

**BASIC**

**ACCOUNTING**

**WILLIAM NIVEN**

**PROCEDURES**

**ANKA OHMAN**

# **BASIC ACCOUNTING PROCEDURES**

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## **PREFACE**

This book is written for beginning students of accounting. Nonaccounting majors preparing for employment in the secretarial, clerical, technical, and sales fields will find this text helpful to them in developing their procedural skills and in broadening their general knowledge to include business concepts and business terminology. Students interested in accounting as a profession will receive a thorough grounding both in the "alphabet" of accounting and in the logical relationships of accounting—subjects that are often de-emphasized in management-oriented accounting texts. Knowledge of procedural fundamentals will enhance the serious accounting student's chances for success in advanced accounting courses.

The material in this book can be presented in one semester or over a period of two semesters or quarters, depending upon the number of class hours devoted to the subject during each term. The text information starts with simple data and progresses to more complex matter. Each new subject introduced is related to material just learned to maximize transfer of learning. The repetition and drills of previously covered learning are carried forward into all new materials presented. Discussion questions at the end of each chapter present opportunities for exploring the justification for the procedures discussed; workbook and supplementary problems are presented in order of difficulty so that the student can relate them to the text material and then extend their application to more demanding situations.

Special attention is given to the needs of students who may be performing

the recording and summarizing functions of accounting by hand, or with the aid of accounting machines. The systems and procedures of accounting are emphasized, and the student is made consistently aware of the sequential pattern of the accountant's work. Frequent detailed illustrations—such as charts, diagrams, and explanatory problems—present accounting procedures simply and clearly. The essentials of accounting are explained thoroughly and in simple language throughout the text.

Accounting vocabulary, the early steps of the accounting cycle, important accounting principles, and debit and credit applications are presented in initial discussions in their relation to the basic accounting statements and the fundamental accounting equation. Discussion of the cycle is then extended to include the use of special journals and the general journal. The student is introduced to journalizing and posting, beginning with the two-column journal and advancing to the multi-column and specialized journals. In each chapter covering special journals and the general journal, the need for business papers, subsidiary ledgers, orderly processes of recording and posting, as well as the use of direct posting and the requirements of internal control, are included. Wherever applicable, the need for short-cut methods of accounting, including references to mechanical and electronic devices used in carrying out accounting routines, is indicated. Upon completion of Chapter 9, the student will have had a thorough exposure to the analysis, recording, and posting processes involved in the use of all types of journals.

The preparation of payrolls and the problems relating to payroll taxes are examined thoroughly in Chapter 10 for those who wish to include this material in an introductory course. End-of-the-period activities—including adjustments, the work sheet, and closing procedures—are carefully examined, and financial statement preparation is completely reviewed, for service firms in Chapters 11 through 13, and for merchandising businesses in Chapters 14 and 15. In their approach to the periodic summary, the authors have first of all isolated the most difficult phase of the process, that of accumulating data for adjustments and analyzing these data in terms of debits and credits. This ground-work makes the formal steps in the end-of-the-period sequence—preparing work sheets and statements, journalizing adjustments, recording closing and reversing entries—easier for the student to assimilate. Finally, the three practice set problems accompanying the text are presented in order of complexity to provide a coordinated review of the complete accounting cycle.

The instructor may present, consecutively, the first nine chapters on the accounting cycle and journalizing and posting. Chapter 10, covering payrolls and payroll taxes, logically follows these chapters, but may be omitted in the one-semester plan. The omission of Chapter 10 will not interfere with the student's understanding of the succeeding Chapters 11 through 15, which include adjustments, statement preparation, closing entries, and reversing entries for service organizations and merchandising establishments. The first two practice set problems accompanying the text either make no

reference or scant reference to payrolls and may be used for review even if Chapter 10 is omitted. The third practice set problem is offered as a review for students who have completed Chapters 1 through 15.

The sole proprietorship, the partnership, and the corporation are presented in illustrations and problems throughout the book. Special ownership equity matters relating to partnerships and corporations are not presented, however.

The authors sincerely appreciate the helpful comments and suggestions received from their colleagues at City College of San Francisco and San Francisco State College and from interested teachers who reviewed the preliminary plans and materials of this text. Professor Evar H. Nelson of Wright Junior College, Chicago, Illinois, Professor John E. Defty, of Lamson Business College, Tucson, Arizona, and Professor Richard M. Colwell of Pennsylvania State University have been especially helpful in reviewing the manuscript and in offering many valuable suggestions for improvements. The willing cooperation received from the Todd-Hadley Division of the Burroughs Corporation and the International Business Machines Corporation has also assisted greatly in making realistic the illustrative material used throughout the book.

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ANKA OHMAN



# **CONTENTS**

<b>ONE: INTRODUCTION—THE BALANCE SHEET</b>	<b>1</b>
What Accounting Is and Does; Summary Reports—The Balance Sheet; The Heading; How Balance Sheet Items Are Valued; Classification on the Balance Sheet; Alternate Balance Sheet Forms; Titles Used on the Balance Sheet; The Accounting Equation; Balance Sheet Form Rules.	
<b>TWO: INTRODUCTION—THE INCOME STATEMENT</b>	<b>15</b>
Income Statement Illustrated; Titles Used on the Income Statement; When Does a Business Earn Revenue?; When Does a Business Incur Expenses?; Profit or Loss and the Effect on Proprietorship; Profit and Loss, and the Accounting Equation; Rules for Income Statement Form; Summary.	
<b>THREE: INTRODUCTION—THE RECORDING PROCESSES, ACCOUNTS</b>	<b>27</b>
Balance Sheet Changes; Income Statement Transactions; Use of Accounts for Recording Changes; Debits and Credits in Accounts; Balancing Accounts; Illustrative Problem; Illustrative Problem—The Ledger; The Trial Balance; Summary.	
<b>FOUR: INTRODUCTION—JOURNALS</b>	<b>47</b>
Journal Form; Journal Rules; Illustration of Journal Entries; Posting; Illustration—Journalizing and Posting; The Trial Balance; Special-Column Journals; The Accounting Cycle; Summary.	

<b>FIVE: SPECIAL JOURNALS—CASH RECEIPTS</b>	<b>66</b>
The Need for More Than One Journal; Types of Special Journals; Business Papers Used; Internal Control Over Cash; Cash Receipts Journal, Cash Sales Only; Cash Receipts Journal, Sales for Cash and on Account; Short-Cut Systems for Customer Accounts; Summary.	
<b>SIX: THE CASH PAYMENTS JOURNAL—THE CHECK REGISTER</b>	<b>83</b>
The Need for a Cash Payments Journal; Business Papers Used; Cash Payments Journal: Purchases on Cash Basis; Cash in Bank Balances; Cash Payments Journal or Check Register—Payments on Accounts Payable; Short-Cut Systems for Accounts Payable; Summary.	
<b>SEVEN: OTHER CASH RECORDS</b>	<b>105</b>
Business Papers for Bank Accounts; Depositing Money in the Bank; Endorsement of Checks for Deposit; Bank Account Reconciliations; Petty Cash Systems; Bookkeeping for Petty Cash; Summary.	
<b>EIGHT: REVENUE (OR SALES) JOURNAL</b>	<b>119</b>
Simple Form; Multi-Column Sales Journal; Taxes on Sales; Short-Cut Posting—Customer Accounts; Cash Discounts on Sales; Accounting for Cash Discounts; Sales Returns and Allowances; Summary.	
<b>NINE: PURCHASES JOURNAL AND INVOICE REGISTER</b>	<b>141</b>
Business Papers; Simple Purchases Journal; Multi-Column Invoice Register; Cash Discounts on Merchandise Purchases; Trade Discounts on Merchandise Purchases; Purchase Returns and Allowances; Voucher System; Summary.	
<b>TEN: PAYROLLS AND PAYROLL TAXES</b>	<b>167</b>
PAYROLL TAXES AND PAYROLL TAX FORMS: Federal Income Tax Withheld; F.I.C.A. or Old Age and Survivors' Insurance Taxes; Unemployment Insurance Taxes; TIME RECORDS AND PAYROLLS: Time Cards; Payrolls; Employee Earnings Records; ACCOUNTING FOR PAYROLLS: Distribution of Payrolls; Recording Employers' Payroll Taxes; Payment of Payroll Taxes; Other Payroll Problems; Summary.	
<b>ELEVEN: THE GENERAL JOURNAL—ADJUSTING ENTRIES</b>	<b>201</b>
The Need for and Nature of Adjusting Entries; Adjusting Accounts with Mixed Balances; Adjusting for Accruals; Sources of Information for Adjustments; Mechanics of Analyzing and Determining Adjusting Entries; Recording Adjusting Entries; Illustrative Problem.	

<b>TWELVE: THE WORK SHEET</b>	<b>227</b>
Preparation of the Work Sheet; The Work Sheet—Trial Balance Columns; The Work Sheet—Adjustments Columns; Chart of Accounts; The Work Sheet—Adjusted Trial Balance Columns; Checking for Errors; The Work Sheet—Income Statement and Balance Sheet Columns; Preparation of the Statements; Journalizing and Posting of Adjusting Entries; Summary.	
<b>THIRTEEN: CLOSING ENTRIES, COMPLETION OF THE ACCOUNTING CYCLE, AND REVERSING ENTRIES</b>	<b>268</b>
Closing Entries for Sole Proprietorships; Closing Entries for Partnerships; Totaling and Ruling Closed the Temporary Proprietorship Accounts (Standard-Form); Balancing and Ruling Balance Sheet Accounts (Standard-Form); Ruling Procedures for Balance-Form Accounts; Preparation of the Post-Closing Trial Balance; Reversing Entries; Reversing Adjustments for Accruals; Reversing Adjustments for Deferrals; Summary.	
<b>FOURTEEN: PROBLEMS OF ACCOUNTING FOR MERCHANDISING BUSINESSES</b>	<b>307</b>
Merchandising vs Service Organizations; Uncollectible Accounts Receivable (Bad Debts); Bad Debts on the Financial Statements; Merchandising Business—Cost of Goods Sold; Merchandising Business—Income Statement; Merchandising Business—Balance Sheet; Summary.	
<b>FIFTEEN: COMPLETION OF THE ACCOUNTING CYCLE FOR A MERCHANDISING BUSINESS</b>	<b>334</b>
Work Sheet; Income Statement and Schedule of Cost of Goods Sold; Balance Sheet; Adjusting Entries; Closing Entries; Post-Closing Trial Balance; Summary.	
<b>INDEX</b>	<b>363</b>

## *Chapter One*

# **INTRODUCTION— THE BALANCE SHEET**

Many of the activities in which people engage are analyzed in terms of money. The clothes, cars, houses, and other properties individuals buy are measured in this way. Members pay dues to social clubs or union and professional organizations and receive monthly or perhaps yearly reports that tell them how much money these organizations received and how the money was spent. Everyone pays taxes to city, county, and state governments and to the federal government. The public is told how much it will cost to run these branches of the government and how much tax each person must pay to cover these costs. Individuals work for, and perhaps have an ownership interest in, business organizations. These businesses, too, must measure the monetary value of the properties they own, the debts they owe, the sales they make, and the expenses they must pay.

### **WHAT ACCOUNTING IS AND DOES**

Accounting is the art, or the process, that enables a person, a social organization, a government unit, or a business firm to measure accurately, in terms of money, the many operations they perform. Accounting may be described as the “language of business” if the meaning of the word business is broadened to include all these areas of activity.

As the means of telling interested people about business operations, accounting performs several important tasks. First, accounting sets up routines or procedures for *recording* the daily transactions of business, such as the dollar amount of merchandise sold, the cost of merchandise bought for resale, and the cost of salaries, taxes, and other expenses. Second, accounting takes this recorded information and *classifies* it so that the data may be more easily understood by the businessman. Third, accounting gathers together the recorded and classified information and *summarizes* it—that is, arranges the information in meaningful groups of items to eliminate unnecessary detail and to highlight the most important financial facts. Fourth, accounting takes these summarized facts and *interprets* them by comparing certain sets of these facts with other sets of facts on the same summary, and by tracing back and analyzing changes that have taken place in successive summaries from year to year.

These functions of recording, classifying, summarizing, and interpreting financial data form the basic subject matter of this text. Accounting performs these functions for nonbusiness organizations, social clubs, nonprofit charities, and government—as well as for privately owned businesses. However, because accounting functions are probably more clearly explained in terms of a private business setting, they will be discussed only in relation to this kind of operation.

### SUMMARY REPORTS— THE BALANCE SHEET

In all business enterprises, accounting information is summarized in at least two basic financial reports. One of these reports shows what the business is worth in terms of the properties

**MAYNARD ROBERTS,**

Balance  
December

Assets		
Current assets		
Cash .....	\$ 3,150.00	
Dental supplies on hand .....	2,500.00	
Office supplies on hand .....	900.00	
Prepaid insurance .....	700.00	
Total current assets .....		\$ 7,250.00
Fixed assets		
Land .....	\$ 3,000.00	
Building .....	28,000.00	
Dental equipment .....	7,000.00	
Office furniture and fixtures .....	1,800.00	
Total fixed assets .....		39,800.00
Total assets .....		<u>\$47,050.00</u>

it owns, the debts it owes, and the investment of the owner or owners of the enterprise. It is called the *balance sheet* or the *statement of financial condition*.

The other basic report shows the amount of sales of goods or services the business has made during a specified period of time—a month, three months, or a year, for example—and the amount of expenses that were incurred in making these sales. This statement is called an *income statement*, a *profit and loss statement*, or a *statement of operations*.

Both of these reports are important in evaluating the financial position of the business. They do not tell all the financial facts that may be needed—special reports may be required for special situations—but they do give basic information businessmen must understand.

The balance sheet, the first of the two basic accounting reports to be examined, attempts to picture the financial condition of a business on one particular date. Certain information about the business organization must be obtained before the balance sheet can be prepared. The data required can be separated into three main groups. The first group consists of the properties the business owns. These properties are called assets. The second group represents the debts the business owes to its creditors. These debts are called *liabilities*. The last group measures the investment made by the owner or owners of the business plus the profits that the owners have left in the business. *Proprietorship*, *capital*, or *owner's equity* are names that are commonly applied to this section of the balance sheet.

The following statement illustrates a typical method of presenting the assets, liabilities, and proprietorship of a business organization. The form illustrated is called the *account form*. The term “account” will be explained in Chapter 3, where its use in relation to this style of balance sheet will become obvious. In the account form of the balance sheet, the assets are listed on the left side of the report and the liabilities and proprietorship items on the right side.

**DENTIST**

Sheet  
31, 1964

Liabilities and Proprietorship	
Current liabilities	
Accounts payable .....	\$ 2,000.00
Note payable—Bank .....	2,500.00
Taxes payable .....	<u>500.00</u>
Total current liabilities .....	\$ 5,000.00
Long-term liabilities	
Mortgage loan payable (due July 1, 1966) .....	<u>18,000.00</u>
Total liabilities .....	\$23,000.00
Proprietorship	
Maynard Roberts, capital .....	<u>24,050.00</u>
Total liabilities and proprietorship .....	<u>\$47,050.00</u>

## THE HEADING

There are several important points about the balance sheet that should be understood. First, notice that it has a heading which indicates that the statement describes the financial condition of Dr. Roberts' dental "business." The heading contains the name of the business, shows the kind of statement it is—a balance sheet—and gives the date on which the assets, liabilities, and proprietorship were the amounts shown on the balance sheet. It does not include properties Dr. Roberts owns outside his business, nor does it list any personal, non-business debts owed by Dr. Roberts. The capital item tells only what his investment in this practice is worth in terms of dollars invested. The reason a separation is made between business and personal assets and liabilities is to limit the accounting records to this one business activity as if this business activity were completely separated from all other activities of Dr. Roberts. This is often spoken of as the *business entity* concept in accounting. By following this idea in practice, we avoid mixing nonbusiness items with business properties and debts and gain a more accurate financial picture of the business entity on the balance sheet date.

## HOW BALANCE SHEET ITEMS ARE VALUED

Second, notice that the items shown on the balance sheet are given in dollar amounts. It is possible that there are things of value contributing to the success of this dental practice that are not included in the assets listed on the statement. If no money value can be assigned to these items, they cannot be measured for accounting purposes. For example, Dr. Roberts' personality and the excellent quality of his work may attract many patients to his office. Obviously, these personal characteristics contribute greatly to the financial success of his business; but because there are no means available to measure their dollar worth, they cannot be included in the balance sheet.

Third, the dollar amounts shown for the assets, liabilities, and capital are arrived at according to well-established accounting rules. Among the assets, cash is listed on the basis of money that is in the office and in the checking account balance that Dr. Roberts maintains for the business. The dollar amounts for all of the other assets shown on this statement relate to the *cost values*<sup>1</sup> of each of these assets. The two supplies-on-hand assets represent the cost price of the supplies. The prepaid insurance

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<sup>1</sup> Cost value represents the purchase price of an asset plus any other costs needed to ready the asset for use.

asset represents that part of the total premium that has been paid for, but not yet used. To illustrate, assume that on January 1, 1964, Dr. Roberts paid a total premium of \$1,050 for three years' insurance protection. On December 31, 1964, one year's insurance protection, costing \$350 or one-third of the total premium, has been used up. Two years of insurance protection is left unused. At a cost of \$350 per year, the prepaid insurance equals \$700 as shown on the balance sheet. The land asset is shown at the amount originally paid for it. The building, dental equipment, and office furniture and fixture assets were originally placed in the records of the business at their cost when purchased. But since these properties will not last forever, a part of their original cost is deducted each year and is considered business expense. These deductions are called *depreciation* deductions. The values at which assets of this type are shown on the balance sheet—after depreciation deductions are made—are called depreciated values, or *book values*.

Liabilities are measured in terms of the actual dollar amounts owed by the business on the balance sheet date. The capital or proprietorship is measured by the value of the assets the owner contributes or invests in the business, plus whatever profits he leaves (reinvests) in the business.

## CLASSIFICATION ON THE BALANCE SHEET

The fourth observation that should be made about this statement of financial condition, or balance sheet, concerns the grouping of the assets and the liabilities into *current* and *fixed* or *long-term* items. Current assets are those properties of a business that are cash, will soon be converted into cash, or will be used up by the business in a relatively short time, usually within a year of the balance sheet date. Assets which are useful to the business for longer periods are classified as fixed or noncurrent assets. As students become familiar with assets, classifying them into current or fixed categories will become almost routine.

Current liabilities are distinguished from long-term (fixed) liabilities in the same way that current assets are distinguished from fixed assets. Debts due and payable within one year from the date of the statement of financial condition are usually included among the current liabilities. Amounts owed by the business which are due after one year from the balance sheet date are usually called long-term liabilities.

The separation of assets and liabilities into current and noncurrent categories is necessary to make the financial statement clearer, and to make it easier to compare similar groups of items (such as current assets and current liabilities) for the purpose of finding the significance



of balance sheet figures. Grouping helps in the interpretation of the statement by the owner, by creditors who may be interested in lending money to the business, or by agents of the various government units that assess taxes on the business and its operations.

The proprietorship section of Dr. Roberts' business reads: Maynard Roberts, capital, \$24,050.00. Among other things, this tells us that the dental practice is owned by one person. Businesses are often owned by two or more persons. Such businesses are called partnerships. Balance sheets or statements of financial condition for partnerships show separately the amounts each partner has invested in the enterprise. For example, if the balance sheet on pages 2-3 were for Roberts and Rinehart, Dentists, and each partner had an equal investment in the partnership, the proprietorship section of the balance sheet would show the following information:

Proprietorship:		
Maynard Roberts, capital .....	\$12,025.00	
James Rinehart, capital .....	<u>12,025.00</u>	
Total proprietorship .....		<u>\$24,050.00</u>

In this case, the term "proprietorship" might be replaced by the word "capital" or by the term "partners' capital."

A business may be owned by a group of stockholders, in which case it is called a *corporation*. Stockholders own parts of the company and hold shares of stock to show the portion of the total capital of the corporation that they own. The proprietorship section of a corporation balance sheet is different in at least two ways from that of a single-ownership business or partnership. First, the separate investment of each stockholder is not shown on the statement; only the total amount of all the investments by stockholders is shown. Second, the profits kept by the business are not added directly to the item representing the amount invested by the stockholders. Instead such profits are shown separately and are called earned surplus or retained earnings.

#### **ALTERNATE BALANCE SHEET FORMS**

We should keep in mind that the illustration on pages 2-3 represents a rather simple grouping of assets, liabilities, and proprietorship and is one of several possible balance sheet forms. A balance sheet form that is probably used as often is illustrated on page 7.