Bookkeeping Video Training

(Handout)

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Learning Debits and Credits

1. Transactions are entered into records known as **accounts**. For example, there is an account in which *cash* is recorded, another account for *equipment*, an account for the amounts *owed* to suppliers, an account for *sales*, another for *advertising expense*, and so on. It is common for companies to use hundreds of accounts to record, sort and store transactions. The amounts in the accounts will appear on the company's financial statements.

2. Two of the main financial statements on which the account balances and amounts will be reported are:

    - **balance sheet** - reports assets, liabilities and stockholders' (owner's) equity

    - **income statement** - reports revenues/sales, expenses, gains, losses, and net income

3. A company's accounts are organized according to those two financial statements. Here's a partial list (shown on the next page):

Acct No.	Account Title	Type of Account	Financial Statement
1010	Petty Cash	Current asset	Balance sheet
1030	Checking Account	Current asset	Balance sheet
1071	Money Market Account	Current asset	Balance sheet
1200	Accounts Receivable	Current asset	Balance sheet
1290	Accrued Revenues Receivable	Current asset	Balance sheet
1400	Inventory	Current asset	Balance sheet
1510	Supplies	Current asset	Balance sheet
1530	Prepaid Insurance	Current asset	Balance sheet
1700	Land	Noncurrent asset	Balance sheet
1710	Building	Noncurrent asset	Balance sheet
1730	Equipment	Noncurrent asset	Balance sheet
1810	Accumulated Depreciation - Building	Noncurrent asset	Balance sheet
1830	Accumulated Depreciation - Equipment	Noncurrent asset	Balance sheet
2010	Loans Payable - Due Within 1 Year	Current liability	Balance sheet
2070	Current Portion of Long-term Debt	Current liability	Balance sheet
2100	Accounts Payable	Current liability	Balance sheet
2310	Interest Payable	Current liability	Balance sheet
2380	Accrued Expenses Liability	Current liability	Balance sheet
2410	Customer Deposits	Current liability	Balance sheet
2570	Loans Payable - Due After 1 Year	Noncurrent liability	Balance sheet
2600	Deferred Taxes	Noncurrent liability	Balance sheet
2710	Common Stock	Stockholders' equity	Balance sheet
2750	Retained Earnings	Stockholders' equity	Balance sheet

The balance sheet accounts are also referred to as permanent accounts.

The balances in these accounts are not closed at the end of an accounting year.

The balances in these accounts will carry forward to the next accounting year.

Acct No.	Account Title	Type of Account	Financial Statement
3010	Sales - Retail	Revenue - operating	Income Statement
3110	Sales - Wholesale	Revenue - operating	Income Statement
3200	Accrued Revenues	Revenue - operating	Income Statement
3600	Fees Earned	Revenue - operating	Income Statement
6010	Salaries - Office	Expenses - operating	Income Statement
6090	Fringe Benefits - Office	Expenses - operating	Income Statement
6310	Rent	Expenses - operating	Income Statement
6320	Utilities	Expenses - operating	Income Statement
6410	Repairs & Maintenance - Office	Expenses - operating	Income Statement
6420	Repairs & Maintenance - Other	Expenses - operating	Income Statement
6610	Advertising - Internet	Expenses - operating	Income Statement
6630	Advertising - Other	Expenses - operating	Income Statement
6710	Insurance	Expenses - operating	Income Statement
7810	Depreciation Expense - Building	Expenses - operating	Income Statement
7830	Depreciation Expense - Equipment	Expenses - operating	Income Statement
9010	Interest Earned	Other revenue	Income Statement
9210	Interest Expense	Other expense	Income Statement
9610	Loss on Sale of Assets	Loss	Income Statement

The income statement accounts are known as temporary accounts, because their balances will be closed to an owner's or stockholders' equity account at the end of each accounting year.

The balances in these accounts do not carry forward to the next accounting year.

4. The listing of account numbers and account titles is referred to as a **chart of accounts**.

5. The accounts listed in the chart of accounts are also referred to as **general ledger accounts** because they are housed in the company's general ledger. The general ledger could be an electronic file, a printed version of the electronic file, or a binder with a separate ledger page for each account.

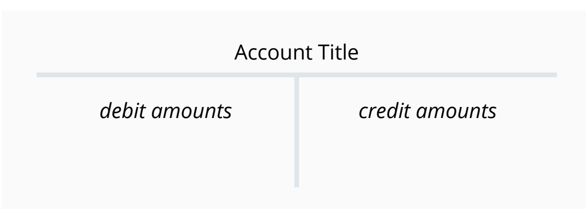
6. Every transaction entered into the accounting records must involve **two accounts** (or more). For instance, if a company borrows money, the company's account Cash will increase and the company's liability account Loans Payable will increase. If someone works for us, we have an expense and a liability to pay them. If we make a sale on credit, we have a sale and an account receivable. If we pay a debt, we have less cash and less obligations. This is known as double-entry bookkeeping or double-entry accounting.

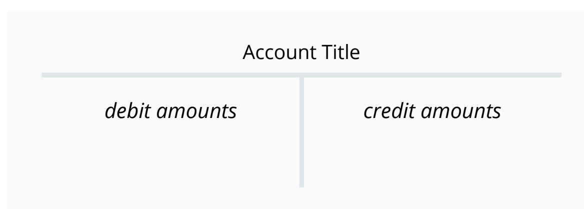
7. Double-entry also means that one account will need an entry as a **debit**, another account will need an entry as a **credit**. These terms go back 5 centuries when double-entry was documented by an Italian monk. Today accountants continue to use dr. as the abbreviation for debit, and cr. as the abbreviation for credit.

8. **Debit means left-side, credit means right-side**. (Do <u>not</u> think of debit as good or bad. Do <u>not</u> think of credit as good or bad.)

9. Each entry's **debit amounts must equal the credit amounts**.

10. To help us understand the effects of recording a transaction under the double-entry system, we will use a visual aid known as **T-accounts**. Of course, for every transaction we will need at least two T-accounts:





Let's illustrate the use of T-accounts with a transaction. We will assume that a company borrows $10,000 from its bank on April 12. The company's asset account Cash increases and the company's liability account Loans Payable increases. Recall that one account must have the amount entered as a debit (entered on the left-side) and one account must have the amount entered as a credit (entered on the right-side). In this situation, Cash is debited and Loans Payable is credited.

Cash	
Apr 12 10,000	

Loans Payable	
	10,000 Apr 12

The challenging part of learning debits and credits is knowing which account gets the amount entered as a debit and which account gets the amount entered as a credit.

11. Understanding the **accounting equation** can help us master debits and credits. The accounting equation for a corporation is:

assets = liabilities + stockholders' equity

Another aspect of double-entry is that the accounting equation must always be in balance.

12. In the accounting equation, assets are on the left-side or debit side, and...
    - The asset accounts are expected to have debit balances (balances on the left-side).
    - To increase the balance in an asset account, you debit the account.

13. In the accounting equation, liabilities and stockholders' equity are on the right-side or credit side, and...
    - The liability and stockholders' equity accounts are expected to have credit balances.
    - To increase the balances in the liability or stockholders' equity accounts, you credit the account.

Recall our transaction where a company borrowed $10,000 from its bank on April 12. Since the company's asset account Cash is increasing we entered a $10,000 debit in the Cash account. That means that another account will need a credit entry of $10,000. We also know that a credit amount will increase the balance in a liability account such as Loans Payable.

Cash	
Apr 12 10,000	

Loans Payable	
	10,000 Apr 12

Recap (for #12 and #13)

You increase an asset account (such as Cash, Inventory, Equipment, Land) with a debit, and you should expect asset accounts to have debit balances.

You increase the balance in a liability account (such as Loans Payable and Accounts Payable) with a credit, and you should expect liability accounts to have credit balances.

In terms of the accounting equation, we see that the April 12 transaction has the following effect:

assets	=	liabilities	+	stockholders' equity
+ 10,000	**=**	**+ 10,000**		

Next, let's assume that on the following day the company repays $4,000 of the loan. This means we need to decrease the asset Cash. This is done with a credit entry of $4,000. Hence, we entered $4,000 on the right-side of the Cash T-account. With the credit identified, we must now debit an account. In this case we need to decrease the liability account Loans Payable and a debit will decrease a liability account balance. Hence, we entered a debit of $4,000 in Loans Payable as of April 13.

Cash

Apr 12	10,000		
		4,000	**Apr 13**
Bal Apr 13	6,000		

Loans Payable

		10,000	Apr 12
Apr 13	**4,000**		
		6,000	Bal Apr 13

14. We learned that the chart of accounts and general ledger were organized according to the following categories:

assets	examples: Cash, Inventory, Equipment
liabilities	examples: Notes Payable, Accounts Payable
stockholders' or owner's equity	examples: Common Stock, Retained Earnings
revenues and gains	examples: Sales, Fees Earned, Gain on Sale of LT Assets
expenses and losses	examples: Cost of Goods Sold, Rent, Loss on Sale of LT Assets

We will now look at the category of accounts known as **revenues**.

15. From the chart of accounts we know that revenues are income statement accounts. Examples of revenue accounts are Sales, Service Revenues or Fees Earned, Sales of Warranties, Interest Earned, and others.

16. Revenues cause stockholders' equity to increase. Therefore, the entries to revenue accounts will be *credits*.

17. Revenue accounts are *temporary accounts* because at the end of the accounting year, the amounts in the revenue accounts will be transferred to the stockholders' equity account Retained Earnings.

18. Under the *accrual method of accounting*, revenues are reported when goods or services are delivered, which is often earlier than the date the money is received.

    Let's illustrate revenues with an example. Suppose that a local bakery sells $530 of goods at a local farmers market on April 16. This transaction will affect the asset account Cash and the income statement account, Sales - Farmers Market. Since the asset Cash is increasing, we need to debit the Cash account for $530. That means the other account, Sales - Farmers Market, will have to be credited for $530 as shown in these T-accounts:

Cash

Apr 16	**530**		

Sales - Farmers Market

		530	**Apr 16**

In terms of the accounting equation, this April 16 transaction has the following effect:

assets	**=**	**liabilities**	**+**	**stockholders' equity**
+ 530	=		+	+ 530

Next let's assume that on April 17, the bakery delivers $400 of goods to a restaurant but the restaurant is allowed to pay 15 days later. The April 17 sales transaction will involve the following accounts:

Accounts Receivable

Apr 17	**400**		

Sales - Wholesale

		400	**Apr 17**

Notice that the Sales account has been credited because the goods have been delivered. (Cash is not required for recording a sale under the accrual accounting method.) The asset Accounts Receivable is increased with a debit.

In terms of the accounting equation, the April 17 sales transaction has the following effect:

assets	=	liabilities	+	stockholders' equity
+ 400	=		+	+ 400

On May 2 when the bakery receives the $400 from the restaurant, the bakery will increase its asset Cash with a debit of $400 and will credit the asset account Accounts Receivable for the $400 as shown here:

Cash			
May 2	400		

Accounts Receivable			
		400	May 2

In terms of the accounting equation, the May 2 collection has the following effect:

assets	=	liabilities	+	stockholders' equity
+ 400	=		+	
- 400				

As we can see, the collection of the $400 of cash on May 2 did not involve a liability, revenue, expense, or stockholders' equity.

19. Now let's look at the other major category of income statement accounts: **expenses**. Expenses are entered into general ledger accounts such as Rent Expense, Wages Expense, Advertising Expense, Depreciation Expense, Insurance Expense, Interest Expense, and perhaps hundreds more.

20. Expenses cause stockholders' equity to decrease. Therefore, the entries to expense accounts must be *debits*.

21. Expense accounts are *temporary accounts* because at the end of the accounting year, the amounts in the expense accounts will be transferred to the stockholders' equity account Retained Earnings.

22. Under the accrual method of accounting, costs will become expenses in one of the following ways:

    - When the expense best matches up with the revenues. Here are two examples:

1) the cost of goods sold expense, and

2) the commissions expense based on sales

- When a cost expires or is used up (depreciation of equipment is an example)
- When we cannot measure a future economic benefit (salaries of office workers, advertising, R&D)

To illustrate an expense, let's assume that on April 16 the local bakery pays $50 for the rent of a space at the farmers market. The asset account Cash is decreasing and the expense Farmers Market Rent is increasing. Since the asset *Cash is decreasing, we credit the Cash account* for $50. This means the other account will need a debit of $50.

Cash			
		50	**Apr 16**

Farmers Market Rent Expense			
Apr 16	**50**		

In terms of the accounting equation, this April 16 transaction has the following effect:

assets	**=**	**liabilities**	**+**	**stockholders' equity**
- 50	=		+	- 50

Next, let's assume that on April 24, the bakery runs a radio ad at a cost of $300 with payment due on May 10. The April 24 transaction will involve the liability account Accounts Payable, and the income statement account Advertising Expense. Since the liability account is increasing, it needs to be credited, and the expense is debited.

Accounts Payable			
		300	**Apr 24**

Advertising Expense			
Apr 24	**300**		

In terms of the accounting equation, this April 24 transaction has the following effect:

assets	**=**	**liabilities**	**+**	**stockholders' equity**
	=	+ 300	+	- 300

When the company pays the radio station the $300 on May 10, the following T-accounts will be involved:

Cash	
	300 May 10

Accounts Payable	
May 10 300	

In terms of the accounting equation, the payment on May 10 has the following effect:

assets	=	**liabilities**	+	**stockholders' equity**
- 300	=	- 300	+	

Note that the May 10 payment was *not a new expense* and therefore stockholders' equity did not change.

23. Recap on expenses:

    Expense accounts are debited and will reduce stockholders' equity. Rarely will we credit expense accounts.

    Expense accounts are temporary accounts because at the end of the accounting year, their balances will be transferred to the stockholders' equity account Retained Earnings.

24. Recap on revenues:

    Revenue accounts are credited and will increase stockholders' equity.

    After the income statement for the year is published, the balances in the revenue accounts are transferred to Retained Earnings, a stockholders' equity account.

25. The following accounts are likely to have **debit balances** and their balances will **increase with a debit** entry.

    assets
    expenses
    losses
    dividends by a corporation or **draws** by a sole proprietor

    Think **D-E-A-L** for Dividends, Expenses, Assets, Losses

    (Expenses, losses, dividends, and draws will reduce the normal credit balance in stockholders' equity.)

26. The following accounts are likely to have **credit balances** and their balances will **increase with a credit** entry.

    liabilities
    revenues
    income
    gains
    stockholders' equity

    Think **G-I-R-L-S** for Gains, Income, Revenues, Liabilities, Stockholders' equity

    (Revenues, income, and gains will increase the normal credit balance in stockholders' equity.)

27. Other tips on debits and credits:

    When you **write a check, credit Cash**.

    When you **receive money, debit Cash**.

General Journal and Adjusting Entries

1. Recording routine payments and receipts is easy with today's accounting software. Often you need to indicate only one of the two accounts and the software will automatically supply the other. For example, when writing a check the software will automatically credit the asset Cash and will debit the account which you indicate.

2. However, there are times when you must enter both the debit and credit information. This is usually done in a *general journal*. The general journal might have headings such as these:

Date	Account Number	Account Name or Description	Refer-ence	Debit Amount	Credit Amount

3. One use of the general journal is to make *adjusting entries* prior to issuing the financial statements. Adjusting entries are needed so that:

    - the income statement reports all of the revenues earned and all of the expenses incurred during the accounting period indicated in the heading of the income statement.

    - the balance sheet reports all of the company's assets (including prepayments and receivables) and all of the company's liabilities (including payables and unearned revenue) as of the date appearing in the heading of the balance sheet.

4. Adjusting entries will be recorded in at least one income statement account (revenue or expense) AND in a least one balance sheet account (asset or liability).

Example 1. Adjusting Entry for a Deferral of Expense

On April 29 Loy Corp paid $6,000 for its insurance covering the six-month period of May through October. The accounting software automatically credits Cash and prompts the bookkeeper for the account to be debited. If the bookkeeper enters Insurance Expense, the entire $6,000 will appear as an April expense. Instead of recording the $6,000 as an expense on April 29, it would be better if the debit is entered in the current asset account Prepaid Insurance for $6,000. Then in the months of May through October, the following adjusting entries should be recorded in order to charge each month with $1,000 of expense:

Date	Account Number	Account Name or Description	Refer-ence	Debit Amount	Credit Amount
May 31	6710	Insurance Expense		1,000	
May 31	1530	Prepaid Insurance			1,000
Jun 30	6710	Insurance Expense		1,000	
Jun 30	1530	Prepaid Insurance			1,000
Jul 31	6710	Insurance Expense		1,000	
Jul 31	1530	Prepaid Insurance			1,000
Aug 31	6710	Insurance Expense		1,000	
Aug 31	1530	Prepaid Insurance			1,000
Sep 30	6710	Insurance Expense		1,000	
Sep 30	1530	Prepaid Insurance			1,000
Oct 31	6710	Insurance Expense		1,000	
Oct 31	1530	Prepaid Insurance			1,000

This type of adjusting entry is known as a *deferral* or deferral-type adjusting entry. A deferral-type adjusting entry is needed when the amount recorded at the time of the transaction included an amount which pertains to a future accounting period. In the above example, the $6,000 payment on April 29 was actually a *prepayment* for the following six months of insurance. The deferral-type adjusting entry is needed so that each of the months of May through October will report $1,000 of insurance expense. It assures that the $6,000 prepayment is matched with the accounting periods in which it is expiring or is being used up.

Let’s use T-accounts to help us visualize the results of using adjusting entries.

Prepaid Insurance			
Apr 29	6,000		
		1,000	Adj May 31
		1,000	Adj Jun 30
		1,000	Adj Jul 31
		1,000	Adj Aug 31
		1,000	Adj Sep 30
		1,000	Adj Oct 31
Bal Oct 31	-0-		

Insurance Expense			
Adj May 31	1,000		
Adj Jun 30	1,000		
Adj Jul 31	1,000		
Adj Aug 31	1,000		
Adj Sep 30	1,000		
Adj Oct 31	1,000		
Bal Oct 31	6,000		

Through the use of the adjusting entries, each month's income statement reported insurance expense of $1,000 and each month's balance sheet reported $1,000 less in the account Prepaid Insurance.

NOTE: Prepaid Insurance reports the amount of *unexpired* cost. Insurance Expense reports the amount of *expired* cost.

Example 2. Adjusting Entry for a Deferral of Revenue

When the insurance company receives the $6,000 payment from Loy Corp on May 1, the insurance company has not yet earned the amount received. Therefore, the insurance company will credit Unearned Insurance Premiums (a current liability account) for $6,000 and will debit Cash.

Date	Account Number	Account Name or Description	Refer-ence	Debit Amount	Credit Amount
May 1	1030	Cash		6,000	
	2xxxxx	Unearned Insurance Premiums			6,000

Beginning on May 1 the insurance company will begin earning the premiums at a rate of $1,000 per month. To report the revenues in the months in which they are earned, the insurance company will make a deferral-type adjusting entry in each of the months of May through October similar to the following:

Date	Account Number	Account Name or Description	Refer-ence	Debit Amount	Credit Amount
May 31	2xxxxx	Unearned Insurance Premiums		1,000	
May 31	3xxxxx	Insurance Premium Revenues			1,000

Each month the liability account Unearned Insurance Premiums will be reduced and the income statement account Insurance Premium Revenues will report $1,000 as earned.

Example 3. Adjusting Entry for an Accrual of Revenue

Sometimes a company will have earned revenues and incurred expenses but the paperwork has not been processed as of the date that the balance sheet and income statement is prepared. For example, an electric utility will have generated and delivered a tremendous amount of electricity as of April 30, but the customers' meters have not yet been read and therefore the customers have not yet been billed by the utility.

Without an adjusting entry, the utility will not be reporting an asset (a receivable) for the amount it has a right to receive for the electricity provided as of April 30. The utility's income statement will also fail to report the revenues it has earned during the period. To be in compliance with the accrual method of accounting, the utility will need to make an adjusting entry before its financial statements are prepared.

If the utility determines that as of April 30 it has earned $700,000 of revenues that will not be billed until May, the utility will make the following entry to accrue revenues:

Date	Account Number	Account Name or Description	Refer-ence	Debit Amount	Credit Amount
Apr 30	1xxxxx	Accrued Revenues Receivable		700,000	
Apr 30	3xxxxx	Accrued Revenues Earned			700,000

If the utility had previously accrued March revenues and the related receivable at the end of March, that entry should be reversed (removed) during April. The reason for the reversal of the March 31 accrual is that the actual bills would have been processed during April and we cannot double-count the revenues that were accrued as of March 31.

Example 4. Adjusting Entry for an Accrual of Expense

The Loy Corp uses a significant amount of electricity in its operations. The utility reads Loy Corp's meter on the first day of each month and mails the bill so that Loy Corp receives it on the 10th day of each month. As of April 30, Loy Corp's accounting records reflect the bill it received on April 10. In other words, Loy Corp's accounting records reflect only the electricity used through March 31.

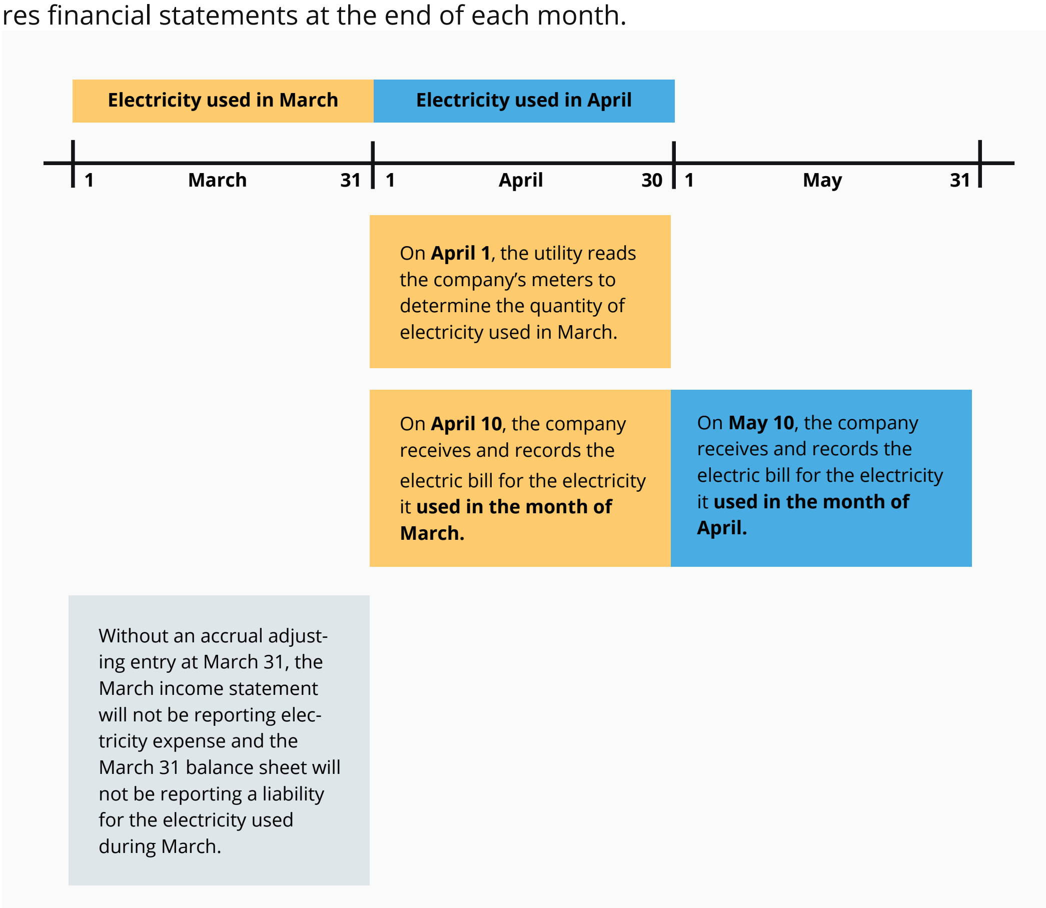
None of the electricity used during the month of April has been recorded as of April 30. If Loy Corp were to issue its financial statements without including the cost of the electricity used in April, it will be omitting a large liability and its retained earnings within stockholders' equity will report an amount that is too high. Its income statement will also have the incorrect amount of electricity expense. To be in compliance with the accrual method of accounting, Loy Corp must process an accrual-type adjusting entry.

If Loy Corp determines that as of April 30 it owes the electric utility $4,100, it should make the following adjusting entry:

Date	Account Number	Account Name or Description	Refer-ence	Debit Amount	Credit Amount
Apr 30	6xxxxx	Electricity Expense		4,100	
Apr 30	2xxxxx	Accrued Expenses Liability			4,100

If Loy Corp had accrued electricity expense at March 31, that entry must be reversed (removed) during April. The reason for the reversal of the March 31 accrual is that the actual bills for the electricity provided during March would have been processed by Loy Corp in April and cannot be double-counted.

To assist you in visualizing the need for the accrual of electricity expense and the related liability, we will use the following illustration. It assumes that a company began operating on March 1 and that it prepares financial statements at the end of each month.



Example 5. Adjusting Entry for Depreciation

Perhaps the most common adjusting entry involves depreciation of the buildings, equipment, furnishings, and vehicles used in a business. (These assets are sometimes referred to as plant assets or fixed assets.) Under the accrual method of accounting for financial reporting (as opposed to income tax reporting) the cost of plant assets should be matched to the accounting periods in which revenues are earned from the use of these assets.

Let's assume that Loy Corp purchased a building for its operations. The cost of the building and land was $950,000 with the building's portion of the cost being $750,000. Loy Corp expects the useful life of the building to be 25 years with no salvage value at the end of the 25 years. Therefore, it calculates its monthly depreciation to be $2,500. (The calculation is: the building's cost of $750,000 divided by 25 years = $30,000 per year divided by 12 months per year = $2,500 per month. Land is not depreciated.) Therefore, the company will make the following entry each month for 300 months:

Date	Account Number	Account Name or Description	Refer-ence	Debit Amount	Credit Amount
Apr 30	7810	Depreciation Expense - Building		2,500	
Apr 30	1810	Accumulated Depreciation - Building*			2,500

*This is a contra-asset account used instead of crediting the asset account Buildings.

At the end of the useful life of 300 months, the depreciation ends (even if the building continues to be used).

Tips on Adjusting Entries

Accruals indicate that a company has not yet recorded a revenue or an expense into the accounts, but a transaction did occur.

Deferrals indicate that a company has recorded a transaction but some of the amount belongs in a future accounting period.

Typical Accrual-type Adjusting Entries Involving Expenses and Liabilities

- Services received but not yet recorded: examples are electricity, gas, phone, sewer, property tax, repairs.
- Compensation earned by employees but not yet recorded: wages, bonuses, employer's share of payroll taxes.

- Interest that was incurred on the company's debt but the interest has not yet been recorded.

Typical Accrual-type Adjusting Entries Involving Revenues and Assets

- Revenues earned from services provided but clients have not yet been billed.

Typical Deferral-type Adjusting Entries Involving Expenses and Assets

- Supplies purchased but not completely used during the current accounting period.
- Prepaid insurance premiums paid, but some of the amount paid covers future accounting periods.
- Prepaid rent, prepaid maintenance, prepaid memberships, prepaid subscriptions covering future accounting periods.

Typical Deferral-type Adjusting Entries Involving Revenues and Liabilities

- Companies and firms receiving advance payments and deposits from customers and clients.

  In other words, money is received in one accounting period, but will be earned or returned in a later accounting period. These are likely to occur at insurance companies receiving premiums for the following 6 or 12 months, organizations receiving annual membership dues in the beginning of the year, companies offering annual service contracts, magazine publishers receiving subscription fees one or two years in advance, lawyers requiring money in advance of taking a case, money paid to manufacturers for special equipment to be produced in future accounting periods, landlords and utilities receiving security deposits, and more.

Other Types of Adjusting Entries

- Depreciation of buildings, equipment, vehicles, and other long-term tangible assets used in a business.
- Adjustment of the Allowance for Doubtful Accounts (pertains to Accounts Receivable and Bad Debts Expense).

The goal of adjusting entries is to comply with the accrual method of accounting...to report all of the revenues and receivables that have been earned, and to report all of the expenses and liabilities that have been incurred.

Introduction to Internal Control

Entering bills and paying bills is easy with accounting software. However, not every invoice received is legitimate. In other words, it is possible that some invoices should not even be entered, much less paid. Some other invoices received may have incorrect quantities or incorrect prices, or both. Some of these incorrect invoices might be accidental while some are intentional.

Here are two examples:

- Someone in your company negotiated a one-time special price on the goods ordered from one of your suppliers. When the supplier prepared its sales invoice, the regular prices were used instead of the special lower prices that were promised.
- A company found out that your internet domain names are due for renewal and mailed your company what appears to be an invoice for renewing the domain names. However, the "invoice" is not from the company that you used to register your domain names.

Those two examples illustrate that the bookkeeper must not only process a high volume of transactions in a limited amount of time, but the bookkeeper must take steps to assure that only approved transactions and accurate amounts are entered into the accounting system.

The entering of incorrect amounts, even if discovered before paying, means that the financial statements will be incorrect. For example, if a purchase of goods or services is entered at the incorrect amount, it could mean that both the income statement and the balance sheet will be incorrect.

Safeguarding a company's assets from dishonest acts or from simple errors is part of what is known as *internal control*.

Our discussion includes only a brief introduction to the topic of internal control.

A Few Examples of Internal Control

One of the common procedures used in the area of accounts payable is known as the *3-way match*. The 3-way match refers to a bookkeeper (or accounts payable clerk) comparing the following:

1. *Vendor's (supplier's) invoice* - what the company is being billed
2. *Company's purchase order* - what the company agreed to buy at a specified price
3. *Company's receiving report* - the quantity of goods actually received by the company

If the three items do not match, the differences must be reconciled before payment is made. For more on accounts payable, I recommend *Controller and CFO's Guide to Accounts Payable* by Mary S. Schaeffer (John Wiley & Sons, Inc., 2007). For current information visit MarySchaeffer.com.

The separation or segregation of duties is an important principle of internal control in order to safeguard assets. For example, internal control is improved when the company's bank statement is reconciled by someone other than the person writing the checks, depositing the money, or entering amounts into the general ledger Cash account. At churches the internal control is improved if the money counters are different from the person recording the contributions into the memberships' giving records. The proper separation of duties will reduce the risk of loss because it will now require two dishonest people (instead of only one person) in the same office working together to defraud an organization.

Our message is that the bookkeeper can assist the owners of a business by insisting on adherence to the company's rules for internal control. The 3-way match, insisting on the proper documentation for travel reimbursements and other payments, and the segregation of duties are a few examples of good internal control practices.

Again, we are *merely introducing the importance of an organization's internal control*. It is important that you consult with a qualified accountant to enhance your organization's internal control.

Bank Reconciliation

An important step to be certain that the company's records are complete and accurate is to prepare a reconciliation of the bank statement. Accountants refer to this as preparing the **bank rec**.

You can see an illustration of a bank reconciliation on AccountingCoach.com under the topic Bank Reconciliation. For now we want to provide you with some of the highlights.

1. The balance in the **company's Cash account** is probably not the correct balance. Here are a few reasons why:

    - The bank may have removed some money from the checking account for its service charge, check printing fees, loan payments, other fees, online transactions, etc.

    - The checking account might have been increased by the bank for some credit card deposits, wire transfers, online transactions, interest earned, and so on.

    - The entries in your general ledger Cash account may have some amounts that were entered incorrectly.

    Since accounting systems are usually double-entry systems, *if there is an error in a company's Cash account, there is going to be an error in another account as well*. This makes it especially important to reconcile the bank statement.

2. The **balance on the bank statement** is probably not the correct amount either. Here are a few reasons why the balance on the bank statement will not be the true amount of cash:

    - Some of the checks written by the company as of the date of the bank statement have not cleared the bank account. These are known as *outstanding checks*.
    - Perhaps some money received by the company on the ending date of the bank statement had not been processed by the bank as of the date of the bank statement. These are known as *deposits in transit* or outstanding deposits.
    - Perhaps the bank made an *error* such as coding the amount or bank account number incorrectly.

3. The method that we recommend for reconciling the bank statement will get both the *balance per the bavnk*, and the *balance per the company's books* to be the same correct (or adjusted) amount.

4. **Here is how to determine the adjusted balance per the BANK:**

Balance per bank statement at March 31, 2023		$ 3,165.00	
Add: Deposits in transit	+	900.00	
Deduct: Outstanding checks	-	1,600.00	
Add or Deduct: Bank errors	+ or -	-	
ADJUSTED BALANCE PER BANK		$ 2,465.00	**A**

5. **Here is how to determine the adjusted balance per the BOOKS:**

Balance per books at March 31, 2023		$ 1,800.00	
Add: Interest earned	+	-	
Deduct: NSF checks	-	100.00	
Deduct: NSF check fees	-	25.00	
Deduct: Bank service charges	-	10.00	
Add: Credit card deposits	+	700.00	
Add: Other electronic deposits	+	100.00	
Add or Deduct: Our errors	+ or -	-	
ADJUSTED BALANCE PER BOOKS		$ 2,465.00	**B**

6. The adjusted balance per BANK must agree to the adjusted balance per BOOKS. ("A" must be equal to "B")

7. **The adjustments to the balance per BOOKS must be entered in the company's records**. Any additions will be a debit to Cash and a credit to another account. The deductions will be a credit to Cash and a debit to another account.

Here's an 80-year-old-tip for reconciling the bank statement: "Put it where it ain't." For example, the bank service charge is on the bank statement but it is not on the books; therefore, put the bank service charge as an adjustment to the balance per books.

Sales on Credit, Accounts Receivable and Bad Debts Expense

1. When a company sells merchandise on credit, the accounting entry at the time of the billing is likely to be a debit to Accounts Receivable (a current asset account reported on the balance sheet) and a credit to Sales (a revenue account reported on the income statement).

2. Another thing that occurs at the time of the sale is the seller's inventory is decreased and the buyer's inventory is increased. In other words, the seller transferred the ownership of the goods to the buyer in return for the receivable that was recorded.

   If the receivable is not collected, the seller will be out the cost of the inventory plus whatever other expenses were incurred. For example, if a company makes a sale for $1,000 and the cost of the merchandise and expenses were $900, the company earns only 10% on its sales ($100 of net income divided by its $1,000 sale). If the customer does not pay the $1,000, the company will need to sell an additional $9,000 of merchandise in order to recover its loss of $900.

3. It is important to continually monitor the accounts receivable in order to minimize any losses resulting from giving customers 10 days, 15 days, 30 days, 60 days, or 90 days to pay.

4. Of course you want to do a credit check on all new customers as well.

5. One tool that we have available is the *aging of accounts receivable*. Usually a company's accounting software can sort the accounts receivable according to the age of each of the receivables. In other words, the date of each sales invoice is compared to the current date and then the amounts are sorted according to the number of days. A general rule is that the older the receivable, the less likely the receivable will be collected in full.

6. The accounting software also allows the seller to send *statements* to its customers. The statement will list any amounts in accounts receivable that the custom owes.

7. If your company sells with credit terms, your company will likely be an *unsecured creditor*. This means if the customer files for bankruptcy, your company's claim will come after the claims of the *secured creditors*. For instance, if your customer's bank has lent your customer money and the bank has a lien on the customer's cash, accounts receivable and inventory, the bank will be paid before your company gets paid. The end result may mean little money available for your company and other unsecured creditors.

8. For financial reporting, the company's balance sheet should report the amount of the accounts receivable that is going to turn to cash within one year of the date of the balance sheet. Therefore, the company has to estimate the amount that will not be collectible. Here's how the balance sheet might report the accounts receivable:

Accounts receivable	$ 13,000
Less: Allowance for doubtful accounts	(1,000)
Accounts receivable - net	$ 12,000

9. Any adjustment to the Allowance for Doubtful Accounts is reported on the income statement in an account such as Bad Debts Expense.

10. For income tax purposes, the estimated allowance account method is not permitted. For income tax purposes, the company must actually write-off a specific account in order to get the income tax deduction.