug. 30, 30 ds. P		316	12

ANALYSIS

1. Is this an account with a debtor or a creditor?
2. For what amounts did we become indebted to the John S. Wilson Co.?
3. How much of this indebtedness has been paid and canceled?
4. How much remains unpaid?
5. Is the John S. Wilson Co. a debtor or creditor for this amount?

83. It is evident that in accounts with creditors there are two classes of items—*credit* items for the amounts for which we have become indebted to them, and *debit* items which wholly or partially cancel such indebtedness.

Rules for Debiting and Crediting Accounts with Creditors

84. Debit their accounts for all items which wholly or partially cancel credit items in their accounts.	**85.** Credit their accounts for all amounts owed to them.

EXERCISE 11

Prepare an account from the following transactions with M. C. Morgan, 1242 Eighth Ave., City. Rule out cancelling items as they are entered.

Sept. 3 Bought merchandise from him, $342.50.
7 Bought merchandise from him, $72.16.
10 Paid cash for bill of Sept. 3, $342.50.
12 Received credit for goods returned on bill of Sept. 7, $12.40.
15 Bought merchandise from him, $158.55.
19 Paid cash for balance due him on bill of Sept. 7, $59.76.
21 Bought merchandise from him, $221.20.
24 Billed him for overcharge on bill of Sept. 15, $28.80.
28 Bought merchandise from him, $36.25.
30 Received credit for damaged goods on bill of Sept. 21, $11.80.

EXERCISE 12

Transactions with Rodney, Gates & Co., 12 Pine St., Philadelphia, Pa.

Oct. 2 Bought merchandise from them, $278.50.
3 Received bill for freight prepaid on bill of Oct. 2, $21.46.
7 Bought merchandise from them, $109.21.

Oct. 8 Billed them for goods returned because they were not of grade ordered, $35.27.
8 Paid cash for balance due them on bill of Oct. 2, $264.69.
10 Bought merchandise from them, $326.18.
11 Billed them for freight on bill of Oct. 7 which they were to prepay according to the terms of the purchase, $5.92.
12 Bought merchandise from them, $158.20.
20 Received credit for overcharge on bill of Oct. 12, $28.80.
22 Paid them balance due on bill of Oct. 7, $103.29.
26 Bought merchandise from them, $37.50.
30 Paid balance due on bill of Oct. 12, $120.40.

86. The balance of an account is the difference between the sum of the debits and the sum of the credits. When the balance of a personal account is to be determined, canceled items usually may be eliminated from the calculation, in which case the difference between the sums of the uncanceled items on the two sides of the account is the balance of the account.

What the Balance of a Personal Account Shows

87. The balance of a personal account is the amount owed to us or by us. If the *debit* side is the larger the balance is the amount owed to us, which, if it is not past due, is *current asset.* Current assets are cash and other assets which can be quickly converted into cash. If the *credit* side is the larger the balance is the amount owed by us, which is a *current liability.* Current liabilities are short-time debts. In either case the balance should appear as an item in the statement of assets and liabilities. Accounts with debtors and accounts with creditors are often referred to as *accounts receivable* and *accounts payable,* respectively.

Ruling Personal Accounts

88. The proper ruling for a personal account depends upon the method followed in the payment of bills. Bills are usually paid in one of four ways: (*a*) each item or bill may be paid separately; (*b*) several items or bills may be paid at one time; (*c*) one item or bill may be paid in two or more payments, and (*d*) payments may be made "on account" but not in full settlement of any particular item or bill. The latter is the method employed in "running accounts." Any one or more of these various methods of payment may be shown in a single account. The following accounts illustrate the various methods of payment referred to and the proper rulings for each.

Explanation. The Park Grocery Co. account illustrates the methods of payments described in ¶**88a** and ¶**88b**. It shows that the item debited March 6 was paid March 16, that the item debited March 12 was paid March 23, and

ILLUSTRATION 23

Park Grocery Co. 33 Elm St.

19 Mar.	6	Mdse		34	40	19 Mar.	16	Cash		34	40
	12			109	48		23	"		109	48
	15	"		68	19		30	"		68	19
	25	"		16	45	Apr.	7	"		145	32
	29	"		128 145	87 32						
Apr.	5	"		83	37						
	24	"		12 95	21 58						

that the item debited March 15 was paid March 39. The items of March 25 and 29 were paid April 7 in one amount. The lines were ruled underneath the balancing items as each credit entry was made. The items of April 5 and 24 are unpaid, and their sum, shown in pencil figures, is the balance of the account. This is an *account receivable.*

ILLUSTRATION 24

Dodge Electrical Supply Co. 139 Water St. Pittsburg Pa.

19 Sep.	5	Cash		45	95	19 Aug.	12	Mdse		12	98
							16	"		23	36
							25	"		9 45	61 95
						Sep.	3	"		43	18
							30	"		11 55	90 08

Explanation. The items of August, 12, 16, and 25 are for purchases which were paid in one amount September 5, at which time the lines were ruled under the balancing items. The pencil footing on the credit side shows the balance of the account on September 30. This is an *account payable.* It illustrates the method of payment described in **¶88b.**

Explanation. An examination of the entries in Gordon & Buchanan's account in the order of their dates will explain the rulings shown. It is an *account receivable* and illustrates the practice of many bookkeepers. It will be noticed that when all items balance above a given point they are ruled out, as shown by those marked "*a*," "*b*" and "*c*," whether they are on the same line or not. The letters also show the method of indicating canceling items. The balance is found by taking the difference between the two sides of the account after the canceled items are excluded, as shown in the small pencil figures in the left hand explanation column. This account illustrates the methods of payment described in ¶88b, c, and d.

Note: The small cross mark (x) may be used for indicating canceling items instead of letters.

ILLUSTRATION 25

Gordon & Buchanan 371 Front St.

19 Apr.	3	Mdse		a	216	50	19 Apr.	14	Cash		a	150	
								19	"		a	66	50
	24	"		b	154	60		26	"		b	100	
	27	"		b	31 186	77 137		27	"		b	50	
	30	"		c	41	75		30	"		b	36 186	37 37
May	5	"		c	16	48	May	15	"		c	150	
	12	"		c	141	41		25	"		c	89 209	14 14
	22	"		c	39 239	50 14		29	"			100	
	26	"			106	20							
	28	"	13.42		7 113	22 42							

89. A debtor may overpay what he owes, in which case the amount overpaid becomes a credit balance in the debtor's account. He becomes a creditor until the overpayment is canceled. In like manner a creditor would become a debtor until the amount overpaid to him is returned or otherwise canceled.

90. Mixed personal accounts are accounts of persons who both buy from and sell to each other; consequently they show both debtor and creditor items with the corresponding canceling items. It is not good accounting practice to keep mixed accounts. The best practice is to keep separate debtor and creditor accounts. Indicating canceling items by letters, as explained above, will be found exceedingly helpful in analyzing and adjusting such accounts. Illustration 26 shows a mixed personal account, and a proper segregation of the items in separate debtor and creditor accounts,

ILLUSTRATION 26

(Mixed Account) P. S. Spangler Pittsburgh, Pa.

19 June	19	Mdse. 60ds. S	Dr.	346	45	July	1	Cash C	Dr.	100	00
	30	" 20ds. S	Dr.	712	17		18	Mdse., 10ds. P	Cr.	185	40
July	20	Cash. C	Dr.	185	40		24	Mdse., 30ds. P	Dr.	485	23
Aug.	16	Mdse., 30ds. S	Dr.	220	65		30	Cash on ap. C	Dr.	200	00
	20	Cash C	Cr.	400	00	Aug.	3	" C	Dr.	200	00
							30	" C	Dr.	400	00

ILLUSTRATION 26—Continued

P. S. Spangler (Debtor)

June	12	S	346	45	July	1	C	100	00
	30	S	712	17		31	C	200	00
Aug.	16	S	220	65	Aug.	3	C	200	00
					Aug.	30	C	400	00

P. S. Spangler (Creditor)

July	28	C	185	40	July	18	P	185	40
Aug.	20	C	400	00		24	P	485	23

OWNERSHIP ACCOUNTS

91. An investment of funds or property by the *owner* of a business is usually necessary to provide working capital to finance his operations, and to secure his creditors for the payment of debts which he may contract with them. Such investments of capital may be increased by additional investments or they may be decreased by withdrawals of funds at any time the owner may so desire or circumstances permit.

92. Business is conducted *to earn profits.* If profits are allowed to remain in the business, they increase the proprietor's invested capital. Losses must be met out of the owner's capital, and hence decrease it. Profits which are withdrawn as they are earned and ascertained do not affect invested capital one way or the other.

93. Invested capital is the excess of assets over liabilities. It represents the owner's interest or equity in the assets of his business after all claims of creditors, which are represented by the liabilities, have been paid.

94. Usually the owner should have two accounts—a *capital* account showing his interest in the business, and a *personal* account. In the capital account only those items affecting the permanent investment of the owner should be recorded. His personal account should receive entries for only such items as withdrawals of money for salary or temporarily on account, goods taken for private use, etc.

Owner's Capital Account

95. This account, while widely different in its purpose, is kept much like an ordinary personal account. It, however, is affected by the profits and losses resulting from and incidental to the business conducted, and, therefore, is not closed *until after the final profit or loss has been ascertained.* It should be kept in the general ledger or in a private ledger.

96. The object in keeping the capital account is to show the owner's investment, interest, or equity in the business. The title of the account is usually the owner's name followed by the word "Capital."

The following transactions affecting F. A. Raymond's capital account are properly recorded in the account which appears below:

Mar.	1	He began business with a cash investment of $8,000.00.
Mar.	1	At the time he began business he owed on personal accounts, $140.00.
May	1	He made an additional cash investment of $5,000.00.
Sept.	1	He withdrew in cash $1,500.00.
Nov.	1	He made an additional cash investment of $6,000.00.
Dec.	1	He paid a personal note amounting to $100.00 out of the cash invested, which he considered as a withdrawal of invested capital.
Dec.	31	His net loss for the first ten months he was in business was $453.00.
Jan.	12	He withdrew in cash $1,000.00
Jan	31	His capital account was charged for the debit balance of his personal account, representing charges for incidental personal expense bills paid out of the funds of the business amounting to $200.00.
Jan.	31	His net profit for the month of January was $1,202.46.

ILLUSTRATION 27

F. A. Raymond, Capital a/c

19 Mar.	1	Owed to others	J	140		19 Mar.	1	Investment	C	8000	
Sept.	1	Withdrawn	C	1500		May	1	"	C	5000	
Dec.	1	Personal note	C	100 (1740)		Nov.	1	" 17260		6000 (19000)	
	31	Net loss 10 mos.	J	453							
	31	Net Capital		16807							
				19000						19000	
Jan.	12	Withdrawal	C	1000		Jan.	1	Net Capital 15807		16807	
	31	Personal a/c	J	200			31	Net profit 1 mo.	J	1202	46
	31	Net Capital		16809	46						
				18009	46					18009	46
						Feby.	1	Net Capital		16809	46

Note: Mr. Raymond ascertained his net capital as of January 31 because he entered into a partnership with another merchant on February 1.

ANALYSIS

1. How much capital did Mr. Raymond invest during the first ten months he was in business?
2. How much did he withdraw from his invested capital during that time?
3. Did the loss on the business transacted during this period increase or decrease his capital?
4. What was his net capital at the beginning of the second year?
5. How much did he increase or decrease it during January?
6. What items entered into the final adjustment on January 31 when his net capital was again determined? Did these items increase or decrease his net capital?

Rules for Debiting and Crediting Proprietor's Capital Account

97. Debit the proprietor's capital account for items which decrease his invested capital.	**98.** Credit the proprietor's capital account for his investments and for items which increase his invested capital.

99. The balance of an owner's capital account, after the net profit or the net loss and any other amounts affecting it have been closed into it, shows the owner's net capital or net insolvency—(a) *net capital* when the credit side is the larger, and (b) *net insolvency* when the debit side is the larger. The capital account should be shown in a separate section of the statement of assets and liabilities, which is the last section of that statement.

CLOSING THE CAPITAL ACCOUNT

100. The object in closing the proprietor's capital account is to show in one amount the net capital or net insolvency at the close of a fiscal period, and at the beginning of the next period. After the income and profit and loss statement has been prepared, the account is credited by a journal entry for the net profit or debited for the net loss shown by that statement. After this entry is posted, if the credit side is the larger, the balance of the account is the net capital. It is entered on the debit side to balance the account, which is then footed and ruled, and the net capital is brought down to the credit side under date of the next business day, as shown in illustration 27.

101. If the debit side is the larger after the net profit or net loss is posted to the account, the balance shows the net insolvency, which should be entered on the credit side to balance the account. The account is then footed and ruled, and the balance brought down under date of the next business day.

EXERCISE 13

Jan. 1	Henry B. Walters invested $2000.00.
Feb. 15	He withdrew $500.00.
July 1	He invested $1000.00.
Oct. 22	He withdrew $200.00.
Dec. 10	He purchased for his business with his private funds a store building and lot costing $6250.00.
Dec. 31	His profit for the year, which he left in the business, was $1346.12.

EXERCISE 14

Jan. 1	Charles E. Ford invested $3200.00 in cash, merchandise worth $900.00, notes made in his favor by his debtors $750.00, and accounts receivable from his debtors $500.00.
Jan. 1	His liabilities to be paid upon their maturity out of the cash capital of his business were accounts payable to his creditors, $375.00; and notes payable, $800.00.
Apr. 1	He invested $1000.00.
May 15	He bought an automobile for his personal use which was paid for with money he withdrew from the business, $750.00.
Nov. 20	He withdrew $500.00.
Dec. 31	His net loss for the year was $275.40.

Proprietor's Personal Account

102. The personal account of an owner is treated like any other personal account. It is kept under the name of the owner followed by the word "Personal." It is opened for the purpose of keeping incidental items separate from the more permanent investment items entered in his capital account.

103. The personal account of an owner is debited for:

(*a*) all sums withdrawn for private use which are not to be deducted from the investment,

(*b*) any personal debts paid from the funds of the business,

(*c*) all sums collected from customers and retained by the owner.

It is credited for:

(*d*) any sums paid in subject to immediate withdrawal,

(*e*) any debts of the business paid from private funds which are not to apply on the investment,

(*f*) the owner's salary when it is paid to him in partial payments as needed,

(g) such part of the net profit the owner may direct.

The following bills for the personal expenses of F. A. Raymond were paid out of the funds of his business and charged to his personal account, which is illustrated on the next page. The balance of this account was closed into the capital account, as shown in illustrations 27 and 28.

Jan. 5 Paid gas bill, \$7.50.
10 Paid life insurance premiums, \$47.52.
16 Paid grocery bill, \$31.40.
21 He withdrew cash, \$75.00.
25 Paid his house rent, \$35.00.
31 Paid electric light bill, \$3.58.

ILLUSTRATION 28

F. A. Raymond, Personal

19 Jan.	5	Gas bill	C	7.50	19 Jan.	31	Capital a/c.	J	200
	10	Life Ins. premiums		47.52					
	16	Grocery bill	C	31.40					
	21	Cash	C	75					
	25	House rent	C	35					
	31	Elec. lgt. bill	C	3.58					
				200					200

104. The balance shows the amount to be paid to or by the owner, or to be closed into his capital account, as a final adjustment. When the personal account is to be closed into the capital account, it must be done by a separate journal entry.

105. The final disposition of the balance shown by the owner's personal account *is determined entirely by the wishes of the owner.* If it shows a debit balance, he may pay into the business out of his personal funds the amount of the balance, which will close the personal account. On the other hand, he might prefer to debit his capital account and credit the personal account for the balance of the latter, which likewise would close it. If his personal account shows a credit balance, he can draw it out in cash, or close the account by debiting it for its balance and crediting his capital account.

EXERCISE 15

Record the following items affecting the personal account of John A. Butler:

Dec. 1 Paid his house rent, \$45.00.
2 He withdrew \$100.00 to apply on his salary.
5 Paid provision bill, \$35.20.
8 Paid auto license, \$12.50.
10 He collected \$22.50 from a customer and kept the money.
15 He made a temporary loan to the business of \$175.00 to pay a note maturing today.
22 He withdrew \$150.00 to apply on his salary.

Dec. 28 He paid an account of the business from his private funds, \$32.75.
31 His account is to be credited for his monthly salary, \$250.00.
31 His personal account is to be credited for his net profit, \$928.16.
31 The balance of his personal account is to be closed into his capital account.

NOTES AND DRAFTS

Notes

106. A promissory note is an unconditional written promise to pay a specified sum of money at a definite future time. It is a *medium of exchange.* There are two principal original parties to a note, *the maker* and the *payee.* The maker is the party who signs the note—who makes the promise to pay. The payee is the party in whose favor the note is made—the one to whom the amount is to be paid.

Illustration 29

No. 964 Buffalo, N.Y., September 24, 19

Sixty days after date I promise to pay to the order of Gordon, Southard & Co. \$743.68

Seven Hundred Forty-three and 68/100 Dollars

payable at Fidelity National Bank

Value received.

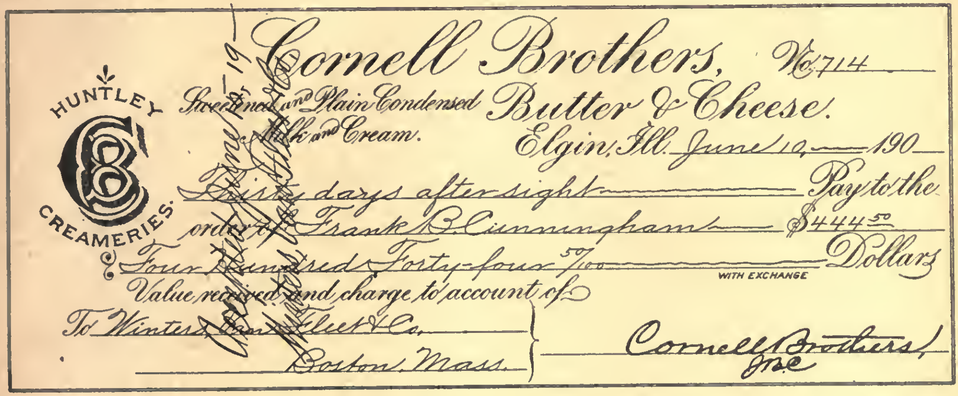
Due Nov. 23, 19 William B. Allison

107. In illustration 29 William B. Allison is the maker and Gordon Southard & Co. is the payee. The maker of a note usually *owes* or is *in debt* to the payee of the note, i.e., the maker is a *debtor* of the payee.

Drafts

108. A draft is a written request to pay a specified sum of money at a certain future time. It is a *medium of exchange.* There are three parties to a draft, the *drawer,* the *drawee,* and the *payee.* The drawer is the party *who makes the request.* The drawee is the party *upon whom the request is made* and who, if he accepts the request, *becomes the payer or "acceptor" of the draft.* The payee is the party *in whose favor the draft is drawn,* the one to whom the amount of the draft is to be paid when due.

ILLUSTRATION 30


HUNTLEY CREAMERIES
Cornell Brothers, No. 714
Sweetened and Plain Condensed Milk and Cream. Butter & Cheese.
Elgin, Ill. June 10 190
days after sight Pay to the
order of Frank B. Cunningham $444.50
Four Hundred Forty-four 50/100 WITH EXCHANGE Dollars
Value received and charge to account of
To Winters Van Fleet & Co.
Boston, Mass.
Cornell Brothers, Inc.

109. In illustration 30 Cornell Brothers is the drawer, Winters, Van Fleet & Company is the drawee and acceptor, and Frank B. Cunningham is the payee. The drawee of a draft usually *owes* or is *in debt* to the drawer; i.e., the drawee is a *debtor* of the drawer. The payee is usually a creditor of the drawer.

110. When the drawer makes a draft payable to a third party it is generally spoken of as a "three party" draft, and in such case it may be assumed that the drawer *owes* the payee.

111. When the drawer and the payee is the same person, the draft is usually drawn for the purpose of collecting a debt. If the draft is drawn in favor of the payee's bank the same purpose is indicated.

112. Drafts are of two kinds as to time of payment. Those payable "at sight" are known as *sight drafts* and are usually payable on presentation. Those payable "after sight" or "after date" are known as *time drafts.* After a time draft has been accepted, it is known as *an acceptance.*

113. Accepting a draft is agreeing to pay it when it is due by writing the word "Accepted" across the face, followed by the date and the name of the drawee, who thus becomes the "acceptor," and the draft is known thereafter as an "acceptance," as stated in the preceding paragraph. (See illustration 30.)

114. The date of maturity is the date on which the note or draft falls due. When the time is indicated in days, the *exact number* of days is meant, not counting the date of making or of acceptance, but counting the date of maturity. When the time is indicated in months, the *same day of the maturing month* is the date of maturity. Drafts and notes are called *negotiable instruments.*

115. A draft drawn "after sight" begins to mature *from the date of the acceptance,* and when drawn "after date" it begins to mature from the date the draft was drawn without regard to the date of acceptance. A note begins to mature from the date it is made.

116. Due on Sunday or a legal holiday. The law in nearly all states is that when the due date falls on Sunday or a legal holiday, the paper falls due on the *next following business day.* In a very few states it is due on the last preceding business day. Days of grace are three days formerly allowed in addition to the time specified for the payment of commercial paper. They have been abolished in all but a few states, and will doubtless be abolished in all states within a short time.

117. Negotiable notes and drafts are those which can be *transferred* by one party to another. To be negotiable, a commercial paper must contain the words "or order" or "or bearer." When it does not contain these words it is said to be non-negotiable, which means that it cannot be transferred by simple endorsement and delivery. In most states special statutes provide that such papers can be transferred by assignment, though the party to whom it is transferred gets no better title to the paper than the original holder had.

118. Transfer. When a payee transfers a negotiable note or acceptance, he does so by writing his name across the back, and then delivers the paper to the *endorsee.* This is known as an *endorsement.* When a note is transferred, the payee becomes the *first* endorser; when an acceptance is transferred, he becomes the *second* endorser, unless the draft is drawn by him in his own favor, in which case he is the *first* endorser. When commercial paper is made payable "to bearer" it is not necessary for the holder to endorse it when transferring it to another, but for prudential reasons it is generally requested and usually required. The different forms of endorsement are shown on the next page. These endorsements apply not only to notes and drafts but to checks and all forms of negotiable paper.

NOTES RECEIVABLE AND NOTES PAYABLE

119. Notes receivable are the written promises of others to pay which are *received* by us. They consist of notes and accepted drafts the value of which we are to receive when they are due.

120. Notes payable are our own written promises to pay *given* (issued) to others. They consist of notes and accepted drafts the value of which we are to pay when they are due.

121. Both show a condition of indebtedness, notes receivable corresponding with accounts receivable and notes payable corresponding with accounts payable. The principal difference between a note receivable or a note payable and an account receivable or account payable is that the note is a *written* promise to pay, and the account indicates an *oral* or *implied* promise to pay.

ENDORSEMENTS

(In Blank)
J. A. Amsbaugh & Co.

(In Full or Special)
Pay to the order of W. E. West.
J. A. Amsbaugh & Co.

(Without Recourse)*
Pay to the order of W. E. West without recourse.
J. A. Amsbaugh & Co.

(Restricted)
Pay to W. E. West only.
J. A. Amsbaugh & Co.

(For Collection)
Pay Tenth National Bank for collection.
J. A. Amsbaugh & Co.

(Endorsement with Guarantee)
We hereby guarantee the payment of the within note.
J. A. Amsbaugh & Co.

(For Part Payment)
$50.00.
July 5, 19 , Received on the within note Fifty Dollars.†

* This means that the party so endorsing is relieved from any further claim or liability as endorser.

† The writing of the name of the holder on the back of a note is a receipt in full in the hands of the maker, therefore it should always be omitted in endorsing for partial payments.

122. Notes and acceptances are generally received and issued in settlement of personal accounts, thus changing oral promises into written promises, which are in fact written contracts.

Note: If A owes B on account and afterwards A gives B his note or acceptance in settlement, while the record of A's indebtedness in B's books is transferred from A's personal account to the notes receivable account, A's indebtedness to B remains just the same. In some states and under some circumstances the written promise (note or acceptance) may be more binding upon A.

123. The principal advantage of notes and acceptances is that they are *negotiable*, that is, they are transferable from one person to another, which lends to them the characteristics of *mediums of exchange* and greatly increases their usefulness in the transaction of business.

124. Because of their negotiability, notes and acceptances are frequently bought and sold, are discounted at bank to raise funds, are transferred "on account," and are sometimes given as security for loans or debts.

Notes Receivable Account

125. Notes receivable account is one of the class in which items relating to *mediums of exchange* are recorded. The object in keeping the account is to show:

(a) The face value of notes and acceptances *received* from debtors,

(b) The face value of such notes and acceptances which have been paid by their makers, or transferred by us before maturity to others to apply on debts owed to them, and

(c) The face value of notes and acceptances receivable *on hand* at any date, which is a *current asset.*

126. Notes and acceptances receivable are considered to be "on hand" until actual payment of them has been received, even though some of them may have been sent to banks or placed in attorneys' hands for collection.

127. All items must first appear on the debit side of this account before they can appear on the credit side. *As notes and acceptances of others are received* they are entered on the debit side of the notes receivable account *at their face value. As they are paid and returned to those who issued them,* or *are transferred to others,* they are entered as *canceling items* on the credit side *at their face value.*

128. When a debtor issues to his creditor a note or acceptance covering a debt already recorded in their respective personal accounts, the creditor debits notes receivable account and credits his debtor's personal account for the face value of the paper. The debtor's record of the transaction is a debit to his creditor's personal account and a credit to notes payable account. Regardless of these bookkeeping entries, however, the debtor still continues to owe his debt until the note or acceptance is paid. He has simply changed an implied or oral promise to pay into a written promise to pay. Accordingly, the bookkeeping entries referred to merely transfer the record of the indebtedness from the debtor's personal account to the notes receivable account on the books of the creditor, and from the creditor's personal account to the notes payable account on the books of the debtor.

129. The giving of a written promise to pay, whether in the form of a note or acceptance, therefore *does not pay the debt.* In case a note or draft is not paid at maturity (when it ceases to be negotiable), it is the best accounting practice to charge it back to the debtor's personal account. In such case, the note or acceptance becomes merely a written evidence of indebtedness over the signature of the debtor. The debtor continues to be responsible for his debt until the note is redeemed or the personal account is paid. For these reasons many concerns do not credit debtors' accounts for notes and acceptances received, but instead make a memorandum record of them in a *notes receivable book.* The debit items in the personal accounts of the debtors are not canceled until the notes or acceptances are paid. Notes and acceptances issued, however, should invariably be credited to the notes payable account and charged to the personal accounts of the parties to whom they were issued.

The following transactions are correctly recorded in the notes receivable account shown below:

Jan.	1	Received note for $500.00.
	4	Received note for $450.00.
	6	Received accepted draft for $375.00.
	15	Received cash for note entered on January 1.
	15	Received note for $220.10.
	17	Received acceptance for $360.75.
	19	Received accepted draft for $900.00.
	21	Received cash for draft entered on January 6.
	23	Received note for $102.14.
	24	Received cash for draft entered on January 4.
	25	Transferred note entered on January 17 to a creditor in part payment of his account.
	26	Received check for draft entered on January 19.
	31	Received $200.00 in part payment of note entered on January 15.

ILLUSTRATION 31

Notes Receivable

19 Jan.	1		J	500		19 Jan.	15		C	500	
	4		J	450			21		C	375	
	6		J	375			24		C	450	
	15		J	220	10		25		J	360	75
	17		J	360	75		26		C	900	
	19		J	900			31		C	200	
										1,460	75
	23		J	102	14						
	30		J	377	76						
	31	900	J	400							
				2,360	75						

ANALYSIS

1. On which side of this account are entered the amounts of the notes and accepted drafts received?
2. What do the amounts on the other side of the account show?
3. On what dates was it possible to rule out balancing items?
4. What do the footings on the debit and credit sides show?
5. What is the balance of the account and what does it show?
6. Which are the balancing items below the rulings?
7. How may the balance of the account be proved?

Rules for Debiting and Crediting Notes Receivable Account

130. Debit for the face value of others' notes and acceptances received.	**131.** Credit for the face value of such notes and acceptances when paid or transferred.

132. The balance of the notes receivable account (if any) shows the amount of notes and acceptances receivable on hand, which is a *current asset* that should be included in the statement of assets and liabilities. The sum of the unpaid notes and acceptances on hand must agree with the balance of the account.

133. When all items balance above a given point they may be ruled out, as shown in illustration 31, but the notes receivable account should never be closed except when it is necessary to forward the account to another page. In this case the balance is entered on the credit side, the account is footed and ruled, and the balance is forwarded to a new account on another page.

EXERCISE 16

George Warren's notes receivable transactions are the following. Enter them in a notes receivable account.

Feb.	2	Received 30 day note for $250.00.
	5	Received 60 day note for $112.50.
	25	Received 10 day acceptance from customer for $96.50.
Mar.	3	Received cash in payment of note entered on Feb. 2.
	4	Received two months note for $165.70.
	7	Received cash in payment of acceptance entered on Feb. 25.
	10	Received 30 day note for $282.19.
	12	Received three months note for $742.56.
Apr.	4	Received cash for note entered on Feb. 5.
	9	Transferred note entered on March 10 to a creditor in part payment of his account.

EXERCISE 17

Enter the following notes receivable transactions of Blake and Ray in a notes receivable account.

May	2	Received 15 day accepted draft from customer for $92.68.
	4	Received 90 day note for $322.18.
	11	Received 60 day accepted draft from customer for $216.22.
	15	Had note entered on May 4 discounted at bank.
	16	Received one month note for $112.70.
	17	Received cash for acceptance entered on May 2.
June	12	Received 30 day note for $175.90.
	15	Had acceptance entered on May 11 discounted at bank.
	16	Received cash for note entered on May 16.

July 2 Received 60 day note for $300.00.
12 Transferred note entered on June 12 to a creditor to apply on account.
28 Received accepted draft drawn at 10 days sight for $211.18.

NOTES PAYABLE ACCOUNT

134. Notes payable account is one of the class in which items relating to *mediums of exchange* are recorded. The object in keeping this account is to show:

(*a*) the face value of our notes and acceptances issued to creditors,

(*b*) the face value of these notes and acceptances which have been redeemed by and returned to us, and

(*c*) the face value we still owe on unpaid notes and acceptances at any date, which is a *current liability.*

135. All items must first appear on the credit side of this account before they can appear on the debit side, because our obligations to pay must be issued before they can be paid and redeemed. *As we pay them and they are returned* to us by those to whom they were issued or transferred, they are entered as *canceling items* on the debit side of the account.

The following transactions are correctly recorded in the notes payable account shown below:

Jan. 1 Gave note for $200.00.
4 Gave note for $633.45.
9 Accepted draft for $89.73.
16 Gave note for $1,137.68.
19 Paid draft entered on January 9.
21 Accepted draft for $113.39.
24 Paid note entered on January 4.
24 Issued note for $150.00.
26 Paid note issued January 1.
30 Accepted draft for $212.32.
31 Paid draft entered on January 21.

ILLUSTRATION 32

Notes Payable

19 Jan.	19		c	89	73	19 Jan.	1		J	200	
	24		c	633	45		4		J	633	45
	26		c	200			9		J	89	73
	31		c	113	39		16		J	1137	68
							21		J	113	39
							24		J	150	
							30	1500.	J	212	32
										[illegible]	[illegible]

ANALYSIS

1. On which side of this account are entered the amounts of notes and accepted drafts issued?
2. What do the amounts on the other side of the account show?
3. On what date was the account in balance?
4. What do the footings of the account show?
5. What is the balance of the account and what does it show?
6. Which are the balancing items below the rulings?
7. How may the balance of the account be proved?
8. At what value are notes receivable and notes payable accounts always debited and credited?

Rules for Debiting and Crediting Notes Payable Account

136. Debit for the face value of our notes and acceptances when paid.	**137.** Credit for the face value of our notes and acceptances issued to others.

138. The balance of the notes payable account (if any) shows the amount of our notes and acceptances unpaid, which is a *current liability* that should be included in the statement of assets and liabilities. The sum of the unpaid notes and acceptances must equal the balance of the account.

139. When all items balance above a given point they may be ruled out, as shown in illustration 32, but the notes payable account should never be closed except when it is necessary to forward the account to another page. In this case the balance is entered on the debit side, the account is footed and ruled, and the balance is forwarded to the credit side of a new account on another page.

EXERCISE 18

J. C. Bond's notes payable transactions are as follows. Enter them in a notes payable account.

Feb.	3	Gave 30 day note for $100.00.
	5	Gave 60 day note for $242.50.
	24	Accepted 10 day draft drawn on him by creditor for $52.60.
Mar.	1	Paid cash in settlement of note entered on Feb. 3.
	3	Gave 30 day note for $133.90.
	6	Paid cash in settlement of draft entered on Feb. 24.
	13	Gave two months note for $211.40.
	22	Gave 30 day note for $175.00.
Apr.	2	Paid cash in settlement of note entered on Mar. 3.
	6	Paid cash in settlement of note entered on Feb. 5.

EXERCISE 19

Enter the following notes payable transactions of Brown and King in a notes payable account:

May	1	Gave 3 months note for $185.40.
	4	Accepted 10 day draft drawn on them by creditor for $125.00.
	7	Gave 30 day note for $278.21.
	13	Paid cash in settlement of draft entered on May 4.
	14	Gave 60 day note for $137.50.
	21	Gave 30 day note for $225.00.
June	6	Paid cash in settlement of note entered on May 7.
	15	Gave 2 months note for $100.00.
	20	Paid cash in settlement of note entered on May 21.
	25	Gave 60 day note for $372.60.
July	2	Gave 30 day note for $165.72.
	13	Paid cash in settlement of note entered on May 14.

CASH ACCOUNT

140. Cash includes gold, silver, coins, bank notes, U. S. Treasury notes, money orders, bank drafts, checks, and whatever else is received or given as money. Cash is the most important of the *mediums of exchange.* The objects in keeping the cash account are to record the *receipts* and *payments* of cash, and to ascertain the *amount of cash that should be on hand.*

141. The cash on hand includes the money in the cash register, safe, or drawer, to which must be added the balance in bank shown by the check book. When money is kept on deposit in more than one bank, the sum of the balances must be added to the cash in the register, safe or drawer. When a separate ledger account is kept with the bank, "cash on hand" includes only the actual cash in the safe or drawer. Ledger accounts with banks are seldom kept.

142. The cash account is frequently not kept in the ledger because the cash book, in which the entries for all receipts and payments of cash are made, is really the cash account. When the cash book is kept, no cash items are entered in any other book.

143. Cash receipts are entered on the left-hand or debit side of the cash book. Entries for cash receipts result in *debits to cash account,* and *credits to the accounts named,* when the items of cash received are posted. Cash payments are entered on the right-hand or credit side. Entries for cash payments result in *credits to cash account,* and *debits to the accounts named,* when the items of cash paid are posted.

The cash receipts and payments of W. B. Ward for the month of January, listed on page 70 are recorded in the cash book shown in illustration 33.

Illustration 33

Cash Receipts

Jan.	1	Balance					129	85
	1	W. B. Ward, Capital a/c	Additional cash investment	1500	00			
	11	Walter Crane	Bill Dec. 3	78	22			
	15	Notes Receivable	F. C. Boyd's note due today	328	55			
	18	W. B. Ward, Pers. a/c	Received for debt due him	10	00			
	31	Total Receipts					1916	77
							2046	62
Feb.	1	Balance					964	46

Jan. 1 Balance on hand $129.85.

1 Mr. Ward made an additional cash investment of $1,500.00, to be credited to his capital account.

2 Paid Jameson & Fox for bill December 5, $218.78.

3 Paid rent for store for January, $50.00. This is an expense item to be debited to expense account.

8 Paid Bowen & Co. to apply on bill December 27, $275.00.

11 Received from Walter Crane for bill December 3, $78.22.

11 Paid a doctor bill of $20.00 for Mr. Ward, to be charged to his personal account.

15 Paid travelling expenses of Mr. Ward for a business trip out of the city, which is an expense item, $11.60.

15 F. C. Boyd paid his note for $328.55 in favor of Mr. Ward which is due today. As the notes receivable account was debited when the note was received, credit it when the note is paid.

17 Paid note for $228.50 in favor of Biggs & Co., which is due today. As the notes payable account was credited when the note was issued, it is debited when the note is paid.

18 Mr. Ward collected a personal debt due him of $10.00, and turned the money over to the business. It is to be credited to his personal account.

22 Paid Bowen & Co. in full for bill December 27, $269.60.

28 Paid gas and light bill, $8.68. This is an expense item.

ANALYSIS

1. What was the cash balance on January 1?

ILLUSTRATION 33

CASH PAYMENTS

Jan.	2	Jameson & Fox	Bill Dec. 5	218	78		
	3	Expense	Rent of store for Jan.	50	00		
	8	Bowen & Co.	a/c bill Dec. 27	275	00		
	11	W. B. Ward, Pers. a/c	Personal doctor's bill	20	00		
	15	Expense	Traveling expenses	11	60		
	17	Notes Payable	Note Biggs & Co. due today	228	50		
	22	Bowen & Co.	In full bill Dec. 27	269	60		
	28	Expense	Gas and light bill	8	68		
	31	Total payments				1082	16
	31	Balance				964	46
						2046	62

2. What were the total receipts for the month?
3. Now much cash would have been on hand January 31 if none had been paid out?
4. What were the total payments for the month?
5. What were the total debits and credits to cash for the month?
6. To which side of the ledger accounts named are cash receipts posted? Cash payments?

The following account shows how the total receipts and total payments are posted from the cash book to the cash account in the ledger:

CASH

Jan.	1	Balance	129	85	Jan.	31	Total payments	1082	16
	31	Total receipts	1916	77					

RULES FOR DEBITING AND CREDITING CASH ACCOUNT

144. Debit cash account for receipts.

145. Credit cash account for payments.

146. The balance of the cash account should always be a *debit* balance, *and should equal the amount of cash on hand.* It is a *current asset* that should be included in the statement of assets and liabilities. The credit side of the account can never properly be the larger since it is impossible to pay out more cash than is received. "Overchecking" on the bank may result in the credit side being the larger, but this is a violation of banking rules, and the cash book should never be closed showing an overdraft.

147. To close. Find the balance and enter it on the credit side. Then foot and rule the book, and bring down the balance on the *opposite* side under the date of the next business day, as shown in illustration 33.

EXERCISE 20

Record the following receipts and payments of J. H. Bond in a cash book. Then balance the cash book in the manner shown in illustration 33.

Jan. 2 Balance on hand, $211.36.

2 Mr. Bond made an additional cash investment of $2000.00 to be credited to his capital account.

3 Paid R. J. Maclean & Co. for bill December 28, $179.20.

4 Paid H. B. Wilson & Co. for bill December 29, $139.85.

5 Paid personal coal bill for Mr. Bond, which is to be charged to his personal account, $36.00.

6 Paid rent for store for January, $47.50.

8 Received from Charles Clyde for bill January 2, $78.52.

11 Paid Archer & Crane, on account bill January 6, $150.00.

15 Received from J. C. Lane for bill January 6, $22.13.

17 Paid bill for office supplies, $18.25.

18 A. H. Morton paid his note for $135.42 in favor of Mr. Bond, which is due today.

20 Paid Mr. Bond $75.00 to apply on his January salary, which is to be charged to his personal account.

20 Received from Allen & Blake, on account bill January 4, $100.00.

22 Paid note for $275.80 in favor of H. B. Wilson & Co., which is due today.

24 Mr. Bond sold some second-hand furniture belonging to him for $20.00 and turned the money over to the business, to be credited to his personal account.

24 Paid Archer & Crane in full for bill January 6, $95.60.

26 Paid note for $125.00 in favor of J. K. Gill, which is due today.

27 Cole & Co. paid their note for $187.50 in favor of Mr. Bond, which is due today.

30 Received from Allen & Blake in full for bill January 4, $72.16.

31 Paid clerk's wages for the month, $60.00.

MERCHANDISE ACCOUNTS

148. Merchandise is the general name given to commodities that are bought for the purpose of selling them at a profit.

149. As the principal profit of a mercantile or trading business is derived from the buying and selling of merchandise, those accounts in which are recorded the various items entering into the *cost of the goods purchased*, the *cost of goods sold*, and the *income from sales* are of first importance, because they provide the data from which the *gross trading profit* is determined.

150. The three principal operations in a trading business are *purchasing* merchandise, *selling* merchandise, which are more or less continuous operations, and taking the *inventory* at the time of closing the books, which operation occurs at the close of each fiscal period.

Note: A fiscal period is any yearly period, and may be the calendar year or any other period of twelve months. For purposes of instruction in this text a fiscal period is usually assumed to be one month.

151. Three principal trading accounts are kept to record the results of the three trading operations referred to in the preceding paragraph, namely the *purchases, sales*, and *inventory* accounts. Current purchases and sales are recorded in the first two accounts, and they are therefore *running* or *continuing* accounts. The inventory account receives entries only when the books are closed at the end of a fiscal period and when they are opened at the beginning of the next period. The items included in these accounts relate only to the commodities dealt in.

PURCHASES ACCOUNT

152. The object in keeping the purchases account is twofold:

(a) To ascertain the *invoice cost of merchandise* for a fiscal period, and

(b) To ascertain the *invoice cost of goods sold* for a fiscal period.

153. The invoice cost of goods purchased is debited to the purchases account. *Invoice cost* is the price at which goods are *billed* when purchased. All items which *decrease* or *reduce* the invoice cost of purchases are credited to the purchases account. Such items are designated as "deductions from cost," and consist of purchases returned for credit, rebates and allowances on purchases for defective or damaged goods and overcharges, and similar items.

154. In order to have the purchases account show the *invoice cost of goods sold* for a fiscal period, it must include the *inventory at the beginning* and the *inventory at the close* of the current period. The inventory at the beginning of the period consists of goods which *were purchased but not sold* in the *preceding* fiscal period or periods. Since these goods are on hand and available for sale at the beginning of the current period, at that time their invoice cost is *debited* to the purchases account. The inventory at the *close* of the current period consists of the *unsold goods on hand*. Their invoice cost is therefore *credited* to the purchases account at the close of the period because *it is not a part of the cost of the goods sold or disposed of during the current period.*

155. When the purchases account is debited for the beginning inventory and goods purchased, the debit footing is the *total invoice cost of merchandise* for the period. The total invoice cost minus the sum of the deductions from invoice cost credited to the account is the *net invoice cost of merchandise.* When the account is credited for both deductions from invoice cost and the closing inventory, the balance is the *net invoice cost of goods sold* for the period.

The following transactions are properly recorded in the purchases account which appears below:

Nov. 1 Inventory at beginning of period, $6842.19.
10 Returned for credit goods which were ordered by mistake, $33.66.
12 Bought merchandise for cash, $22.95.
14 Received a rebate on goods purchased which were damaged because of defective packing, $9.45.
17 Received rebate for overcharge on goods purchased, $13.72.
26 Purchased goods for cash, $15.00.
27 Returned defective goods for credit, $11.16.
30 Total purchases on account per purchases book total, $7002.91.
30 Inventory of unsold goods on hand, $8716.42.

ILLUSTRATION 34

Purchases

19					19				
Nov	1	Inventory		6842 19	Nov	10	Goods ret'd		33 66
	12	Cash purchase		22 95		14	Rebate		9 45
	26	Cash purchase		15 00		17	Rebate		13 72
	30	Pch. book total 509864		7002 91 13883 05		27	Goods ret'd		11 16
						30	Inventory		8716 42 8784 41
						30	To close		5098 64
				13883 05					13883 05

ANALYSIS

1. If no merchandise had been purchased during the month, what would have been the invoice cost of the goods available for sale from November 1?
2. What was the invoice cost of the goods purchased during November?
3. What was the total invoice cost of merchandise for the period?
4. What was the invoice cost of the goods returned, the amount of rebates and allowances, and the total deductions from cost for the period?
5. What was the net invoice cost of merchandise for the period?
6. What was the invoice cost of the goods remaining unsold on November 30?
7. What was the net invoice cost of goods sold for the period?
8. What is the balance of the account and what does it represent?

Rules for Debiting and Crediting Purchases Account

156. Debit for the invoice cost of merchandise on hand at the beginning of and purchased during a fiscal period.

157. Credit for deductions from invoice cost, and for the invoice cost of goods unsold at the close of the period.

To Close Purchases Account

158. After the income and profit and loss statement has been prepared, the purchases account is closed by a journal entry crediting it for the amount of its balance shown in the trial balance. When this entry is posted, the account will be in balance and can be footed and ruled as shown in illustration 34.

EXERCISE 21

C. H. Crook's transactions for January affecting the purchases account were as follows. Record them in an account.

Jan. 1 Inventory of merchandise on hand at beginning of business, $1892.73.
7 Bought merchandise for cash, $175.00.
11 Received credit memorandum for purchases returned, $13.45.
18 Bought merchandise for cash $112.42.
22 Received credit memorandum for defective goods purchased, $42.80.
25 Mr. Crook took for his private use merchandise which cost $11.85.
31 Total purchases of merchandise during month per total of purchases book, $3695.48.
31 Inventory of merchandise unsold at end of month, $1522.76.

EXERCISE 22

Walter E. Lee's transactions affecting the purchases account for January, February, and March, in monthly totals, are as follows:

Jan. 1 Inventory at beginning of period, $12,472.16.
31 Total of purchases returned during January, $117.28.
31 Total of purchases book for January, $3,278.46.
Feb. 28 Total of rebates and allowances received during February, $96.19.
28 Total cash purchases during February, $276.80.
28 Total of purchases returned during February, $161.20.
28 Total of purchases book for February, $7,248.22.
Mar. 31 Total of rebates and allowances received during March. $39.25.
31 Total of purchases returned during March, $185.40.
31 Mr. Lee donated to charity at cost goods amounting to $75.40.
31 Total purchases for March per purchases book, $5,986.21.
31 Inventory of merchandise unsold at end of period, $13,786.28.

Additions to Invoice Cost of Goods Sold

159. The balance of the purchases account shows the net invoice cost of goods sold, as explained in ¶ 155 and illustrated in the above exercises. There are a number of other costs and expenses incurred in purchasing and handling merchandise which *increase* its cost; consequently, they must be *added* to the net invoice cost of goods sold in finding the *total cost of goods sold.* These additional costs and expenses include incoming freight, express, and drayage charges; boxing, packing, and shipping materials; warehouse wages, supplies, and expenses; salaries and expenses incurred in buying goods, etc. Such items are designated as "additions to cost," and it is the best practice to keep separate accounts for them. As this practice is observed in this text, such accounts will be introduced later as required.

SALES ACCOUNT

160. The object in keeping the sales account is to ascertain the net income from sales for a fiscal period. The account is credited for the selling price of all goods sold, which is the *income from sales.* It is debited for all items which *decrease* or *reduce* the income from sales. Such items are designated as "deductions from sales," and consist of goods returned for credit, rebates and allowances on sales for defective or damaged goods and overcharges, and similar items.

161. The credit footing of the sales account is the *total sales,* or *gross sales.* The debit footing is the *total deductions from sales.* The total sales minus the total deductions is the *net income from sales,* which is the balance shown by the account.

The following transactions are correctly recorded in the sales account which appears on page 77.

Jan. 19 A customer was allowed a rebate of $7.56 for an overcharge on goods previously sold to him.

21 Allowed a customer a credit of $12.40 for damaged goods.

25 A customer reported a shortage in a shipment and was allowed a credit for $15.18.

31 A customer returned goods for credit amounting to $64.13.

31 The total sales for the month as shown by the total of the sales book were $7,124.38.

ANALYSIS

1. What were the total sales for the period?
2. What was the amount of the goods returned for credit and the total of the rebates and allowances on sales?
3. What were the total deductions from sales?
4. What were the net sales for the period?
5. What is the balance of the account, and what does it represent?

ILLUSTRATION 35

Sales

19 Jan.	19	Overcharge		7	56	19 Jan.	31	Sales	70251	7124	38
	21	Damaged goods		12	40						
	25	Shortage		15	18						
	31	Goods rtd.		64	13						
				99	27						
	31	To close		7025	11						
				7124	38					7124	38

RULES FOR DEBITING AND CREDITING SALES ACCOUNT

162. Debit for all deductions from the selling price of goods sold.

163. Credit for the selling price of all goods sold.

TO CLOSE SALES ACCOUNT

164. After the income and profit and loss statement has been prepared the sales account is closed by a journal entry debiting it for the amount of its balance as shown in the trial balance. When this entry is posted, the account will be in balance and can be footed and ruled as shown in illustration 35.

EXERCISE 23

C. G. Kirwan's transactions affecting the sales account for January were as follows. Record them in an account.

Jan. 3 Sold merchandise for cash, $27.60.
10 Allowed customer credit for goods returned, $13.72.
14 Sold merchandise for cash, $115.00.
17 Allowed customer credit for overcharge on goods sold him, $3.76.
22 Allowed customer credit for damaged goods, $21.75.
25 Sold merchandise for cash, $12.70.
31 Total sales for month per sales book total, $4,278.89.

EXERCISE 24

Hynson & Westcott's transactions affecting the sales account for the months of January, February, and March, in monthly totals, are as follows:

Jan. 31 Total cash sales during January, $211.83.
31 Total sales per sales book for January, $7,898.85.
31 Total rebates and allowances on sales during January, $368.40.
Feb. 28 Total sales returned during February, $122.19.

Feb. 28 Total cash sales during February, $326.72.
28 Total rebates and allowances on sales during February, $37.22.
28 Total sales per sales book for February, $8,688.78.
Mar. 31 Total sales returned during March, $422.16.
31 Total cash sales for March $521.73.
31 Total rebates and allowances on sales during March, $78.21.
31 Total sales per sales book for March, $9,972.43.

Other Deductions from Sales

165. There are other items in addition to those named in paragraph 160 which reduce the income from sales, but such items are not entered in the sales account. It is the best practice to keep separate accounts for them, and such accounts will be introduced later as they are required.

Cash Sales

166. Cash sales are those sales in which cash is received immediately for the goods sold. They are "spot cash" sales over the counter. When goods are paid for immediately there is no reason for opening an account with the customer. When cash registers or cash drawers are used, the amount received for cash sales during the day is entered as one item in the cash receipts book and credited to sales account. This disposition of cash sales is made in most lines of business. When goods are not paid for immediately an account is opened with the customer.

INVENTORY ACCOUNT

167. A merchandise inventory is a list of merchandise or stock in trade on hand at any time. It is necessary to take an inventory of the merchandise on hand at the end of each fiscal period in order to ascertain the correct profit or loss on the goods sold, because the inventory of unsold goods must be deducted from the total invoice cost of merchandise to ascertain the net invoice cost of goods sold for the period. Read ¶'s 153, 154, and 155.

168. The object in keeping the inventory account is to record in the ledger the value of the merchandise on hand at the end of any fiscal period. The inventory is a *current asset* which should be included in the statement of assets and liabilities. The account on the next page shows the proper entries for inventories taken on October 31, November 30, and December 31.

Explanation: The inventory of $6842.19 was debited to the inventory account on October 31, when the books were closed for that month. Reference to illustration 34 on page 74 will show that when the books were opened again for the next period on November 1, this inventory was debited to the purchases account. At the same time it was credited to the inventory account as shown above. As the inventory account was then in balance, the balancing items were ruled out. On November 30, when the books were closed again, the inventory of $8716.42 on hand at that date was debited to the inventory account and credited to the purchases account, as shown in the two illustrations. When the books were opened again on December 1 for the next period the purchases account was debited (this entry is not shown in illustration 34 because it only includes November items) and was credited to the inventory account, which again brought that account into balance.

ILLUSTRATION 36

Inventory

19 Oct.	31			6842	19	19 Nov.	1			6842	19
Nov.	30			8716	42	Dec.	1			8716	42
Dec.	31			7516	45						

ANALYSIS

1. What account was credited when the inventory account was debited on December 31 for $7516.45?
2. When the books are opened again on January 1 what account will be debited and what account credited for this amount?
3. Why is the inventory account debited and purchases account credited for the inventory on hand at the close of a fiscal period?
4. Why is the purchases account debited and the inventory account credited for the inventory on hand at the beginning of a period?

RULES FOR DEBITING AND CREDITING INVENTORY ACCOUNTS

169. Debit for the inventory on hand at the end of any fiscal period.	**170.** Credit for the same inventory at the beginning of the next fiscal period.

EXERCISE 25

Jan. 1, 1922. R. L. Johnson's inventory of merchandise debited to the inventory account on his books at the beginning of the year was $3,278.42.

Dec. 31, 1922. His inventory at the end of the year was $4,391.12.

1. Open the Inventory Account, debiting it with the inventory of Jan. 1.
2. What entries are required to transfer this inventory from the inventory account to the purchases account at the beginning of business

on Jan. 1? Make the entries in the two accounts and rule out any balancing items.

3. Make the entries required to transfer the inventory of Dec. 31 from the purchases to the inventory account.

EXERCISE 26

Dec. 31, 1923. Mr. Johnson's inventory at the end of the year 1923 was $5,678.40.

1. Follow instructions given in paragraphs 2 and 3 in the above exercise.

FREIGHT, EXPRESS, AND DRAYAGE CHARGES

171. Freight and express charges are the amounts paid for the transportation of goods by public carrier. Drayage and cartage charges represent the cost of hauling goods from freight stations to the warehouse or to other freight stations, and from the warehouse to freight stations or other points of delivery. As understood by accountants the term "freight" includes all freight, express, cartage, postage, and other charges assessed for the transportation of goods.

172. The terms on which goods are bought and sold generally indicate which of the parties is to pay transportation charges. Goods shipped "f. o. b." (free on board) means that the seller delivers the goods on board the cars, boat or ship, after which they are transported at the expense of the buyer. "Charges prepaid" generally means that the seller of goods shipped f. o. b. pays the freight or express charges at the point of shipment for the buyer, and that the buyer becomes indebted to the seller for the amount. Goods shipped "f. o. b. delivery point" means that the seller is to pay the carrying charges; if they are paid by the buyer the seller becomes indebted to him for the amount. However, in any case it is a matter of *agreement between the parties when the sale is made as to who is to bear the expense of the transportation charges.*

173. There are two kinds of freight from an accounting standpoint. *Incoming* freight (or "freight in") consists of all transportation charges on goods purchased. *Outgoing* freight (or "freight out") consists of all such charges on goods sold.

FREIGHT IN ACCOUNT

174. Freight In account is one of the accounts included in the group designated as "additions to cost." Read ¶159. The account is debited for the cost of freight, express, and drayage charges paid on goods purchased. It is credited for the amount of any of these charges rebated and returned because of overcharges resulting from mistakes in rating, etc. Its balance shows the *net increase in cost* for incoming freight to be added to the net invoice cost of goods sold in finding the total cost of goods sold for a fiscal period. Inward freight is a *trading expense.*

ILLUSTRATION 37

FREIGHT IN

Jan.	4	Freight		12 16	Jan.	17	Rebate on dra. 1/5		1 50
	7	Express		9 28		28	Rebate on frt. 1/9		6 12
	9	Freight		21 74		31	To close		82 96
	15	Drayage bill		22 50					
	27	Express		5 40					
	31	Drayage bill		19 50					
				90 58					90 58

ANALYSIS

1. What should the charges have been for the freight entered on January 9?
2. What should have been the amount of the drayage bill entered on January 15?
3. What were the total freight, express, and drayage charges for the month?
4. What were the total rebates on these charges?
5. What is the balance of the account, and what does it show?

RULES FOR DEBITING AND CREDITING FREIGHT IN ACCOUNT

175. Debit for incoming freight, express, drayage, and postage charges.

176. Credit for rebates or allowances on such charges.

177. To close. After the income and profit and loss statement has been prepared, this account is closed by a journal entry, crediting it for the amount of its balance shown in the trial balance. The account is then footed and ruled as shown in illustration 37.

EXERCISE 27

L. C. Rusmisel's transactions affecting the freight inward account are the following. Record them in an account.

June 2 Paid freight bill on goods purchased, $42.65.
8 Paid express charges on incoming goods, $7.63.
15 Paid freight on goods purchased, $35.72.
21 Received rebate for overcharge on freight paid on June 2, $11.22.
28 Paid expressage on incoming goods, $3.16 .
30 Paid bill of City Transfer Co. for hauling incoming goods from freight stations to store, $8.50.

WAREHOUSE EXPENSE ACCOUNT

178. Warehouse expenses consist of the expenditures for labor employed and supplies used in handling merchandise in the warehouse or store. They thus consist of the expenses of receiving, unpacking, placing in stock, and preparing merchandise for sale or shipment, such as the cost of labor and boxing, packing, and shipping materials and supplies.

179. The warehouse expense account is one of the accounts in the group designated as "additions to cost." It is debited for the cost of warehouse expenses. It is credited for rebates resulting from overcharges and such other items as reduce the cost of such expenses. The balance of the account shows the net increase in cost for warehouse expenses to be added to the net invoice cost of goods sold in finding the total cost of goods sold for a fiscal period. Warehouse expenses are *trading expenses.*

Illustration 38

Warehouse Expense

Jan.	5	Boxes		48 00	Jan.	14	Rebate on boxes		3 00
	8	Paper and twine		18 25		22	Cartons sold		4 00
	12	Cartons		26 50		31	To close		261 55
	15	Wages		80 00					
	18	Nails, strapping, etc.		15 80					
	31	Wages		80 00					
				268 55					268 55

ANALYSIS

1 What should have been the amount of the bill for boxes entered on January 5?
2. What was the expense for warehouse labor for the month?
3. What was the expense for materials and supplies?
4. What were the total charges to warehouse expense?
5. How much were these charges reduced by rebates and other credits?
6. What is the balance of the account, and what does it show?

Rules for Debiting and Crediting Warehouse Expense Account

180. Debit for the cost of warehouse labor and supplies.	**181.** Credit for deductions from the cost of items charged to the account.

182. To close. After the income and profit and loss statement has been prepared, this account is closed by a journal entry crediting it for the amount of its balance shown in the trial balance. The account is then footed and ruled as shown in illustration 38.

EXERCISE 28

Record the following transactions affecting R. L. Strong's warehouse expense account:

Aug.	3	Paid bill for nails, twine, and wrapping paper, $17.65.
	8	Paid bill for packing cases and boxes, $79.60.
	11	Paid bill for box strapping and small tools, $9.20.
	15	Paid wages of warehouseman and shipping clerk, $110.00.
	17	Sold six cases to accommodate neighboring merchant for cash, $4.50.
	22	Paid bill for excelsior and barrels, $6.50.
	27	Received rebate for overcharge on boxes paid for on August 8, $4.40.
	31	Paid wages due today, $110.00.

GROSS TRADING PROFIT

183. In a mercantile or trading business, the *gross trading profit* is the excess of *net income from sales* over the *total cost of goods sold.* It represents the profit resulting from the buying and selling operations. It is ascertained by deducting from the net income from sales the total cost of goods sold. If the total cost of goods sold should exceed the net income from sales, the difference is the *gross trading loss.*

The following tabulation, prepared for illustrative purposes from the accounts shown in illustrations 34, 35, 37, and 38, gives the gross trading profit resulting from the buying and selling operations recorded in those accounts:

Net income from sales		7025.11
Net invoice cost of goods sold	5098.64	
Additions to cost:		
Freight in	82.96	
Warehouse expense	261.55	
Total cost of goods sold		5443.15
Gross Trading Profit		1581.96

ANALYSIS

1. The net income from sales is the debit footing, credit footing, or balance of what account?
2. The net invoice cost of goods sold is the debit footing, credit footing, or balance of what account?
3. By what amount was the net invoice cost of goods sold increased by additions to cost?
4. If there had been no deductions from sales, what would have been the net income from sales?

5. If there had been no deductions from the invoice cost of merchandise, what would have been the net invoice cost of goods sold and the total cost of goods sold?
6. If the inventory of November 30 had been $7716.42, what would have been the gross trading profit?

EXERCISE 29

Prepare tabulations showing the gross trading profit or gross trading loss from the two following groups of accounts:

A		B	
Sales	9728.60	Sales	15893.21
Purchases	7263.22	Purchases	14938.20
Freight In	236.78	Freight In	573.98
Warehouse Expense	498.16	Warehouse Expense	1216.93

EXPENSES

184. In general, expenses are the expenditures for services and supplies required in conducting the activities and operations of a business, but for which no permanent value is secured. They consist of the expenditures of funds which necessarily must be made in carrying on the operations from which the income and profits of a business are derived. These expenditures do not represent permanent investments of funds, but on the contrary, they represent the cost of services and of materials and supplies that are used or consumed. Expenses include the cost of such items as rent, fuel, light, taxes, insurance, postage, office supplies and stationery, telephone and telegraph charges, freight, express, and drayage charges, warehouse expenses, interest on borrowed money, salaries of the proprietor or manager, office help, and clerks, etc.

185. When it is possible to determine accurately the expenses of any particular department or operation of a business, they are classified or segregated in a separate account or accounts so they can be charged against the department or operation in connection with which they were incurred. For instance, the freight in and warehouse expense accounts include the cost of two classes of expense items incurred directly in connection with the merchandising operations, and hence are included in the cost of such operations.

186. Expenses which cannot properly be charged *entirely* to any particular department or operation, but which are applicable to and incurred by the business *as a whole*, are referred to in the smaller businesses as general or operating expenses, and are recorded in one account under the title of "Expense," or "General Expense." These expenses include such items as rent, fuel, light, taxes, insurance, etc. If desired, the expense account may be analyzed at any time to determine the cost of each separate item of expense.

EXPENSE ACCOUNT

187. The expense account is debited for the cost of all general expenses. It is credited for any deductions in the cost of items charged to it. The balance of the account shows the net cost of the general expenses, which must be deducted from the gross trading profit in finding the net profit for a fiscal period. In case there is a gross trading loss, the expenses must be added in determining the net loss.

ILLUSTRATION 39

Expense

19 Jan.	10	Coal		11	50	19 Jan.	31	Rent		25	
	14	Team license		3	75		31	To close		85	56
	18	Letter box		1	50						
	31	Elec. light		3	81						
	31	Rent		90	00						
				110	56					110	56

ANALYSIS

1. What were the total general expenses for January?
2. If the $25.00 credited to the account on January 31 was received for space rented to another merchant, what was the net expense for rent for the month?
3. What is the balance of the account, and what does it represent?

RULES FOR DEBITING AND CREDITING EXPENSE ACCOUNT

188. Debit for the cost of all general expenses.

189. Credit for deductions from the cost of items charged to the account.

190. To close. After the income and profit and loss statement has been prepared, this account is closed by a journal entry crediting it for the amount of its balance shown in the trial balance. The account is then footed and ruled as shown in illustration 39.

EXERCISE 30

H. A. Bacon's expenses for October were as follows. Prepare an account for them.

Oct. 1 Paid rent of store for the month, $65.00.
10 Bought 5 tons coal for heating, $37.50.
13 Bought postage stamps, $5.00.
18 Paid electric light bill, $2.48.

24 Bought letterheads, envelopes, and office supplies, $22.40.
28 Paid telephone bill, $5.30.
31 Paid clerk's salary, $60.00.

EXERCISE 31

The Central Drug Company's expenses for February were the following:

Feb. 1 Paid rent for store and warehouse, $135.00.
2 Paid gas and electric light bill, $11.86.
10 Paid bill for building new shelves and sundry repairs, $45.00.
12 Paid printing bill for advertising matter, $75.60.
15 Paid clerks' salaries and wages, $265.00.
18 Paid bill for automobile oils and gasoline, $26.52.
20 Paid telephone bill, $7.85.
22 Received cash for overpayment on bill paid on Feb. 18, $2.00.
27 Paid traveling expenses of salesman, $35.80.
28 Paid clerks' salaries and wages, $265.00.

INTEREST AND DISCOUNT

191. Interest and discount are charges paid for the use of money. When the charge is paid *after* the money has been used, it is called *interest;* when the charge is paid *before* the money is received, it is called *discount.* Discount is interest *paid in advance.* This is the only real difference in the terms and consequently for bookkeeping purposes the term "interest" applies to both interest and discount.

Illustration. If A borrows $100 from B for one year at 6% interest, at the expiration of that time (*after* he has had the use of the money) he will return to B $100 plus $6, or $106. The $100 is in payment of the loan. The $6 is in payment for the use of $100 for one year. If the $6 is deducted from the $100 when the loan is made, the interest is then called *discount,* because it is paid in advance, or *before* the borrower has had the use of the money.

192. Interest is received and paid in connection with many kinds of business transactions, the more common of which are:

(a) Interest paid by banks to depositors for funds on deposit with them.
(b) Interest paid by their customers to banks for funds borrowed.
(c) Interest received and paid on notes receivable and notes payable representing debts arising out of current routine transactions between business concerns.
(d) Interest received and paid on past-due open book accounts.
(e) Interest received and paid on mortgages, bonded indebtedness, and such long-time obligations, which are *fixed liabilities.*

193. Most debts upon which interest is to be received or paid are evidenced by notes receivable or notes payable, which stipulate the rate at which the interest is to be calculated. Such notes are called interest-bearing notes. In most states the legal rate of interest is 6%, but in some states the legal rate is as high as 12%. The charging of interest in excess of the legal state rate is unlawful.

194. Interest is calculated on an interest-bearing note from the date of the note to the date upon which it is paid. Discount is calculated for the exact number of days from the date of discount to the due date. An interest-bearing note is discounted for the *amount* of the note, which is the *face* of the note *plus* the *interest.* The amount of the note less the discount equals the *proceeds*, which is the value of the note on the date it is discounted. Interest on an open book account is calculated from the date on which the account is due to the date on which it is paid.

INTEREST INCOME ACCOUNT

195. Interest received is income earned for the use of money loaned. From the standpoint of the business man who extends credit to his customers, it represents an earning of capital because the capital he has invested in his business is sufficient to enable him to continue to carry the accounts of debtors when they fail to pay their debts within the usual term of credit. Under these circumstances a creditor indirectly lends money to his debtors by giving them the use of a part of his capital. Interest received is therefore frequently referred to as a *capital income,* to distinguish it from operating income.

196. Interest received is recorded in the interest income account, which is credited for all such interest and debited for any rebates to others resulting from overpayments of interest charges. The balance of the account is the net income from interest received. The account is included in the group designated as "additions to income," and its balance is added to the gross trading profit in finding the gross income for a fiscal period.

INTEREST EXPENSE ACCOUNT

197. Interest paid is an expense incurred for the use of money which it is necessary to borrow because the capital invested is not sufficient to meet all debts and obligations when they mature. It represents an expense which would not be incurred if the capital invested were sufficient to finance promptly all the operations of a business. Interest paid is therefore frequently referred to as a *capital expense,* to distinguish it from operating expenses.

198. Interest paid is recorded in the interest expense account, which is debited for such interest and credited for any rebates received from others resulting from overpayments of interest charges. The balance of the account is the net expense for interest paid. The account is included in the group designated as "deductions from income," and its balance is deducted from the gross income in finding the net profit for a fiscal period.

The following transactions are correctly classified and recorded in the interest expense and interest income accounts which appear below.

Mar. 2 Paid interest on note due today at bank, $9.17.
5 Received interest from a customer on note due today but renewed at his request, $4.48.
7 The bank discounted a note for $300.00, deducting discount amounting to $3.00.
12 Paid an interest bearing note due today, the interest amounting to $5.72.
17 Received interest on a past due account amounting to $6.60.
17 Allowed customer credit on the above interest for error in calculating, $3.30.
25 Paid interest on a note due today, $7.80.
31 Received credit from bank for interest accrued on daily bank balance for quarter ending March 31, $17.16.

ILLUSTRATION 40

INTEREST INCOME

Mar.	17			3	30	Mar.	5			4	48
	31	To close		24	94		17			6	60
							31			17	16
				28	24					28	24

ILLUSTRATION 41

INTEREST EXPENSE

Mar.	2			9	17	Mar.	31	To close		25	69
	7			3	00						
	12			5	72						
	25			7	80						
				25	69					25	69

ANALYSIS

1. What was the total income from interest received for the month?
2. Were there any deductions from this income, and if so, what was the net income from interest received?
3. What is the balance of the interest income account, and what does it show?

4. What was the expense for interest paid during the month?
5. Were there any deductions from interest expense?
6. What is the balance of the interest expense account, and what does it show?

Rules for Debiting and Crediting Interest Income Account

199. Debit for items which reduce the income from interest received.	**200.** Credit for all income from interest received.

Rules for Debiting and Crediting Interest Expense account

201. Debit for the expense incurred for interest paid.	**202.** Credit for any items which reduce the expense incurred for interest paid.

203. To close. After the income and profit and loss statement has been prepared, the interest income account is closed by a journal entry debiting it for the amount of its balance shown in the trial balance. The interest expense account is closed by a journal entry crediting it for the amount of its balance. The accounts may then be footed and ruled as shown in illustrations 40 and 41.

EXERCISE 32

C. J. Boone's transactions for July affecting the interest expense and income accounts are as follows. Record them in the proper accounts.

July 2 Paid interest on note due at bank, $7.45.
5 Received interest on note due today, $5.20.
8 The bank discounted a note, deducting discount amounting to $3.68.
11 Received interest from customer on a note due today but renewed at his request, $8.38.
12 Paid interest bearing note due today, the interest amounting to $9.22.
15 Paid interest on an overdue account amounting to $7.48.
15 Received interest from customer on overdue account, $9.62.
15 Allowed customer credit on above interest for error in calculating it, $1.68.
17 The bank discounted a note, deducting discount amounting to $6.42.
18 Received rebate on interest paid on July 12, the interest being due for 30 days instead of 60 days, $4.61.
21 Received interest on note due today, $7.43.
31 Received credit from bank for interest accrued on bank balance, $16.21.

CAPITAL INVESTMENT ACCOUNTS

204. In almost every business some part of the invested capital is reinvested in the property and equipment of various kinds required in conducting it, such as real estate, furniture and fixtures, machinery and tools, delivery equipment, etc. Property of this kind is to be distinguished from the merchandise purchased and from the materials and supplies consumed in operating the business. The property required in conducting a business is used continuously over a period of years and consequently the sums required to purchase it are more or less permanent investments of capital. Such investments constitute that part of the invested capital which is not immediately available for the payment of current debts and expenses. For these reasons such investments are referred to as *capital investments*, and the accounts in which they are recorded are called *capital investment accounts*. The properties themselves are referred to as *capital assets*, or *fixed capital assets*.

205. A capital investment account should be debited for the *cost* of the capital asset acquired. It is credited only for the cost of the whole or any part of the asset that is *sold or otherwise disposed of*, the purpose being to have the balance of the account represent at all times the *cost of the property on hand*. Any profit or loss resulting from the sale of a capital asset is recorded in a separate account opened for that purpose.

EXPENSE AND INCOME ACCOUNTS RELATING TO CAPITAL ASSETS

206. Expenses are incurred and incomes are sometimes earned in connection with the ownership and use of capital assets. The various expenses incurred in their maintenance may be recorded in separate expense accounts, instead of charging them to the general expense account, when it is desired to know the cost of maintaining each particular property. Likewise, some properties classed as capital assets produce incidental incomes which are not a part of the principal income resulting from the regular operations of the business, and hence are recorded in separate accounts. Such incomes are secured by renting vacant space in buildings, leasing idle machinery, hiring the use of equipment to others, etc.

207. The question arises frequently as to whether expenditures made in connection with capital assets should be charged to the investment account or to the expense account. The following rules are usually observed by accountants:

(a) All expenditures on a capital asset, whether for first cost or for improvements, *up to the time the property is ready for use or becomes productive* should be charged to the *investment* account.

(b) All sums expended on a capital asset which *increase its efficiency as an income-producing factor or its market value as an investment* should be charged to the *investment* account.

(c) All sums expended to *maintain* a capital asset at its *normal efficiency as an income producing factor or at its original cost or investment value* should be charged to the *expense* account.

REAL ESTATE ACCOUNT

208. Real estate is a general name that is applied to real property, which consists of land and the houses, buildings, and permanent improvements erected thereon. An investment account with all of the real property owned may be kept under the title of "Real Estate," or "Real Estate Investment," but it is better practice when more than one property is owned to open an account with each piece of property under an appropriate heading, such as, "House and lot, 96 North Street," and "Elm Township Farm."

209. The real estate account is a typical capital investment account representing a permanent investment in a capital asset. The object in keeping it is to show the original cost of an investment in real property, which includes:

(a) The first cost of the property purchased, including the land, buildings, and other improvements thereon, and the cost of surveying, examination of title, recording fees, etc.

(b) The cost of all permanent improvements which result in increasing the earning or rental value of the property, such as repairs and alterations, grading, sidewalks, etc.

(c) The cost of taxes, interest on mortgages, or other similar items incurred prior to the time the property becomes productive or is ready for use.

210. The cost of these items constitutes the *investment* in the property. The account is credited for the original cost of the whole or any part of the property sold or otherwise disposed of. The balance of the account at all times is the original cost of the property on hand, which is a fixed capital asset that should appear in the statement of assets and liabilities.

The following transactions are recorded in the account which appears on the next page:

Jan. 1 Purchased an 80 ft. lot improved by a 40 x 60 ft. building known as 9 West Main Street for a purchase price of $11,500, the cost of the lot being $6,000 and of the building $5,500.

5 Paid contractor's bill of $450.00 for permanent improvements and alterations on the store building.

6 Paid for examining the title and recording the deed for the property, $63.75.

12 Paid for repairing the sidewalk and putting in new front steps, $86.25. The property was ready for use on January 15.

25 Sold the vacant half of the lot for cash, $3,000.

ANALYSIS

1. What was the purchase price of the property when it was taken over?
2. How much was spent for improvements and other outlays until the time the property was ready for use?

ILLUSTRATION 42

Real Estate #9 W. Main St.

Date						Date					
19 Jan.	1			11500		19 Jan.	25			3000	
	5			450			31	Balance		9100	
	6			63	75						
	12	9100		86	25						
				12100						12100	
Feby.	1	Balance		9100							

3. What was the original cost price of the entire investment?
4. Why was the account credited for $3,000?
5. What is the balance of the account, and what does it represent?

FURNITURE AND FIXTURES ACCOUNT

211. Furniture and fixtures is a general name applied to the furniture, fixtures, machines, and appliances required to equip business offices and stores for the efficient transaction of business. The cost of such furniture and equipment is recorded in the furniture and fixtures account, which is another typical capital investment account. It is debited for the cost of all furniture and equipment. It is credited for the cost price of anything sold which has previously been charged to the account. The balance of the account is at all times the cost of the furniture and equipment on hand, which is a fixed capital asset that should appear in the statement of assets and liabilities.

ILLUSTRATION 43

Furniture & Fixtures

Date						Date					
19 Jan.	1	Mahog. desk		82	50	19 Jan.	31	Copy press		5	
	1	Single desk		45			31	Balance		392	50
	1	3 chairs		17	50						
	1	Typewriter		75							
	1	Filing case		12	50						
	1	Copy press		5							
	1	Typewriter table		7	50						
	1	Rug for office		20							
	1	Telephone booth		7	50						
	15	Safe 392.50		125							
				397	50					397	50
Feby.	1	Balance		392	50						

ANALYSIS

1. What was the total cost of the furniture and fixtures charged to the above account?
2. What reasons can be suggested for the credit to the account dated January 31 for $5.00?
3. At what price was the copy press credited to the account?
4. What is the balance of the account, and what does it represent?

Rules for Debiting and Crediting Capital Investment Accounts

212. Debit for the cost of capital assets, including all expenditures (if any) until the time they become productive or ready for use.

213. Credit for the cost price of the whole or any part of a capital asset sold or otherwise disposed of.

Closing Capital Investment Accounts

214. A capital investment account is never closed except:

(a) When the capital asset is sold or otherwise disposed of, and

(b) When the account contains so many items that it is desirable to re-state them in one total amount, which is done by entering the balance of the account on the lesser side, footing and ruling it, and bringing the balance down on the opposite side as shown in illustrations 42 and 43.

EXERCISE 33

J. K. Marston began business as a retail grocer on May 1. His transactions involving the purchase of capital assets are given below. Record them in the proper accounts.

May 1 Purchased a store and lot at 122 Pine Street, the price of the store building being $4,250.00 and of the lot $2,500.00.

1 Paid for examining the title, recording the deed, and real estate agent's commission for negotiating the purchase, $172.50.

3 Purchased furniture and equipment required to equip the office and store, the bill amounting to $478.60. Mr. Marston desires to have but one account kept for both the office and store furniture and fixtures.

9 Paid carpenters' bill for building shelves and counters, $100.00. These shelves and counters are not permanent improvements to the building.

11 Paid plumber's bill for repairs and replacements required to put the plumbing in first class condition, $16.20.

15 Mr. Marston opened his store for business on this date, all alterations and repairs having been completed.

18 He returned for credit a single typewriter desk included with the other furniture and fixtures purchased on May 3, the cost of which was $21.50, and purchased in place of it a combination typewriter and flat-top desk for $37.50 and paid the difference.

22 Paid for an electric coffee grinding machine, $75.00.

29 Sold a hand-operated coffee grinding machine for $15.00, the cost of which was $20.00.

REAL ESTATE EXPENSE

215. The real estate expense account is kept to show the expenses incurred in maintaining real property. It is an expense account typical of the kind kept in connection with the investment account for a capital asset. As explained in paragraph 206, the expenses of maintaining capital assets may properly be recorded in the general expense account, but when it is desired to separate the expenses incurred in maintaining a particular property from other expenses, they should be recorded in a special expense account.

216. The real estate expense account is debited for all expenses incurred in maintaining the real estate owned. It is credited for any rebates or deductions resulting from overcharges on the items debited to the account. The balance of the account is the net expense of maintaining the real property owned for a fiscal period. The expenses on real estate used in a business are part of its general or operating expenses. The expenses on real estate owned by but not used in a business are included in the group of accounts designated as "deductions from income," because in that case they are not operating expenses of the business.

The following transactions are properly recorded in the account which appears at the top of page 95.

Jan. 15 Paid tinner's bill for repairing roof and rain spouts, $6.50.

25 Paid plumber's bill for repairing frozen pipe, $2.56.

31 Paid city tax bill for installing extra water hydrant, $3.50.

31 Paid annual premium on fire insurance policy covering the store building, $8.50.

ANALYSIS

1. What were the total real estate expenses paid during the month?
2. What is the balance of the account, and what does it represent?

217. To close. After the income and profit and loss statement has been prepared, the real estate expense account is closed by a journal entry crediting it for the amount of its balance shown in the trial balance. The account may then be footed and ruled as shown in illustration 44.

ILLUSTRATION 44

Real Estate Expense

19 Jan.	15	Repairs		6	50	19 Jan.	31	To close		31	06
	25	"		2	56						
	31	Taxes		3	50						
	31	Insurance		8	50						
				31	06					31	06

REAL ESTATE INCOME ACCOUNT

218. The real estate income account is kept to show the income received from real property. It is an income account typical of the kind kept in connection with the investment and expense accounts for a capital asset. Since the income from real property is not a part of the principal income derived from the regular income-producing operations of a business, is recorded in a special account as explained in paragraph 206.

219. The real estate income account is credited for all incomes received from real property, owned or rented. It is debited for any reductions from such income. The balance of the account is the net income from real estate for a fiscal period, which is included in the group of accounts designated as "additions to income."

The following transactions are properly recorded in the account which appears below:

Jan. 2 Received cash for rent of second floor of the store building, $22.50.
20 Received cash for storing temporarily the surplus stock of another merchant, $10.00.
25 Refunded $2.50 to the tenant on the second floor in consideration of his signing a year's lease for the space at a monthly rental of $20.00.

ILLUSTRATION 45

REAL ESTATE INCOME

Jan.	25			2	50	Jan.	2			22	50
	31	To close		30	00		20			10	00
				32	50					32	50

ANALYSIS

1. What was the total income from real estate received during the month?
2. What was the net income?
3. What is the balance of the account, and what does it represent?

220. To close. After the income and profit and loss statement has been prepared, the real estate income account is closed by a journal entry debiting it for the amount of its balance shown in the trial balance. The account may then be footed and ruled as shown in illustration 45.

EXERCISE 34

Classify and record the following transactions in the general expense, real estate expense, and real estate income accounts:

May 2 Paid bill for office supplies and stationery, $8.65.
3 Received rent for offices on the second floor of the store building, $20.00.
8 Paid city and state taxes on the assessed value of the building and lot for the current year, $211.83.
10 Paid gas and electric light bill, $9.43.
12 Paid carpenter's bill for repairs on floors, steps, weather stripping, etc., $18.00.
15 Rented a vacant office on the second floor and received rent for one-half month, $6.25.
15 Paid salaries and wages of office help and clerks, $170.00.
21 Paid the premium on a fire insurance policy covering the building, $12.40.
24 Paid advertising bill for the announcement of a special sale, $36.00.
28 Paid bill for painting the front of the building, $20.00.
31 Paid salaries and wages of office help and clerks, $170.00.
31 Paid proprietor's salary, $175.00.

RECORDING TRANSACTIONS AND POSTING TO THE LEDGER

221. Instruction and practice in recording transactions in books of original entry, and in posting the entries in such books to ledger accounts, are provided in the "Introduction to Bookkeeping" at the beginning of this text, and in the Elementary Set which accompanies it. As explained therein, a book of original entry is any book which receives the first entry of a transaction. Posting is the process of transferring the debit and credit items from books of original entry to the ledger. The ledger is the book of final entry.

222. In the development of ledger accounts from page 48 to page 96 inclusive, debit and credit items were entered directly in the accounts. Original entries and posting were dispensed with in order to simplify the presentation of the principles involved in keeping these accounts. The accounts treated are shown as they appear after the debit and credit items are posted to them from books of original entry. The process of recording transactions and posting to ledger accounts is explained and illustrated in connection with the model set in the Introduction to Bookkeeping beginning on page 12.

TRIAL BALANCE

223. After all entries are posted to the ledger, the next step in bookkeeping procedure is to take a trial balance. A trial balance is a list of open accounts in the ledger, with the balance of each account set opposite its name, showing that the sum of the debit balances is equal to the sum of the credit balances. Trial balances are usually taken on the last day of each month, and must always be taken before the statements which show the results of the business transacted for a fiscal period are prepared.

The following trial balance includes all the accounts heretofore considered in this text. It will serve as a basis for instruction in the preparation of statements.

Illustration 46

Trial Balance, December 31, 19 . John Spangler

		Cash	1187	52		
		Merchandise Inventory	2736	84		
		Notes Receivable	578	60		
		Accounts Receivable	2975	43		
		Real Estate Investment	7250	00		
		Furniture and Fixtures Investment	428	75		
		Notes Payable			3006	86
		Accounts Payable			1635	80
		John Spangler, Capital			10000	00
		John Spangler, Personal	122	50		
		Purchases	6278	37		
		Freight In	91	72		
		Warehouse Expense	275	84		
		Sales			7719	16
		General Expense	388	70		
		Real Estate Expense	75	16		
		Real Estate Income			35	00
		Interest Expense	21	72		
		Interest Income			14	33
			22411	15	22411	15

Explanation: The accounts receivable item in the trial balance includes the balances of all personal accounts showing debit balances. The accounts payable item includes the balances of all personal accounts showing credit balances. Accounts receivable and accounts payable are grouped in this way to shorten the trial balance. A detailed exhibit that includes the items which make up the balance of an account in a trial balance or statement is called a *supporting schedule.* The following schedules support the accounts receivable and accounts payable items referred to:

Schedule A—Accounts Receivable		Schedule B—Accounts Payable	
M. J. Forgan	782 91	Platt & Co.	313 18
Bronson Bros.	598 26	James L. Vernon	209 76
R. C. Nelson & Co.	322 50	Matthews & Kling	778 96
Dodd Mercantile Co.	978 20	Bell & Bell	333 90
Wilson & Marcott	293 56	Total accounts payable	1635 80
Total accounts receivable	2975 43		

224. **A trial balance** does not necessarily prove that the accounts in the ledger are correct—it demonstrates merely that the sum of the debits is equal to the sum of the credits. Any one or more of the following errors might exist in a ledger and a trial balance could still be taken from it:

(a) A debit or a credit item posted to the wrong account; as for example, the posting of a debit of $10.00 to general expense instead of to real estate expense.

(b) The posting of a debit item to the credit side of the ledger and the posting of the corresponding credit item to the debit side; as for example, debiting a debtor's personal account and crediting notes receivable for a note received from him.

(c) An error in addition or subtraction in footing accounts and finding their balances, which is equalized by a similar error for the same amount on the opposite side of the ledger.

Note: Other errors detected at the time the trial balance is taken will be referred to later.

225. The errors mentioned above are detected by a process called "checking," which consists of comparing all postings with the entries in the books of original entry to determine whether each entry has been correctly posted. All figures should be checked as the footings and balance of each account are calculated.

226. **Accounts may be grouped** in two principal classes: (a) asset, liability, and capital accounts, and (b) income and profit and loss accounts. The statement

of assets and liabilities is prepared from the asset, liability, and capital accounts. The statement of income and profit and loss is prepared from the income and profit and loss accounts. Accounts showing assets, costs, expenses, and losses have debit balances. Accounts showing liabilities, invested capital, incomes, and profits have credit balances. Classify mentally the accounts in the trial balance shown in illustration 46 under the two principal groups named above. Then reclassify them according to whether they represent assets, liabilities, capital, costs, expenses, losses, incomes, or profits.

INCOME AND PROFIT AND LOSS STATEMENT

227. The income and profit and loss statement is prepared at the close of each fiscal period to exhibit in detail the results of the income-producing operations of a business, which are expressed finally in terms of net profit or net loss. The net profit may be quickly found by adding the balances of the income and profit and loss accounts showing credit balances, and deducting from the total the sum of the balances of such accounts showing debit balances, as shown by the following tabulation prepared from the above trial balance.

Sales	7719.16	
Real Estate Income	35.00	
Interest Income	14.33	
Total credit balances		7768.49
Purchases	6278.37	
Freight In	91.72	
Warehouse Expense	275.84	
General Expense	388.70	
Real Estate Expense	75.16	
Interest Expense	21.72	
Total debit balances		7131.51
Net Profit		636.98

228. An income and profit and loss statement, however, should be arranged to exhibit *in their proper relations* all the *essential facts and figures* shown by the accounts, so as to provide the detailed and properly classified information that is necessary in managing a business intelligently. The statement on page 101, showing the same final result as the above tabulation, was prepared from the same accounts in the trial balance, but includes an analysis of the purchases and sales accounts, which appear in the ledger as follows:

Illustration 47

Purchases

Dec.	1	Inventory	2276 80	Dec.	5	Rebate	12 16
	14	Cash purchase	92 50		18	Return	32 20
	31	Pch. Bk. total	6724 11		27	Rebate	33 84
		6278.37	9093 41		31	Inventory	2736 84
							2815 04

Sales

Dec.	3	Return	23 60	Dec.	9	Cash sale	28 62
	17	Rebate	42 30		20	Cash sale	21 80
	23	Return	45 12		31	Sales Bk. total	7779 76

The preparation of statements is facilitated when explanations such as the above are included in posting to accounts which must be analyzed in a statement.

Construction and Interpretation of Income and Profit and Loss Statement

229. This statement is arranged in "report" form. It is divided into five sections under the captions "Income from Sales," "Cost of Goods Sold," "Operating Expenses," "Additions to Income," and "Deductions from Income."

1. *The sales account* is analyzed in the "income from sales" section for the purpose of exhibiting certain units of information that are not shown in a statement prepared from trial balance figures only, such as the tabulation on page 99 and the statement on page 83. The *gross sales* is the credit footing of the account. This item is frequently designated as *total sales.* The items under *deductions from sales* are the *returned sales* and *rebates and allowances on sales* debited to the account. The difference between the total sales and the sum of the deductions is the *net income from sales,* or balance of the sales account.

2. *The purchases account* is analyzed in the "cost of goods sold" section. *The Inventory of December 1* is the invoice cost of the goods which were on hand at the *beginning* of the fiscal period and which was consequently debited to the account at that time. To this inventory is added the invoice cost of goods purchased during the period to find the *total invoice cost of merchandise* for the period. From this amount is deducted the invoice cost of the goods on hand at the *close* of the period, represented by the credit to the purchases account for the *inventory of December 31,* to find the *total invoice cost of goods sold* for the period. It is evident that the invoice cost of goods sold must be the inventory at the beginning of a period, plus the purchases during the period, minus the inventory at the close of the period.

ILLUSTRATION 48

INCOME AND PROFIT AND LOSS STATEMENT, DECEMBER 31, 19 . JOHN SPANGLER

Income from Sales:					
Gross sales		7830	18		
Deductions from sales:					
Returns	68.72				
Rebates and allowances	42.30	111	02		
Net income from sales				7719	16
Cost of Goods Sold:					
Inventory Dec. 1, 19 .		2276	80		
Purchases during month		6816	61		
Total invoice cost of merchandise		9093	41		
Inventory Dec. 31, 19 .		2736	84		
Total invoice cost of goods sold		6356	57		
Deductions from cost:					
Returns	32.20				
Rebates and allowances	46.00	78	20		
Net invoice cost of goods sold		6278	37		
Additions to cost:					
Freight in		91	72		
Warehouse expense		275	84		
Total cost of goods sold				6645	93
Gross Trading Income				1073	23
Operating Expenses:					
General expense		388	70		
Real estate expense		75	16	463	86
Net Income from operations				609	37
Additions to Income:					
Real estate income		35	00		
Interest income		14	33	49	33
Total income from operations and all other sources				658	70
Deductions from Income:					
Interest expense				21	72
Net Profit for the month				636	98

After the invoice cost of goods sold has been determined, any deductions from such cost for *returned purchases* and *rebates and allowances on purchases* must be subtracted to find the *net invoice cost of goods sold*, which is the balance of the purchases account. To this amount must be added any additions to cost for *trading expenses*, such as *freight in* and *warehouse expense*, to find the *total cost of goods sold*. Such expenses are called trading expenses because they *decrease* the gross trading profit, since they must be included in the cost of goods sold.

The difference between the net income from sales and the total cost of goods sold is the *gross trading profit*. This profit is frequently referred to as the *gross trading income*, and is so designated in this statement. It is the income derived directly from the buying and selling operations before any other incomes have been added or before any non-trading expenses have been deducted.

3. "Operating expenses" are the general expenses applicable to and incurred by a business as a whole and which therefore cannot properly be charged against any particular department or operation. They may be designated as *non-trading* expenses to distinguish them from *trading* expenses, which are included in the cost of goods sold in finding the gross trading income, as stated in ¶2 above. In other words, trading expenses must be included in the cost of goods sold, but operating expenses must be excluded from such cost and must be set up, in calculating the net profit, as one of the deductions from gross trading income after it has been ascertained. Operating expenses must of necessity be incurred in order to earn income and profits. Some of them, such as rent, insurance, and taxes, are *fixed charges;* that is, they are incurred and must be paid regardless of whether a concern is making money or not. If earnings are not sufficient to meet them, they must be paid out of capital. Other operating expenses, such as light, fuel, salaries and wages, public service charges, materials and supplies, etc., can be reduced or eliminated in case of low earnings, lack of business, or temporary suspension of operations.

The operating expenses included in this statement are the expenses recorded in the *general expense* and *real estate expense* accounts. The real estate expenses are included in operating expenses because the real estate is owned by and used in the business. If this real estate, while owned by the business as an investment, were not used in conducting it, the real estate expenses would not be considered as operating expenses, but in such case would be included in "deductions from income" as a non-operating expense. The difference between the gross trading income and total operating expenses is the *net income from operations*.

4. "Additions to income" include the *incidental and miscellaneous incomes* which are not earned by the regular income-producing operations of a business. They are therefore *non-operating incomes*. The income from real estate is an incidental earning resulting from renting a portion of the space in the building in

which the business is conducted. As the investment in the building is a capital asset, the income received from the investment in the form of rentals is a *capital income.* The income from interest is likewise an incidental income which results from having sufficient capital invested to loan money directly or indirectly to debtors temporarily. The sum of the net income from operations and the additions to income is the *total income from operations and all other sources.*

5. "Deductions from income" include *incidental expenses* which cannot properly be charged against the regular income-producing operations of a business as operating expenses in finding the net income from operations. They are therefore *non-operating expenses.* The interest expense included under this heading represents an expense that would not have been incurred had sufficient capital been invested to pay all debts and obligations when they matured. It represents the cost of borrowing money directly or indirectly with which to finance the business. For these reasons it is classified as a *capital expense.* The difference between the total income from operations and all other sources and the sum of the deductions from income is the *net income* for the fiscal period. The net income is generally referred to as the *net profit,* and is so designated in this statement.

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL

230. The assets and liabilities of a business and its financial condition on a given date are set forth in the *statement of assets, liabilities, and capital.* The difference between the total assets and total liabilities is the *net assets* when the assets are the larger, or *net liabilities* when the liabilities are the larger. The net assets represent the proprietor's interest or equity in his business, and constitute his *net capital.* The net liabilities are the excess of creditors' claims over the assets available to meet them, and constitute the proprietor's *net insolvency.*

Cash	1187.52	
Merchandise Inventory	2736.84	
Notes Receivable	578.60	
Accounts Receivable	2975.43	
Real Estate Investment	7250.00	
Furniture & Fixtures Investment	428.75	
Total Assets		15157.14
Notes Payable	3006.86	
Accounts Payable	1635.80	
Total Liabilities		4642.66
Net Assets		10514.48

231. The net assets may be quickly ascertained by adding the balances of the asset accounts, and deducting from the total the sum of the balances of the liability accounts, as shown by the tabulation on page 103, which was prepared from the trial balance on page 97.

232. In a properly prepared statement of assets, liabilities, and capital, however, the assets and liabilities are exhibited in classified order in their proper relations so as to provide all the units of information required to interpret the statement correctly. The following statement, showing the same final result as the tabulation referred to, was prepared from the same accounts:

ILLUSTRATION 49

STATEMENT OF ASSETS, LIABILITIES, AND CAPITAL, DECEMBER 31. 19 .

JOHN SPANGLER

		Assets					
		Current Assets:					
		Cash	1187.52				
		Merchandise inventory	2736.84				
		Notes receivable	578.60				
		Accounts receivable	2975.43				
		Total current assets		7478	39		
		Fixed Capital Assets:					
		Real estate investment	7250.00				
		Furniture and fixtures investment	428.75				
		Total fixed capital assets		7678	75		
		Total Assets				15157	14
		Liabilities					
		Current Liabilities:					
		Notes payable		3006	86		
		Accounts payable		1635	80		
		Total liabilities				4642	66
		Net Assets				10514	48
		Capital					
		John Spangler, Capital %	10000.00				
		Add Net Profit for December per I. & P. & L. Statement	636.98	10636	98		
		Deduct John Spangler, Personal %		122	50		
		John Spangler's Net Capital December 31, 19 .				10514	48

Construction and Interpretation of Statement of Assets, Liabilities, and Capital

233. This statement is divided into three sections under the captions "Assets," "Liabilities," and "Capital." It is arranged in "report" form, which requires the assets, liabilities, and capital to be listed in the order named. In setting up this statement, the assets are usually classified or grouped as *current assets* and *fixed capital assets.* Liabilities should be arranged in the same relative groups; namely, *current liabilities* and *fixed liabilities.* There are, however, no fixed liabilities to be considered in this instance. Assets are also called *resources;* hence this statement is frequently referred to as the *statement of resources and liabilities.* It is sometimes called the *statement of financial condition.*

1. *Current assets* consist of cash and such other assets as can be quickly converted into cash or its equivalent if necessary to meet maturing debts. They are frequently referred to as *quick, liquid,* or *floating* assets, because they are quickly convertible into cash or its equivalent and because they fluctuate continuously in amount as a result of the daily transactions of a business.

Current assets should be listed in the order of their *availability* to meet maturing obligations or *convertibility* in securing working cash capital. As the cash on hand is always immediately available to pay debts, it is given first place in the statement. The merchandise inventory is given second place because the stock in trade is continuously being converted into cash as goods are sold, and for the further reason that loans for a considerable part of the present market value of the goods on hand can usually be negotiated at bank when the stock in trade is offered as security. Notes receivable are listed next because they are short-time *contracts* to pay at a *specified date,* and because they can usually be readily discounted at bank if the notes are made and endorsed by responsible parties. Debtors' accounts receivable are listed next because they are usually short-time debts based upon *implied promises* to pay at the expiration of the term of credit, and can ordinarily be collected sooner if a sufficient inducement in the way of a cash discount is offered for prepayment. They can also be offered to banks as security for loans for a part of their book value if they are "good" accounts. They may also be sold at a discount to concerns which make a business of buying accounts receivable from business men who are in need of funds. These concerns collect the accounts they buy at their *book value* at maturity, and their profit is the difference between the book value and the *discounted value* at which they were purchased. These concerns, however, charge back any part of an account which cannot be collected to the party from whom it was purchased. Accounts receivable that are past due and which therefore may not be collected should not be listed as current assets with such other accounts receivable as are not yet due, but should be included in the statement as "Doubtful Accounts Receivable" under the caption "Other Assets."

Fixed capital assets are the *permanent investments* in the various kinds of property and equipment required in conducting a business. They are to be distinguished from investments in stock in trade and such other assets that are purchased to be sold at a profit. As a rule they are the kind of assets in which some part of the capital of a concern must first be invested before the income-producing operations can be started or maintained. They *do not fluctuate* in amount as a result of daily routine transactions and *cannot be as readily converted* into cash as current assets. However, because of their status as permanent investments in tangible real or personal property, most of them can be pledged as security for long-time loans when funds are borrowed to finance current obligations, new operations, or permanent improvements and betterments. Fixed capital assets are usually listed in the order of their importance and permanence as investments, the largest being listed first.

2. *Liabilities* should be grouped in the same relative order as assets. When current assets are stated first among the assets, current liabilities should be listed first among the liabilities. Current liabilities are the obligations and debts which will mature and be payable *in the near future,* and thus as a rule represent the first claims upon assets. Careful management requires that care be taken at all times to have sufficient current assets available to pay current liabilities as they mature, in order to keep the credit of a concern unimpaired.

Current liabilities should be listed in the order in which they will have to be liquidated. Notes payable are listed first because they are usually short-time *written promises* or *contracts* to pay on *definitely specified dates.* Accounts payable are listed next because they are usually short-time debts based upon *implied promises* to pay at the expiration of the term of credit. As previously stated, there are no fixed liabilities in this statement. The long-time loans referred to above in connection with fixed capital assets, such as mortgages on real estate and bonded indebtedness, are examples of fixed liabilities.

3. *The capital* of a business at a given date is its owner's *net assets* invested therein. The net assets are the *total assets* minus the *tctal liabilities.* The net assets are equal to the proprietor's capital investment at the beginning of a given period plus the profit or minus the loss for the period, and plus or minus the balance (if any) of the proprietor's personal account, which is usually closed into the capital account at the close of the period.

Mr. Spangler's income and profit and loss statement shows that he has made a profit of $636.98. His *wealth* has been increased by the amount of this profit. Any part of the net profit may be *withdrawn,* or it may be allowed to *remain in the business* as an addition to invested capital. If Mr. Spangler had allowed his entire profit to remain in his business, his invested capital would have been increased by the amount of the profit. If he had withdrawn all of the profit, his invested capital would have remained unchanged, because in that case the profit would no longer have been included in the assets of his business.

Mr. Spangler's books show that during the month there were paid out in settlement of his personal debts sums amounting to \$122.50, which were charged to his personal account. Such items are to be regarded as withdrawals of profit made prior to the date on which the net profit is ascertained. The difference between \$636.98 and \$122.50, or \$514.48, is the amount of the profit yet to be disposed of in the final adjustment of his accounts for this period. Mr. Spangler desires to have it credited to his capital account as an addition to invested capital. This disposition and adjustment of his profit is provided for in the capital section of the statement of assets and liabilities.

The proprietorship interest in a business, as set forth in the statement of assets and liabilities, may therefore be stated in the form of an equation as follows:

$$\text{Assets} - \text{Liabilities} = \text{Capital}$$

In the ledger, however, assets are debits and liabilities are credits, because the only way to distinguish between them in keeping books by double entry is to record them on *opposite* sides of their respective ledger accounts. No provision is made in double entry bookkeeping for the usual method of subtracting one item from another as required in the above equation. The only way to secure a subtraction in the ledger is to record the item to be subtracted on the opposite side of either the same or another account. For example, the credit items in debtors' accounts are subtractions from debit items. Likewise, the debit items in creditors' accounts are subtractions from credit items. Hence, transposing the negative quantity in the above equation gives a new equation which states the proprietorship interest in ledger form, thus:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

Substituting the total assets, total liabilities, and net capital, as shown in the statement of assets and liabilities, for the members of the above equation, we have the following:

Total Assets	15157.14	Total Liabilities	4642.66
		Capital	10514.48
	15157.14		15157.14

Since in double entry bookkeeping an equality of debits and credits is to be maintained, and further, since assets are debits and liabilities are credits, it follows that capital must be treated as a credit for bookkeeping purposes. It is erroneous, however, to reason that since capital is a credit it is in any sense a liability of its owner or, of the business in which he invested it, or that the business owes the proprietor the amount of the capital invested. Since an owner owns his business he cannot be owed for something which already belongs to him. The credit balance of his capital account merely shows the *excess* of his assets over his liabilities, and represents *his interest* or *equity* in *his assets.* His liabilities represent the claims held by *his creditors* against his assets. If he has no liabilities he is the *sole* owner of his assets, and the balance of his capital account will be equal to the sum of his assets. It stands as a credit in the ledger as an offsetting or balancing item against the assets appearing on the debit side.

The accounting practice of treating assets as debits, and liabilities and capital as credits, is the equivalent of crediting a proprietor in his capital account for his assets and debiting him for his liabilities, thus:

Assets

Total assets	15157.14		

Liabilities

		Total liabilities	4642.66

John Spangler, Capital

Total liabilities	4642.66	Total assets	15157.14

The capital account as now set up above shows the same balance as it would if the proprietor were credited with his net assets, or the difference between his total assets and total liabilities, thus:

John Spangler, Capital

		Net assets	10514.48

A trial balance of the above ledger accounts therefore shows:

Assets	15157	14		
Liabilities			4642	66
John Spangler, Capital			10514	48
	15157	14	15157	14

Reconciliation of Income and Profit and Loss Statement With Statement of Assets, Liabilities, and Capital

234. The net profit or net loss for a fiscal period can be determined by taking the difference between the net capital at the beginning and the net capital at the close of the period. If the net capital at the close of the period is the larger, the difference is the net profit. If it is less than the net capital at the beginning of the period, the difference is the net loss. Stated in another way, since the net capital of a business is its net assets, the amount of the increase in net assets during the period is the net profit, or the amount of the decrease is the net loss. The following tabulation shows how the final results in the income and profit and loss statement and statement of assets and liabilities are reconciled in proving the correctness of the net profit:

Net capital at close of period	10514.48
Net capital at beginning of period	10000.00
Profit credited to capital account of proprietor	514.48
Profit withdrawn during period and charged to proprietor's personal account.	122.50
Net profit shown by income and profit and loss statement.	636.98

CLOSING THE BOOKS

235. It is the best practice to post daily all current entries in the books of original entry and to post the totals of the books at the end of the month, after which they may be ruled and closed for the month. In order to make a periodical test of the equality of debits and credits in the ledger, it is customary to take a trial balance at the end of each month. By doing so, errors in original entries or in posting may be detected and corrected promptly.

236. As a rule it is customary to prepare statements and ascertain the net profit or loss and the financial condition of a business annually at the end of each fiscal period, although in some instances they are prepared semi-annually, quarterly, or even monthly. The ledger should be closed at the end of each fiscal period, after the annual statements have been prepared, for the following purposes:

(a) To indicate the end of an accounting or fiscal period.

(b) To close the current income and profit and loss accounts and thus eliminate them as open accounts in the ledger so as to prepare them to receive entries for the next fiscal period.

(c) To record the final distribution of the net profit or net loss in the proper ledger accounts in accordance with the directions of the proprietor, and

(d) To close the proprietor's capital account for the current period and to reopen it for the amount of the capital invested at the beginning of the next fiscal period.

237. It is the function of the income and profit and loss accounts to supply the classified data from which to ascertain the net profit or the net loss for each fiscal period. The various elements of cost, expense, loss, income, and profit shown by these accounts are summarized in the income and profit and loss statement and are therein reduced to the single result of net profit or net loss. The income and profit and loss accounts should therefore be closed, or "written off the books," after the statement referred to has been prepared. These accounts are frequently referred to as *fiscal* accounts because they are opened at the beginning and closed at the end of each fiscal period.

238. On the other hand, asset and liability accounts are not closed because their function is to show at all times, regardless of fiscal periods, the amounts of the various assets and liabilities. They are *continuing* accounts, showing the assets and liabilities not only at the close of one accounting period, but also at the beginning of the next period and during that and succeeding periods, until the assets are finally disposed of or the liabilities are paid.

Closing and Adjusting Entries

239. The closing of the ledger is accomplished by means of certain closing and adjusting entries made in the journal, which, when posted, will *balance* and thus close out all accounts in the ledger except the asset, liability, and capital accounts. These entries summarize in one account all the income and profit and loss accounts in substantially the same manner in which they are summarized in the income and profit and loss statement. This account is called the Profit and Loss Summary. It is set up by transfer entries which close the balances of the various income and profit and loss accounts into it, with the result that its balance is the net profit or net loss shown on the statement. The balance of the profit and loss summary is closed into the proprietor's capital account. The balance of his personal account is then closed into his capital account in most instances. Read ¶105. The closing and adjusting entries referred to are prepared from the trial balance and statements.

240. The debits and credits in an account must be equal before it can be closed. If an account shows a debit balance, it must be credited for the amount of its balance to close it; and likewise, if it shows a credit balance it must be debited for the amount of its balance. The income and profit and loss accounts can thus be closed by journal entries which transfer their balances to the profit and loss summary account. The entries in the journal on page 111 set up the profit and loss summary account in Mr. Spangler's ledger, and close the income and profit and loss accounts included in his trial balance on page 97.

241. Illustration 51 shows the income and profit and loss accounts and the profit and loss summary account in Mr. Spangler's ledger after the transfer and closing entries referred to have been posted. Notice that all of the income and profit and loss accounts are footed and ruled to show that they are closed, and that the profit and loss summary has a credit balance equal to the amount of the net profit shown by the income and profit and loss statement. These entries have therefore

Illustration 50

Journal, December 31, 19 .

		Sales	7719	16		
		Profit & Loss Summary			7719	16
		To close sales account and transfer income from sales to the P. & L. Summary				
		31				
		Real Estate Income	35	00		
		Profit & Loss Summary			35	00
		To close real estate income account and transfer its balance to P. & L. Summary				
		31				
		Interest Income	14	33		
		Profit & Loss Summary			14	33
		To close interest income account and transfer its balance to P. & L. Summary				
		31				
		Profit & Loss Summary	6278	37		
		Purchases			6278	37
		To close purchases account and transfer cost of goods sold to P. & L. Summary				
		31				
		Profit & Loss Summary	91	72		
		Freight In			91	72
		To close freight in account and transfer its balance to P. & L. Summary				
		31				
		Profit & Loss Summary	275	84		
		Warehouse Expense			275	84
		To close warehouse expense account and transfer its balance to P. & L. Summary				
		31				
		Profit & Loss Summary	388	70		
		General Expense			388	70
		To close general expense account and close its balance into P. & L. Summary				
		31				
		Profit & Loss Summary	75	16		
		Real Estate Expense			75	16
		To close real estate expense account and close its balance into P. & L. Summary				
		31				
		Profit & Loss Summary	21	72		
		Interest Expense			21	72
		To close interest expense account and transfer its balance to P. & L. Summary				

resulted finally in recording the net profit on the books as a credit to the profit and loss summary.

242. **The profit and loss summary** contains exactly the same data as the tabulation showing the net profit which appears on page 99. In the tabulation the sum of the costs, expenses, and losses is deducted from the sum of the incomes and profits, while in the summary account the costs, expenses, and losses are debits, and the incomes and profits are credits. In other words, the profit and loss summary is an abbreviated or condensed income and profit and loss statement in ledger form.

Illustration 51

PURCHASES

Dec.	1	Inventory		2276	80	Dec.	5	Rebate		12	16
	14	Cash purchase		92	50		18	Return		32	20
	31	Pch. Bk. total		6724	11		27	Rebate		33	84
							31	Inventory		2736	84
							31	To close		6278	37
				9093	41					9093	41

Freight In

Dec.	10	Freight		22	16	Dec.	21	Frt. rebate		3	46
	14	Express		9	37		31	To close		91	72
	22	Freight		39	15						
	31	Drayage		24	50						
				95	18					95	18

Warehouse Expense

Dec.	12	Supplies		95	84	Dec.	31	To close		275	84
	31	Wages		180	00						
				275	84					275	84

Sales

Dec.	3	Return		23	60	Dec.	9	Cash sale		28	62
	17	Rebate		42	30		20	Cash sale		21	80
	23	Return		45	12		31	Sales Bk. total		7779	76
	31	To close		7719	16						
				7830	18					7830	18

General Expense

Dec.	4	Coal		66 25	Dec.	31	To close		388 70
	15	Office supplies		42 45					
	31	Salaries		280 00					
				388 70					388 70

Real Estate Expense

Dec.	12	Taxes		52 42	Dec.	31	To close		75 16
	20	Repairs		22 74					
				75 16					75 16

Real Estate Income

Dec.	31	To close		35 00	Dec.	10	Rent		10 00
						31	Rent		25 00
				35 00					35 00

Interest Expense

Dec.	12	Interest		13 12	Dec.	31	To close		21 72
	24	Discount		8 60					
				21 72					21 72

Interest Income

Dec.	31	To close		14 33	Dec.	19	Interest		3 21
						29	Interest		11 12
				14 33					14 33

Profit and Loss Summary

Dec.	31	Purchases		6278 37	Dec.	31	Sales		7719 16
	31	Freight In		91 72		31	R. E. Income		35 00
	31	Ware. Expense		275 84		31	Int. Income		14 33
	31	Gen. Expense		388 70			636.98		7768 49
	31	R. E. Expense		75 16					
	31	Int. Expense		21 72					
				7131 51					

243. The profit and loss summary now stands open in the ledger with a credit balance equal to the amount of the net profit. The next step in the process of closing the ledger is to transfer this balance, which is the net profit, to the capital account of the proprietor. The following journal entry will therefore close the profit and loss summary into Mr. Spangler's capital account:

ILLUSTRATION 52

	31			
		Profit & Loss Summary	636 98	
		John Spangler, Capital		636 98
		To close P. & L. Summary and credit proprietor's capital account for net profit shown on I. & P. & L. Statement, Dec. 31, 19 .		

When the above entry is posted, the summary account, after being footed and ruled, and the capital account will appear as follows:

ILLUSTRATION 53

PROFIT AND LOSS SUMMARY

Dec.	31	Purchases		6278 37	Dec.	31	Sales		7719 16
	31	Freight In		19 72		31	R. E. Income		35 00
	31	Ware. Expense		275 84		31	Int. Income		14 33
	31	Gen. Expense		388 70					
	31	R. E. Expense		75 16					
	31	Int. Expense		21 72					
	31	J. Spangler, Cap.		636 98					
				7768 49					7768 49

JOHN SPANGLER, CAPITAL

					Dec.	1	Investment		10000 00
						31	Net profit		636 98

244. After the net profit is carried to the credit of the capital account, the next step in the closing process is to make such final adjustment of the owner's personal account as he may direct. The personal account may be closed into the capital account, it may be allowed to stand as an open account for future adjustment, it may be credited with such part of the net profit as is required to close it, or with such part of the net profit as the proprietor may elect to withdraw. In any case, that part of the net profit not withdrawn or applied against the debit balance of the owner's personal account remains as a credit in his capital account as an addition to invested capital. In case the owner has a credit balance in his personal account, it may be closed by transferring the balance to his capital account as an additional investment, by withdrawing the amount of the balance in cash or some other asset, or by charging it, in the case of a net loss, with that part of the loss required to close it.

245. In Mr. Spangler's case, he has decided to credit his personal account with such part of the net profit as is required to close it, and to allow the remainder of the net profit to remain in his business as an addition to invested capital. This adjustment is made by the following journal entry:

ILLUSTRATION 54

	31				
	John Spangler, Capital	122	50		
	John Spangler, Personal			122	50
	To close balance of personal account and credit capital account with that part of net profit invested.				

After the above entry is posted, the personal account, after being footed and ruled, and the capital account will appear as follows:

ILLUSTRATION 55

JOHN SPANGLER, PERSONAL

Dec.	1	House rent		75	00	Dec.	31	Capital a/c		122	50
	4	Coal		47	50						
				122	50					122	50

JOHN SPANGLER, CAPITAL

Dec.	31	Personal a/c		122	50	Dec.	1	Investment		10000	00
							31	Invested profit		636	98

246. The process of closing the ledger is completed when the final distribution of the net profit or net loss is recorded in the ledger and the accounts are footed and ruled. It is customary, however, to "balance" the proprietor's capital account in order to restate his present invested capital, or net capital, in one amount. This is done by entering the credit balance on the debit side, footing and ruling the account, and bringing the balance down on the credit side under date of the next business day, as illustrated on the next page. Read 214b.

Illustration 56

John Spangler, Capital

Dec.	31	Personal a/c		122	50	Dec.	1	Investment		10000	00
	31	Net Capital		10514	48		31	Net profit		636	98
				10636	98					10636	98
						Jan.	1	Net Capital		10514	48

247. Observe that a journal entry is not required in balancing an account in the manner described in ¶246. An account is balanced by a *cross entry* within the account itself—a credit above the ruling and a debit below, or vice versa. It is stated in ¶238 that asset and liability accounts are not *closed*. They may be *balanced*, however, at the close of each fiscal period, in the manner described above, if it is preferred to do so. As a rule it is customary not to balance them until it is necessary to forward them to new pages in the ledger. Illustrations 42 and 43 on page 92 show howsuch accounts may be balanced.

Compound Journal Entry to Close

248. The process of closing the ledger may be considerably simplified and shortened if the profit and loss summary account is not opened. If the debits and credits to the profit and loss summary included in illustrations 51 and 53 are omitted and the remaining debits and credits in these entries are combined in one entry, a compound journal entry will result which will include:

(a) all the debits and credits required to close the income and profit and loss accounts, and

(b) a credit to the proprietor's capital account for the amount of the net profit, thus:

Illustration 57

Journal, December 31, 19 .

		Sales	To close	7719	16		
		Real Estate Income	" "	35	00		
		Interest Income	" "	14	33		
		Purchases	" "			6278	37
		Freight In	" "			91	72
		Warehouse Expense	" "			275	84
		General Expense	" "			388	70
		Real Estate Expense	" "			75	16
		Interest Expense	" "			21	72
		John Spangler, Capital	Net profit for December			636	98

249. In order to complete the closing of the ledger, a second entry adjusting the proprietor's personal account is required. This entry is shown in illustration 54. The method to be followed in closing the ledger is largely a matter of individual preference. Those who close by the first method illustrated prefer it because they wish to group all the elements of profit and loss in one account in the ledger. This method is to be preferred principally because it supplies a record in the ledger of all the amounts entering into annual net profits or losses from year to year that can be checked up easily when books are audited for income tax purposes. Those who use the compound journal entry claim that the profit and loss summary account in the ledger is useless because the income and profit and loss statement contains the same information in greater detail, and consequently the compound entry is to be preferred because of its brevity.

Exercise 35

From the following trial balance and other data, prepare an income and profit and loss statement, a statement of assets, liabilities, and capital, and the closing and adjusting entries required to close the ledger. Set up the profit and loss summary account. The proprietor's capital account is to be credited with the net profit, and his personal account is to be closed into his capital account.

Trial Balance, December 31, 19 . J. M. Warren

		Cash	2460	20		
		Inventory	3647	19		
		Notes Receivable	2214	45		
		Accounts Receivable	3114	34		
		Real Estate Investment	5215	90		
		Furniture & Fixtures Investment	322	40		
		Notes Payable			4629	45
		Accounts Payable			3514	26
		J. M. Warren, Capital			8246	51
		J. M. Warren, Personal	19	16		
		Purchases	10725	04		
		Freight In	578	82		
		Warehouse Expense	1621	93		
		Sales			15746	21
		General Expense	2225	42		
		Real Estate Expense	328	72		
		Real Estate Income			447	60
		Interest Expense	129	67		
		Interest Income			19	21
			32603	24	32603	24

Additional Data Required for Income and Profit and Loss Statement

Inventory January 1, $2378.82; returned purchases, $113.26; rebates and allowances on purchases, $212.63; total purchases, $12319.30.

Gross Sales, $16246.53; returned sales, $328.42; sales rebates and allowances, $171.90.

Exercise 36

Prepare statements and a compound journal entry to close from the following trial balance and other data. The net profit or loss is to be recorded in the proprietor's personal account, the balance of which is not to be closed into the capital account because the proprietor intends to withraw whatever sum stands to his credit in his personal account after final results are determined.

Trial Balance, December 31, 19 . F. B. Clarke

		F. B. Clarke, Capital			10296 50
		Green Spring Farm Investment	2092 60		
		Notes Payable			2793 14
		Store and Lot Investment	6245 00		
		Notes Receivable	2312 62		
		Accounts Payable			2191 26
		Inventory	3225 06		
		Accounts Receivable	2515 20		
		Mortgage Payable			3000 00
		Purchases	12593 55		
		Farm Expense	750 59		
		Store Expense	225 62		
		Freight In	628 31		
		Interest Income			33 78
		Sales			16672 95
		Farm Income			875 15
		Store Income			540 00
		Furniture and Fixtures Investment	529 70		
		General Expense	2526 30		
		Interest Expense	125 80		
		Cash	1454 24		
		Warehouse Expense	1428 19		
		F. B. Clarke, Personal			250 00
			36652 78		36652 78

Additional Data Required for Income and Profit and Loss Statement

Inventory January 1, $1972.80; total purchases, $14134.77; returned purchases, $173.14; purchase rebates and allowances, $90.22; goods donated to charity at invoice cost, $25.60.

Gross sales, \$16894.36; returned sales, \$125.19; sales rebates and allowances, \$96.22.

RECAPITULATION OF PRINCIPLES

A review of the subject matter of Part One, which should be made the basis of a series of very thorough class drills and recitations.

1. Bookkeeping is the art of classifying and recording business transactions and facts systematically.

2. Accountancy is the science which treats of the methods of classifying business transactions and accounts so that the facts they exhibit shall be shown in their proper relations, expressed in terms that will most fully provide the information necessary to successful business and financial administration.

3. The two principal objects of accounting are: (a) to determine at stated intervals the financial condition of an enterprise, and (b) to determine at stated intervals the net profit or loss resulting from conducting the enterprise.

4. Accounts are grouped in two principal classes: (a) asset, liability, and capital accounts, and (b) income and profit and loss accounts.

5. It is the function of the statement of assets and liabilities to exhibit in complete detail the financial condition of an enterprise as reflected by the relative condition and amounts of its various assets and liabilities, and invested capital.

6. The function of the income and profit and loss statement is to exhibit in their proper relations and in complete detail the sources and amounts of all costs, returns, expenses, incomes, losses, and profits which enter into the determination of the net profit or net loss for a fiscal period.

7. The invested capital of an enterprise is its net assets, which consist of the difference between its total assets and its total liabilities.

8. In an accounting sense, assets include all real and tangible personal property, the rights to such property, and claims against debtors.

9. Current assets consist of cash and such other quick, liquid, or floating assets as in the usual course of business can readily be converted into cash or its equivalent if necessary to meet maturing debts.

10. Fixed capital assets are the more permanent investments in the various kinds of real and tangible personal property and equipment required in conducting a business and in maintaining its operations.

11. In an accounting sense, liabilities include all claims of creditors and debts and obligations owed to others.

12. Current liabilities are the obligations and debts which in the usual course of business mature and become due and payable in the near future.

13. Fixed liabilities are long-term debts and obligations in the form of mortgages and bonded indebtedness.

14. Income and profit and loss accounts are subdivided and grouped as trading accounts, income and expense accounts, and profit and loss accounts.

15. A trading account is one in which are recorded items which increase or decrease the cost of goods sold, or which increase or decrease the income from sales.

16. An income account is one in which are recorded the receipts, returns, proceeds, or income from a particular operation, activity, or transaction.

17. An expense account is one in which is recorded a certain class of expenditures for the services and supplies required in conducting the operations of a business that are necessarily incurred in order to earn incomes and profits, but from which no definite permanent value is derived.

18. A profit account is one in which is recorded an unusual, incidental, non-operating, or miscellaneous increase in assets which does not result from the regular income-producing operations of a business.

19. A loss account is one in which is recorded an unusual, incidental, or miscellaneous decrease in assets arising out of a non-operating source and which results in a pure waste, destruction, or forfeiture of capital and wealth.

20. Trading accounts are divided into two groups—those affecting the income from sales, and those affecting the cost of goods sold.

21. The total, or gross, sales is the gross income from sales, from which all deductions from sales must be subtracted to find the net income from sales.

22. Deductions from sales include all amounts which reduce the returns, proceeds, or income from sales.

23. The invoice cost of goods sold is the invoice cost of the goods on hand at the beginning of a period, plus the invoice cost of purchases during the period, minus the invoice cost of goods on hand at the end of the period.

24. All deductions from cost must be subtracted from and all additions to cost must be added to the invoice cost of goods sold in finding the total cost of goods sold.

25. Deductions from cost include all amounts which reduce the invoice price of goods purchased.

26. Additions to cost are the trading expenses which increase the cost of goods sold.

27. Trading expenses are those which increase the cost of goods sold because they are incurred directly in connection with the buying and selling, or trading, operations.

28. Operating expenses are the general expenses applicable to and incurred by a business as a whole and which therefore cannot properly be charged against any particular department or operation.

29. Additions to income are the non-operating, incidental, and miscellaneous incomes and profits which are not earned by the regular income-producing operations of a business.

30. Deductions from income are the non-operating, incidental, and miscellaneous expenses and losses which are not necessarily incurred in connection with the regular income-producing operations of a business.

31. Gross trading income is the profit remaining after the total cost of goods sold has been deducted from the net income from sales.

32. The net income from operations is the gross trading income minus operating expenses.

33. The total income from operations and all other sources is the net income from operations plus additions to income.

34. The net profit is the total income from operations and all other sources minus the deductions from income.

35. Profits increase one's wealth—losses decrease it.

36. Profits retained in a business increase its invested capital—losses must be met out of invested capital and hence decrease it.

37. Profits are accounted for finally in increased assets or in decreased liabilities.

38. Losses are accounted for finally in decreased assets or increased liabilities.

39. The function of books of original entry is to provide a convenient and efficient method of classifying and recording the transactions of a business as they occur from day to day, and to serve as posting mediums by means of which the debit and credit items resulting from transactions can be readily transferred to ledger accounts.

40. When books are kept by double entry, an equality of debits and credits in the ledger is maintained by posting all entries in the books of original entry to the ledger accounts in such manner as to always offset debit items with credit items, or vice versa.

41. Entries in books of original entry do not assume the status of debits and credits until they are posted to and appear in ledger accounts.

42. The purpose of recording the various classes of transactions in separate books of original entry is to reduce posting to the minimum, since the totals of such books can be posted as offsetting debits or credits to the individual items posted from them.

43. The journal is the book in which are recorded the transactions which cannot be classified in other books of original entry.

44. Any entry in a book in which transactions are classified is the equivalent of a journal entry insofar as the final result in the ledger is concerned.

45. No item should appear in the ledger that is not posted from some book of original entry, except cross entries which balance accounts.

46. The purpose of ledger accounts is to group the financial records of all transactions under their proper classifications.

47. Accounts must be classified so that the balance of each account will show one definite financial result and unit of accounting information.

48. The only way to secure a subtraction in the ledger is to record the item to be subtracted on the opposite side of either the same or another account.

49. With respect to the manner in which the rules of debit and credit apply to them, accounts may be classified as personal and impersonal.

50. Personal accounts include all accounts receivable with individuals, firms, and corporations showing what they owe to us, and all accounts payable with individuals, firms, and corporations showing what we owe to them.

51. Impersonal accounts include all other asset, liability, capital, income, profit, and loss accounts.

52. Assets, costs, investments, receipts, expenses, and losses are always debits. Liabilities, capital, expenditures, incomes, and profits are always credits.

53. All expenditures on a capital asset, whether for first cost or for improvements, prior to the time it is ready for use or becomes productive, or which increase its efficiency as an income-producing factor or its market value as an investment, should be charged to the asset investment account. All other expenditures on a capital asset are capital expenses.

54. Capital is treated as a credit for bookkeeping purposes in order to maintain an equality between the debits for assets and the credits for liabilities.

55. A trial balance merely shows that in the ledger the total debits are equal to the total credits, but it does not prove the correctness of the ledger accounts, or of the balances which compose it.

56. A supporting schedule or exhibit is a supplementary statement setting forth in detail the items which make up an item or account included in a trial balance or statement.

57. The net profit or net loss can be determined by taking the difference between the capital at the beginning and the capital at the close of an accounting period; that is, the net profit or loss is the measure of the increase or decrease in net assets during a period.

58. The purposes of closing a ledger are to record the final distribution of the net profit or net loss in the proper ledger accounts, and to eliminate the income and profit and loss accounts as open accounts in the ledger.

59. The profit and loss summary account is a recapitulation in the ledger of the balances of all the income and profit and loss accounts which were included in finding the net profit or net loss.

60. The function of the post-closing trial balance is to test the equality of debits and credits in the ledger after it has been closed.

REVIEW EXERCISES

Exercises 37 to 44 inclusive, which follow, provide a test of the student's knowledge of the principles underlying the classification of accounts which have been presented up to this point. A double sheet of journal paper and a double sheet of ledger paper will be required. Allow twenty-two lines for the cash account, eight lines for the purchases account, and six lines each for all other accounts —one line for the heading and five lines for the entries.

R. E. Wood began business as a hardware merchant on November 1. He did not keep a regular set of books. All of his records of the business he transacted to December 31 are in the form of memorandums he made from time to time, bills he received for purchases of merchandise and bills for expense items, memorandum charges to customers for merchandise sold, and his check book stubs showing the records of all cash deposits and payments. On December 31 it is necessary for him to ascertain what his profit or loss has been for the two months he has been in business so he can prepare his income tax return. He also wishes to determine the financial condition of his business on this date because he intends to open a set of books at the beginning of business for the new year.

The student has just been employed as his bookkeeper. It is first necessary to set up accounts which will properly record his transactions for November and December, from which to prepare an income and profit and loss statement and a statement of assets and liabilities as of December 31. As it will be somewhat difficult to record his transactions in chronological order, all entries are to be journalized and entered under date of December 31, and then to be posted to the ledger.

EXERCISE 37

Mr. Wood reports that when he began business on November 1 he invested $10,000.00 in cash, a stock of merchandise he had purchased at auction on October 20 which cost him $2,750.00, office and store furniture, fixtures, and equipment which were also purchased at the same auction sale for a price of $700.00, and a new automobile truck which cost $1,500.00, that was delivered to him on October 29. On that date he issued a check for $1,200.00 to apply on the purchase price. This payment, however, was not made out of the funds he invested in his business, but from other money he had in his possession at that time. On November 1 he issued a 60 day note for $300.00, dated November 1, with interest at 6% payable at maturity, for the balance of the purchase price of this delivery equipment, the note to be paid from the funds of his business when it matured.

Prepare a journal entry to record the assets invested. Then prepare another entry to record any claims against these assets. Next, open the ledger accounts required and post the entries.

EXERCISE 38

Mr. Wood closed a deal on October 20 for the purchase of a business property located at the corner of Main and Oak Streets. It is known as 32 Main Street. The property consists of a lot having a frontage of 40 feet on Main Street and a depth of 100 feet on Oak Street, improved by a two-story brick store and warehouse building 40 feet wide and 70 feet deep. The purchase price of the building was $7,000.00 and the lot cost $4,000.00.

Mr. Wood did not take title to the property until November 1, on which date he issued a check for $5,000.00 on the checking account of his business to apply on the purchase price, and executed a mortgage, dated November 1, in the amount of $6,000.00, bearing interest at the rate of 6% per annum, for the balance. The former owner of the property had already paid the taxes for the current year, which amounted to $261.18. Mr. Wood accordingly issued his check to him for $43.53, which amount was one-sixth of the year's taxes applicable to the months of November and December. He also issued a check for $142.52 to pay the bill for examining the title, recording the deed, arranging for the mortgage, and other expenses incurred on the property prior to the time he began to use it for business purposes.

EXERCISE 39

Among the furniture and fixtures which Mr. Wood purchased at auction was a second-hand typewriter for which he paid $28.00. He traded this machine in on November 3 on the purchase of a new machine, the price of which was $87.50. He was allowed $20.00 for the old machine and issued his check to the typewriter company for the difference, $67.50.

Note: Losses similar to the loss between the cost price of the old typewriter and the price received when it was disposed of are *unusual* or non-operating losses in the sense that they result from transactions outside of those from which the regular or operating income of the business is derived. They are referred to as *incidental* or *miscellaneous* losses. Consequently, they should be accounted for in a separate account under the title of "Miscellaneous Losses." The losses charged to this account should be listed separately in the income and profit and loss statement with the other "deductions from income." Likewise, unusual or non-operating profits such as the profit on the sale of real estate reported in the next transaction are not operating profits. They are *incidental* or *miscellaneous* profits, and should be accounted for in a separate account under the title of "Miscellaneous Profits." They should be listed separately in the statement with the other "additions to income."

On November 15 he sold the rear part of his lot for $1,500.00, accepting at the time the transaction was consummated a check for $500.00 and two notes for $500.00

each. Both notes were dated November 15, one payable in 30 days and the other in 60 days with interest at 6% payable at maturity. The cost of that part of the lot disposed of was $1,200.00. The purchaser intends to erect a building in which to conduct a drug store.

On October 21 Mr. Wood employed a contractor to build a partition on the second floor so as to make a room for a photographer's studio. He leased the space, the tenant taking possession on November 1. The cost of this partition and of other alterations and repairs about the building required to put it in first-class condition was $280.00, for which Mr. Wood issued his check to the contractor on November 5.

EXERCISE 40

An analysis of Mr. Wood's merchandising transactions for the two months he has been in business discloses the following facts and figures:

The bills for merchandise purchased amount to $2,147.16. All of this merchandise was bought on open account. For one reason or another he returned for credit merchandise included in these purchases amounting to $72.26, and received rebates and allowances amounting to $13.52. He also took from his stock of merchandise tools and other articles for use in the store and warehouse which cost $32.90.

Note: Open an accounts receivable account and an accounts payable account in which to record all debits and credits to trade debtors and trade creditors respectively.

Mr. Wood billed all goods sold to customers on open account in duplicate, and retained the duplicate copies as his records of the transactions. As his customers paid him he marked the carbon copies "Paid." His sales, as shown by these carbon copies, total $2,714.88. His customers returned goods amounting to $15.80, for which he allowed credit, and he rebated various sums to his customers on sales amounting to $22.37.

His inventory of unsold merchandise on hand on December 31 taken at invoice cost amounts to $3,267.28.

EXERCISE 41

Since he began business on November 1, Mr. Wood has deposited all cash received. He classified his deposits when entering them on the stub of his check book so as to show the amounts received in settlement of accounts receivable, the proceeds from cash sales, the income from rentals, etc. An analysis of these deposits shows that he received in settlement of customers' accounts the sum of $1,842.55. Included in this amount was an item of $1.36 for interest on a past due account. The deposits of receipts from cash sales amounted to $312.18.

In drawing a check in payment of one of his bills for merchandise purchased, he transposed the figures on the bill from \$123.50 to \$132.50. His creditor refunded the overpayment by a check for \$9.00, which was deposited. He also made two deposits of \$35.00 each for the checks received in payment of the rent of the studio for November and December. He received a check for \$5.44 from the railroad company for an overpayment on a freight bill on goods purchased due to a mistake in the rate assessed on the shipment, which was also deposited.

On December 15 he received a check for \$502.50 in payment of the first note he accepted from the purchaser of the rear part of his lot. This check included the interest on the note for 30 days. This check was deposited also.

EXERCISE 42

An analysis of Mr. Wood's cash payments, exclusive of those previously reported, as prepared from the stubs in his check book discloses the following data:

During November and December his payments in settlement of sums owed to his creditors amounted to \$928.47. On December 30 he issued a check for \$303.00 in payment of the note he gave on November 1 for the balance of the purchase price of his truck. The check included the interest on the note for 60 days. During the period he paid freight bills on goods purchased amounting to \$97.84. He issued two checks in favor of himself for \$125.00 each for his salary for November and December.

On November 3 he issued a check for \$75.00 in payment of a bill for repairing, painting, and varnishing the furniture and fixtures he purchased at auction. These permanent improvements were necessary to put the equipment in good condition. The work was completed prior to the time he began to transact business. His bills for boxing, packing, and shipping materials and store and warehouse supplies paid during the two months amount to \$52.60. On November 8 he issued a check for \$43.25 in payment of a bill for repairing the plumbing and installing new plumbing and fixtures in the building. These were permanent improvements required to put the plumbing in first-class condition.

Mr. Wood employs a warehouseman and truck driver whose time is fully occupied in handling incoming and outgoing stock in the warehouse. His wages for the two months were \$180.00. He also employs a sales clerk to wait upon customers in the store and to assist him in the general conduct of the business. His salary was \$162.00 for the period. On December 20 a carpenter's bill for \$5.80 for minor repairs to different parts of the building was paid by check. In filling an order the clerk dropped a hammer and broke a plate glass top in a show case. It cost \$11.50 to replace it, which was paid by check. On November 2 he insured the building against fire, the face value of the policy being \$7,000.00. He issued a check for \$32.90 in payment of the premium on the policy. He paid bills amounting to \$123.84 for office supplies and stationery, electric light, coal, license fees for the truck, gasoline, oils, and similar expenses.

On December 31 he made a payment of $1,000.00 on the mortgage covering his real estate to retire a part of the principal. He included in his check the accrued interest from November 1 to December 31 on the full amount of the mortgage, his check amounting to $1,036.00. The balance of cash shown by the check book is $4405.92.

EXERCISE 43

In addition to the above he had the following transactions during the period. On November 22 he accepted a draft drawn on him by a creditor at 60 days after sight dated November 20 for $224.58, the amount of a bill of merchandise purchased. He intends to pay this draft at maturity.

One of his customers who owed him $103.95 for a bill which matured on December 15 could not pay the bill at that time, and Mr. Wood accepted his 30 day note dated December 15 with interest at 6% for the amount of the bill.

EXERCISE 44

After all the transactions in Exercises 37 to 43, inclusive, have been entered and posted, take a trial balance and then prepare an income and profit and loss statement. Then close the income and profit and loss accounts into the profit and loss summary account.

Mr. Wood states that he wants the profit he made on the sale of the lot plus such other part of his profit from other sources credited to his capital account as to make an investment of an even $15,000.00 with which to start business at the beginning of the new year. The remainder of his profit is to be credited to his personal account subject to withdrawal whenever he may wish to draw it. Make the entries to record this distribution of profits and post them to the ledger.

Prepare a statement of assets, liabilities, and capital as of December 31, showing in the capital section the distribution of profit which has been ordered.

Next prepare a trial balance from the ledger as it stands after the income and profit and loss accounts have been closed. Such a trial balance is called a *post-closing* trial balance. It includes only the asset, liability, and capital accounts. Its purpose is to make certain that the ledger is in balance after it has been closed for a fiscal period and before any entries for the next fiscal period have been posted.

On January 1 Mr. Wood drew a check in his favor for that part of his profit that was credited to his personal account. Make the journal entry to adjust.

Mr. Wood has purchased a complete set of books in which to keep the accounts of his business for the ensuing year. Set up the journal entry that would be required to open his new books and ledger at the beginning of business on January 1. Then make the adjusting entry for the inventory of merchandise of December 31.

Note to Teacher: Accruals are not to be taken into consideration in working exercises 37 to 44 inclusive.

INDEX TO PART ONE