

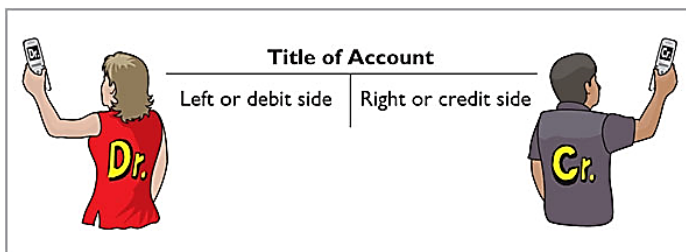
Congratulations! You have graduated from T-Accounts

Now we can get to the REAL stuff



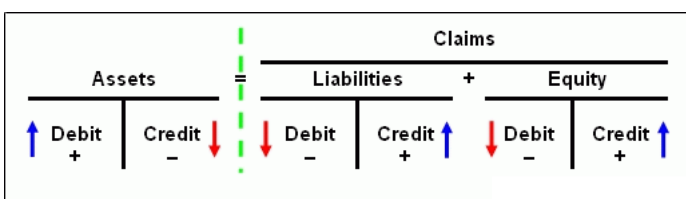
Because accounting is based on organizing, summarizing, and reporting financial information; there are standard processes. That is why accounting is a valuable skill to learn. When you learn how to apply the accounting cycle, you have a skill that every business person relies on. You also can better manage your personal finance.

Accounting is not hard – it is a system or organizing numbers into columns. The math is easy – you just add columns of numbers. When you learn the terms and concepts, you are ready for the calculations. Recall that we have learned to work with 2 columns. The left column is a debit. *The right is a credit – from this point forward, WE WILL NOT TALK LEFT/RIGHT.* We will use the accounting terms “debit” and “credit”.



We begin learning debits and credits with simple stick figures, the T-Account. This is a conceptual tool only. It would not be convenient to do real-word accounting this way. So now we will learn how accounting is done with paper forms. Then we will be ready to understand how computers help us and make accounting easy.

We’ve already learned the accounting equation and seen it at a series of T-Accounts.



We begin an accounting system with a chart of accounts. This is a listing of all the data for one type of information. Once we have made a chart listing all the accounts, then we can set up a ledger – a record of the financial data on each account.

Instead of using T-accounts, we need a more useful format. Traditionally, accounting ledgers (a collections of accounts from the ledger) may have used the form below:

Information needed to trace entry back to journal page			T Account	
			Debit side	Credit side
ACCOUNT				
DATE	ITEM	POST. REF.	DEBIT	CREDIT

Do you see this is a T-account? The only real difference is professional accounting forms are organized to include more details – important details. BUT! One important detail is still missing. Wouldn’t it be helpful to have a form that included the balance in each account after each entry? (sometimes called a running-balance).

ACCOUNT				ACCOUNT NO.	
DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE
					DEBIT CREDIT

The accounting form more commonly used places 2 T-accounts side-by-side. This is called 4-column ledger paper. Usually, the BALANCE column only is used on the *normal balance* side. Typically, the other column is not used.

Journals

As we have reviewed, all financial transactions affect at least 2 accounts. All transactions have a debit and a credit entry. This is why professional accounting is called “double-entry” accounting. Now that we understand how to analyze transactions and record them in ledgers, we need 1 more thing before we can understand accounting.

Business people are *busy* people. An accounting system needs to be set up so that busy people on-the-go can accurately record all transactions. Remember, our ledgers and financial statements are no good if they are not complete.

They are inaccurate if we forget to record a transaction. Accounting systems are set up so that we can easily record each and every transaction “on-the-fly” when we have time to do so. Later, we can organize, summarize, and report financial information.

When transactions occur, it is not feasible to go to the ledger and make entries directly in each account as they happen. Even computerized accounting does not do this. Instead, we need a system to record each and every transaction accurately and without-fail. Each transaction must have documentation – a source document – that objectively demonstrates each transaction as it occurs and allows us to agree on the amount(s) of money involved. All transactions must have a *source document* which allows each transaction to be verified.

We begin the process of recording financial data with a general journal. Whether done on paper or on a computer, the purpose is to accurately verify and record each transaction while documenting the source document that objectively demonstrates a financial transaction occurred.

To be useful, each source document must:

- A description of a business transaction
- The date of the transaction
- A specific amount of money
- Proof the transaction is authorized

Examples of source documents include:

- **Bank statement.** This contains a number of adjustments to a company's book balance of cash on hand that the company should reference to bring its records into alignment with those of the bank.
- **Cash register tape.** This can be used as evidence of cash sales, which supports the recordation of a sale transaction.
- **Credit card receipt.** This can be used as evidence for a disbursement of funds from petty cash.
- **Lockbox check images.** These images support the recordation of cash receipts from customers.
- **Packing slip.** This describes the items shipped to a customer, and so supports the recordation of a sale transaction.
- **Sales order.** This document, when coupled with a bill of lading and/or packing list, can be used to invoice a customer, which in turn generates a sale transaction.
- **Supplier invoice.** This is a source document that supports the issuance of a cash, check, or electronic payment to a supplier. A supplier invoice also supports the recordation of an expense, inventory item, or fixed asset.
- **Time card.** This supports the issuance of a paycheck or electronic payment to an employee. If employee hours are being billed to customers, then it also supports the creation of customer invoices.

Transactions with source documents are recorded in a journal as shown below:

The diagram shows a journal entry table with the following structure:

Journal		Page 1	
Date	Account Titles and Explanation	Debit	Credit
2016			
Apr. 2	Cash	250,000	
	Lisa Hunter, Capital		250,000
	Received initial investment from owner.		

Callouts and annotations:

- Date of the transaction:** Points to the date "Apr. 2".
- Debit account name and dollar amount. Debits are always listed first.** Points to the "Cash" entry in the Debit column.
- Brief explanation:** Points to the line "Received initial investment from owner." below the indented credit entry.
- Credit account name and dollar amount. The credit account name is indented.** Points to the "Lisa Hunter, Capital" entry in the Credit column.
- Dollar signs are omitted in the money columns because it is understood that the amounts are in dollars.** Points to the values "250,000" in both the Debit and Credit columns.

Ledger Accounts

Journals, called “the book of first-entry” are used to create an easy way to document transactions. A small business might collect all receipts for money spend, carefully use their checkbook register (a list of all check & deposits), and keep copies of all receipts for revenues and cash received in a jar.

Periodically, the business owner can pull all the source documents for each transactions out of the jar, record each transaction in their journal, filing source documents in a cabinet in case there are any questions about the accuracy of journal entries.

A ledger can be set-up for the next step of the accounting process, organizing financial data into each account. This simple accounting system can be done manually, with spreadsheet software like Microsoft Excel, or with specialty accounting software like Quickbooks.

Regardless of whether computers are being used or not, the process of creating ledgers is the same. Each account in the chart of account gets its own ledger.

CHART OF ACCOUNTS	
Balance Sheet Accounts	Income Statement Accounts
(100) ASSETS	(400) REVENUE
110 Cash	410 Sales
120 Petty Cash	(500) EXPENSES
130 Accounts Receivable—Kids Time	510 Advertising Expense
140 Accounts Receivable—Learn N Play	520 Insurance Expense
150 Supplies	530 Miscellaneous Expense
160 Prepaid Insurance	540 Rent Expense
(200) LIABILITIES	550 Supplies Expense
210 Accounts Payable—Ling Music Supplies	560 Utilities Expense
220 Accounts Payable—Sullivan Office Supplies	
(300) OWNER'S EQUITY	
310 Barbara Treviño, Capital	
320 Barbara Treviño, Drawing	
330 Income Summary	

When manual, 4-column forms are used so that debits and credits can be entered and the balance can be calculated after each entry. Each account in the ledger has an *account title* and *account number* from the chart of accounts.

[illegible]

Recording Transactions in the Journals

Let's look at an example – here are some transactions for a service business owned by Ms. Barbara Trevino (a sole proprietorship), for the month of August:

1. Trevino invests \$10,000 to start-up. She writes a receipt to document this investment, number R1.
3. Supplies purchased for cash, check 1, \$150
4. Pay for business insurance, \$1,200 with check number C2
7. Purchase supplies on account for \$272 from Ling Music Supply, writing memo #1 to document the purchase until the invoice arrives.
11. Pay *Ling Music Supply* \$1,360 using check number C3
12. Receive cash from sales, \$325, documented on calculator tape T12
12. Sale on account to *Kids Time*, \$200, sales invoice S1
12. Pay month's rent, check #4 for \$250
12. Pay electric bill, check #5, for \$45
12. Receive cash on account, *Kids Time*, \$100, receipt R2
12. Trevino withdraws \$100, check #6
13. Sale account to *Learn N Play*, \$20, sales receipt S2
14. Pay for advertising, check #7, \$68
14. Receive cash from sales, \$120, documented on calculator tape T14
17. Set up Petty Cash fund with check #8, \$200
18. Pay for advertising, check #9, \$200
20. Buy supplies on account from *Sullivan Office Supplies*, memo #2, \$20.

Each of the transactions on page 3 is journalized as shown below:

GENERAL JOURNAL									
PAGE 1									
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT		CREDIT		
1	Aug. 1	Cash	R1	110	10 000 00				1
2		Barbara Treviño, Capital		310			10 000 00		2
3		Supplies	C1	150	1 577 00				3
4		Cash		110			1 577 00		4
5		Prepaid Insurance	C2	160	1 200 00				5
6		Cash		110			1 200 00		6
7		Supplies	M1	150	2 720 00				7
8		Accounts Payable—Ling Music Supplies		210			2 720 00		8
9		Accounts Payable—Ling Music Supplies	C3	210	1 360 00				9
10		Cash		110			1 360 00		10
11		Cash	T12	110	3 250 00				11
12		Sales		410			3 250 00		12
13		Accounts Receivable—Klds Time	S1	130	2 000 00				13
14		Sales		410			2 000 00		14
15		Rent Expense	C4	540	2 500 00				15
16		Cash		110			2 500 00		16
17		Utilities Expense	C5	560	450 00				17
18		Cash		110			450 00		18
19		Cash	R2	110	1 000 00				19
20		Accounts Receivable—Klds Time		130			1 000 00		20
21		Barbara Treviño, Drawing	C6	320	1 000 00				21
22		Cash		110			1 000 00		22
23		Accounts Receivable—Learn N Play	S2	140	2 000 00				23
24		Sales		410			2 000 00		24
25		Advertising Expense	C7	510	680 00				25
26		Cash		110			680 00		26
27		Cash	T14	110	1 200 00				27
28		Sales		410			1 200 00		28
29		Petty Cash	C8	120	200 00				29
30		Cash		110			200 00		30
31		Advertising Expense	C9	510	200 00				31
32		Cash		110			200 00		32
33		Supplies	M2	150	200 00				33
34		Accounts Payable—Sullivan Office Supplies		220			200 00		34

- If posting is interrupted, the accounting personnel can easily see which entries in the general journal still need to be posted. A blank in the Post. Ref. column of the journal indicates that posting for that line still needs to be completed. Therefore, the posting reference is always recorded in the journal as the last step in the posting procedure.

5 Step Posting Process: Debits

- Write the date, 20—, Aug. 1, in the Date column of the account, Cash.
- Write the journal page number, G1, in the Post. Ref. column of the account. The letter G is an abbreviation for the general journal. Post. Ref. is an abbreviation for Posting Reference.
- Write the debit amount, \$10,000.00, in the Debit amount column of the account.
- Write the new account balance, \$10,000.00, in the Balance Debit column. Because this entry is the first in the cash account, the previous balance is zero. The new account balance is calculated as shown below:

Previous Balance	+	Debit Column Amount	=	New Debit Balance
\$0.00	+	\$10,000.00	=	\$10,000.00

- Return to the journal and write the account number, 110, in the Post. Ref. column of the journal.

Posting from the General Journal to Ledgers

Transferring information from a journal entry to a ledger account is called *Posting* sorts journal entries so that all debits and credits affecting each account are brought together in one place. For example, all changes to Cash are brought together in the cash account.

Each amount in the Debit and Credit columns of a general journal is posted to the account written in the Account Title column. The numbers in the Post. Ref. columns of the general ledger account and the general journal serve three purposes.

- An entry in an account can be traced to its source in a journal.
- An entry in a journal can be traced to
- where it was posted in an account.

GENERAL JOURNAL									
PAGE 1									
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT		CREDIT		
1	Aug. 1	Cash	R1	110	10 000 00				1
2		Barbara Treviño, Capital					10 000 00		2
3									3
4									4

1 Date		3 Debit Amount		5 Account Number	
ACCOUNT Cash		ACCOUNT NO. 110			
DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE
Aug. 1		G1	10 000 00		DEBIT 10 000 00

Account Balance

5 Step Posting Process: Credits

1. Write the date, 20—, Aug. 1, in the Date column of the account, Barbara Treviño, Capital.
2. Write the journal page number, G1, in the Post. Ref. column of the account.
3. Write the credit amount, \$10,000.00, in the Credit amount column of the account.
4. Write the new account balance, \$10,000.00, in the Balance Credit column. Because this entry is the first in the capital account, the previous balance is zero. The new account balance is calculated as shown below.

Previous Balance	+	Credit Column Amount	=	New Credit Balance
\$0.00	+	\$10,000.00	=	\$10,000.00

1. Return to the journal and write the account number, 310, in the Post. Ref. column of the journal.

GENERAL JOURNAL							PAGE 1
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1 Aug. 1	Cash	R1	110	10 000 00		1	
	Barbara Treviño, Capital		310		10 000 00	2	
						3	
						4	

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE		
1 Aug. 1		G1		10 000 00		4	
					10 000 00		

Diagram illustrating the 5-step posting process for credits:

1. Date: 1 Aug. 1
2. Journal Page Number: G1
3. Credit Amount: 10 000 00
4. Account Balance: 10 000 00
5. Account Number: 310

Complete General Journal After Posting

GENERAL JOURNAL							PAGE 1
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1 Aug. 1	Cash	R1	110	10 000 00		1	
	Barbara Treviño, Capital		310		10 000 00	2	
3	Supplies	C1	150	1 577 00		3	
	Cash		110		1 577 00	4	
4	Prepaid Insurance	C2	160	1 200 00		5	
	Cash		110		1 200 00	6	
7	Supplies	M1	150	2 720 00		7	
	Accounts Payable—Ling Music Supplies		210		2 720 00	8	
11	Accounts Payable—Ling Music Supplies	C3	210	1 360 00		9	
	Cash		110		1 360 00	10	
12	Cash	T12	110	3 250 00		11	
	Sales		410		3 250 00	12	
12	Accounts Receivable—Kids Time	S1	130	2 000 00		13	
	Sales		410		2 000 00	14	
12	Rent Expense	C4	540	2 500 00		15	
	Cash		110		2 500 00	16	
12	Utilities Expense	C5	560	4 500		17	
	Cash		110		4 500	18	
12	Cash	R2	110	1 000 00		19	
	Accounts Receivable—Kids Time		130		1 000 00	20	
12	Barbara Treviño, Drawing	C6	320	1 000 00		21	
	Cash		110		1 000 00	22	
13	Accounts Receivable—Learn N Play	S2	140	2 000		23	
	Sales		410		2 000	24	
14	Advertising Expense	C7	510	6 800		25	
	Cash		110		6 800	26	
14	Cash	T14	110	1 200 00		27	
	Sales		410		1 200 00	28	
17	Petty Cash	C8	120	2 000 00		29	
	Cash		110		2 000 00	30	
18	Advertising Expense	C9	510	2 000 00		31	
	Cash		110		2 000 00	32	
20	Supplies	M2	150	2 000		33	
	Accounts Payable—Sullivan Office Supplies		220		2 000	34	
						35	