

4
**Post to
Ledgers**

General Ledger. The general ledger summarizes the transactions in journals by account balances. Some of the characteristics of the general ledger are as follows:

- The number and description of general ledger accounts depend on the needs of management. Some companies have hundreds of accounts; others have only a few. The account titles for a company are included in the chart of accounts. The chart of accounts for Simple Example Company is shown in Figure 1-5.
- All transactions must be transferred (posted) from the journals to the general ledger periodically, usually monthly. For specialized journals, such as the sales journal, the transactions are totaled monthly in each journal for each account. Only the total is posted to the general ledger. For the general journal, individual transactions are posted to the general ledger. The reason is that general journal transactions vary considerably, which results in few common ledger accounts and no totals to post.

FIGURE 1-5
Chart of Accounts
Simple Example Company

| | | | |
|-------------------------------------|----------------------------------|------------------------|---|
| <u>Current Assets</u> | | <u>Revenues</u> | |
| 101 | Cash in bank | 601 | Sales |
| 102 | Payroll cash | 602 | Miscellaneous revenue |
| 103 | Accounts receivable | 603 | Sales returns and allowances |
| 104 | Allowance for doubtful accounts | 604 | Sales discounts taken |
| 105 | Inventory | <u>Expenses</u> | |
| 106 | Prepaid rent | 701 | Cost of goods sold |
| <u>Fixed Assets</u> | | 702 | Purchases |
| 201 | Delivery equipment | 703 | Purchases discounts |
| 202 | Accumulated depreciation | 704 | Purchases returns and allowances |
| <u>Current Liabilities</u> | | 705 | Rent expense |
| 301 | Accounts payable | 706 | Repair expense |
| 302 | Wages and salaries payable | 707 | Utility expense |
| 303 | Payroll taxes payable | 708 | Postage expense |
| 304 | Rent payable | 709 | Depreciation expense |
| 305 | Withholding taxes payable | 710 | Travel expense |
| 306 | FICA taxes payable | 711 | Bad debt expense |
| 307 | Dividends payable | 712 | Wages and salaries expense—administrative |
| <u>Long-term Liabilities</u> | | 713 | Wages and salaries expense—selling |
| 401 | Notes payable | 714 | Employer's FICA expense |
| <u>Stockholders' Equity</u> | | 715 | Other payroll tax expense |
| 501 | Common stock | 716 | Miscellaneous expense |
| 502 | Paid-in capital in excess of par | 717 | Income tax expense |
| 503 | Retained earnings | 718 | Interest expense |
| 504 | Dividends | 800 | Income Summary |

5

**Prepare
Unadjusted
General Ledger
Trial Balance**

A general ledger trial balance is a listing of general ledger account balances at a point of time, with the debits in one column and the credits in another. The total debits must equal the total credits. If they don't, the error in the general ledger or trial balance should be corrected. A trial balance is typically prepared whenever a company plans to prepare financial statements. A distinction should be made between an unadjusted and an adjusted trial balance. An unadjusted trial balance is the listing of account balances in the general ledger before adjusting journal entries are made for month- and year-end accruals, prepayments, and errors. An adjusted trial balance is the listing of account balances after all adjustments are made.

An unadjusted trial balance is prepared only as an aid in preparing adjusting entries and financial statements. Most accountants can prepare financial statements more efficiently after information is summarized on one or two pages rather than in the more detailed general ledger.

The most common method used by accountants to list the unadjusted trial balance is a worksheet. A worksheet is illustrated for Simple Example Company in Figure 1-8 (page 18). Although Figure 1-8 is a year-end worksheet, a similar worksheet can be prepared monthly or

quarterly. Notice that the worksheet typically includes the following columns:

- Account Number
- Account Title
- Prior Year Post-Closing Trial Balance – debit and credit columns
- Current Year Unadjusted Trial Balance – debit and credit columns
- Adjustments – debit and credit columns
- Adjusted Trial Balance – debit and credit columns
- Income Statement – debit and credit columns
- Balance Sheet – debit and credit columns

Columns 3 and 4 are the current year's unadjusted trial balance for Simple Example Company. Those account balances were taken directly from the general ledger. The unadjusted trial balance should not be prepared until all transactions, except adjusting entries, have been recorded in the journals and posted to the general and subsidiary ledgers. If the debits and credits in the unadjusted trial balance are not equal, it is inappropriate to continue until the error or errors are corrected. Similarly, the debits must equal the credits in the adjustments columns and the adjusted trial balance columns.

FIGURE 1-8
SIMPLE EXAMPLE COMPANY
Year-End Worksheet
 December 31, 2022

| ACC. NO. | ACCOUNT TITLE | 12-31-21 | | 12-31-22 | | ADJUSTMENTS | | ADJUSTED TRIAL BALANCE | | INCOME STATEMENT | | BALANCE SHEET | |
|----------|--------------------------------------|----------------------------|--------------------------|-------------|------------------------|-------------|---------------|------------------------|-------|------------------|------|---------------|--------|
| | | POST-CLOSING TRIAL BALANCE | UNADJUSTED TRIAL BALANCE | ADJUSTMENTS | ADJUSTED TRIAL BALANCE | STATEMENT | BALANCE SHEET | | | | | | |
| 101 | Cash in bank | Dr 88 | Cr 5 | 78 | 5 | | 78 | 5 | | | | Dr 78 | Cr 5 |
| 102 | Payroll cash | 5 | | | | | | | | | | | |
| 103 | Accounts receivable | 267 | | 298 | | | 272 | | | | | | |
| 104 | Allowance for doubtful accounts | | 41 | | 18 | (2) | 272 | 41 | | | | | |
| 105 | Inventory | 126 | | 126 | | (8) | 114 | | | | | | |
| 106 | Prepaid rent | 7 | | 8 | | (3) | 4 | | | | | | |
| 201 | Delivery equipment | | 60 | 60 | | | 60 | | | | | | Cr 60 |
| 202 | Accumulated depreciation | | | | 45 | (4) | | 60 | | | | | Cr 60 |
| 301 | Accounts payable | | 135 | | 158 | (5) | | 158 | | | | | Cr 158 |
| 302 | Wages and salaries payable | | -0- | | -0- | (5) | | 12 | | | | | Cr 12 |
| 303 | Payroll taxes payable | | 3 | | -0- | (6) | | 4 | | | | | Cr 4 |
| 304 | Rent payable | | -0- | | -0- | (6) | | -0- | | | | | Cr 6 |
| 305 | Withholding taxes payable | | 5 | | 6 | | | 6 | | | | | Cr 6 |
| 306 | FICA taxes payable | | 9 | | 5 | | | 10 | | | | | Cr 10 |
| 307 | Dividends payable | | -0- | | -0- | (7) | | -0- | | | | | Cr 10 |
| 401 | Notes payable | | 12 | | -0- | | | -0- | | | | | Cr 12 |
| 501 | Common stock | | 200 | | 200 | | | 200 | | | | | Cr 200 |
| 502 | Paid-in capital in excess of par | | -0- | | -0- | | | -0- | | | | | Cr 103 |
| 503 | Retained earnings | | 103 | | 103 | | | 103 | | | | | Cr 103 |
| 504 | Dividends | | -0- | | -0- | | | -0- | | | | | |
| 601 | Sales | | | | 3,648 | | | 3,648 | | | | | |
| 602 | Miscellaneous revenue | | | 214 | | | 214 | | | | | | |
| 603 | Sales returns and allowances | | | 182 | | | 182 | | | | | | |
| 604 | Sales discounts taken | | | | | | | | | | | | |
| 701 | Cost of goods sold | | -0- | | -0- | (8) | 2,132 | (8) | 2,166 | | | | |
| 702 | Purchases | | 2,166 | | 46 | (8) | | 48 | | | | | |
| 703 | Purchases discounts | | | | -0- | (3) | | 69 | | | | | |
| 704 | Purchases returns and allowances | | | | | 4 | | 62 | | | | | |
| 705 | Rent expense | | 44 | | 44 | | | 49 | | | | | |
| 706 | Repair expense | | 69 | | 62 | | | 49 | | | | | |
| 707 | Utility expense | | 62 | | 49 | | | 15 | | | | | |
| 708 | Postage expense | | 49 | | -0- | (4) | | 57 | | | | | |
| 709 | Depreciation expense | | 57 | | 57 | | | 49 | | | | | |
| 710 | Travel expense | | | | -0- | (1) | | 49 | | | | | |
| 711 | Bad debt expense | | | | | (5) | | 270 | | | | | |
| 712 | Wages and salaries expense - admin. | | 264 | | 453 | (5) | | 459 | | | | | |
| 713 | Wages and salaries expense - selling | | 51 | | 51 | (7) | | 56 | | | | | |
| 714 | Employer's FICA expense | | 41 | | 41 | (6) | | 45 | | | | | |
| 715 | Other payroll tax expense | | -0- | | -0- | | | -0- | | | | | |
| 716 | Miscellaneous expense | | -0- | | -0- | | | -0- | | | | | |
| 717 | Income tax expense | | 2 | | 2 | | | 2 | | | | | |
| 718 | Interest expense | | | | | | | | | | | | |
| 800 | Subtotals | | | | | | | | | | | | |
| | Income Summary - Net Income (Loss) | | | | | | | | | | | | |
| | TOTALS | 553 | 553 | 4,229 | 4,229 | 2,293 | 2,293 | 4,242 | 4,242 | 3,648 | (61) | 533 | 533 |

CHAPTER 1

Post-Closing Trial Balance

After closing entries are posted to the general ledger, only balance sheet accounts will have balances. The amount in each balance sheet account, except retained earnings, should be the same as the amount in the adjusted trial balance. The balance in retained earnings should equal the ending balance in the statement of retained earnings.

Many accountants prepare a post-closing trial balance after all closing entries are posted.

The purposes are to make sure that debits equal credits in the general ledger before the recording process starts for the next year, the retained earnings balance is correct, and there are no balances in any income statement accounts.

The post-closing trial balance is a two-column listing, much like the first two columns in a worksheet. The source of each amount is the general ledger balance.

Figure 1-12 illustrates a post-closing trial balance for Simple Example Company at 12-31-22.

FIGURE 1-12
Simple Example Company
Post-Closing Trial Balance
December 31, 2022

| | Account | Dr | Cr |
|-----|---------------------------------|--------|--------|
| 101 | Cash in bank | 78 00 | |
| 102 | Payroll cash | 5 00 | |
| 103 | Accounts receivable | 272 00 | |
| 104 | Allowance for doubtful accounts | | 41 00 |
| 105 | Inventory | 114 00 | |
| 106 | Prepaid rent | 4 00 | |
| 201 | Delivery equipment | 60 00 | |
| 202 | Accumulated depreciation | | 60 00 |
| 301 | Accounts payable | | 158 00 |
| 302 | Wages and salaries payable | | 12 00 |
| 303 | Payroll taxes payable | | 4 00 |
| 305 | Withholding taxes payable | | 6 00 |
| 306 | FICA taxes payable | | 10 00 |
| 501 | Common stock | | 200 00 |
| 503 | Retained earnings | | 42 00 |
| | | 533 00 | 533 00 |

Relationships Among Financial Statements, Trial Balances, Ledgers, Journals, Documents, and Transactions


To summarize the recording process, Figure 1-13 shows the relationships among financial

statements, trial balances, ledgers, journals, documents, and transactions. The documents, journals, and ledgers are used to record transactions. Each of them is essential to the proper preparation of financial statements.

| ACTIONS | DOCUMENTS |
|---|--|
| <p>Receive order from customer – Receipt of an order from a customer for goods is the starting point for a sale. The order may be a document or an order can be prepared by a salesperson or receptionist taking orders over the phone or in person.</p> | <p>Customer purchase order – A document prepared to request goods or services from a customer. The form should include the name and address of the customer, goods or services desired, and the desired delivery or performance date.</p> |
| <p>Ship goods or perform services – In most cases, generally accepted accounting principles require the recognition of a revenue and the transaction recorded as of the date when the goods were shipped or services performed. The shipment of goods or performance of services is therefore an essential function in accounting. In some systems, a shipping document is prepared as a by-product of billing customers. In these systems, billing precedes shipping.</p> | <p>Bill of lading or other shipping document – A document prepared at the time of shipment indicating the description of the merchandise, the quantity shipped, and other relevant data. A bill of lading is a written contract of the receipt and shipment of goods between the seller and the carrier. It must be used when a common carrier (shipper registered with the Interstate Commerce Commission) ships the goods. A different type of shipping document is used when a company ships its own goods, but the document's function is the same. Ordinarily, bills of lading and other shipping documents do not include dollar values. Figure 3-2 (page 36) shows an example of a completed bill of lading for the shipment of goods sold by Simple Example Company. In this example, the freight is being charged to the seller.</p> |
| <p>Bill customer – Billing is the means by which the customer is informed of the amount that is owed for the merchandise shipped. The proper amount of the bill depends on the quantity shipped and the price charged. The billing must also recognize freight charges, insurance, and terms of payment.</p> | <p>Sales invoice – A document prepared indicating the description and quantity of goods sold, the price including freight, insurance, terms, other relevant data, and the total amount of the sale. It is the method of indicating to the customer the amount of a sale and due date of a payment. The original is sent to a customer and one or more copies are retained. It is also the document used for recording sales in the accounting records.</p> |
| | <p>Price List – A list prepared by the company indicating product prices for billings. It is usually developed by marketing personnel and approved by management.</p> |

FIGURE 3-2
Example of a Typical Bill of Lading

UNIFORM STRAIGHT BILL OF LADING — Domestic



Simple Example Company
19100 Stewart Avenue
Battle Creek, Michigan 49015
(616) 555-2600

Shipper No. 138694
Carrier No. 5439
Date 11-17-22

TO:
Consignee Taylor Products
Street 5005 Territorial Boulevard
City/State East Lansing, MI Zip Code 48826

Lucas Trucking Company
(Name of Carrier)

Route Express Vehicle Number XY 2497

| No. Shipping Units | Kind of Packaging, Description of Articles, Special Marks and Exceptions | Weight (Subject to Correction) | Rate per 100 lb. | Charges (for Carrier use only) |
|--------------------|--|--------------------------------|------------------|--------------------------------|
| 4 | Cartons UB734 Frames | 124 lb. | \$19.00 | 23.56 |
| 2 | Cartons TX201 Photo Albums | 113 lb. | \$19.00 | 21.47 |
| 6 | Cartons DF844 Digital Cameras | 225 lb. | \$19.00 | 42.75 |
| 1 | Carton VJ693 Scanners | 70 lb. | \$19.00 | 13.30 |
| | | | | |
| | | | | |
| | | | | |

REMIT C.O.D. TO: ADDRESS N/A

COD Amt: \$ N/A

C.O.D. FEE:
PREPAID \$ N/A
COLLECT \$ N/A

Note — Where the rate is dependent on value, shippers are required to state specifically in writing the agreed or declared value of the property.
The agreed or declared value of the property is hereby specifically stated by the shipper to be not exceeding.

\$ N/A per N/A

N/A
(Signature of Consignor)

Total Charges \$ 101.08

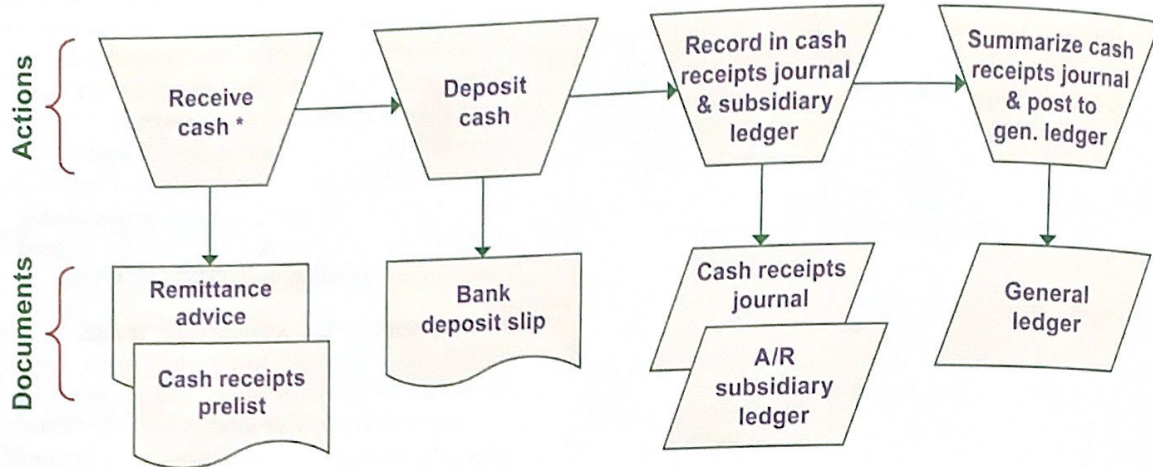
FREIGHT CHARGES
Check Appropriate Box:
 Freight Prepaid Collect
 Bill to Shipper

Received subject to the classifications and tariffs in effect on the date of the issue of this Bill of Lading, the property described above in apparent good order, except as noted (contents and condition of contents of packages unknown), marked, consigned, and destined as indicated above which said carrier (the word carrier being understood throughout this contract as meaning any person or corporation in possession of the property under the contract) agrees to carry to its usual place of delivery at said destination, if on its route, otherwise to deliver to another carrier on the route to said destination. It is mutually agreed as to each carrier of all or any of, said property over all or any portion of said route to destination and as to each party at any time interested in all or any said property, that every service to be performed hereunder shall be to all the bill of lading terms and conditions in the governing classification on the date of shipment.
Shipper hereby certifies that he is familiar with all the bill of lading terms and conditions in the governing classification and the said terms and conditions are hereby agreed to by the shipper and accepted for himself and his assigns.

| | |
|---------------------------------------|--|
| SHIPPER <u>Simple Example Company</u> | CARRIER <u>Lucas Trucking</u> |
| PER <u>Simple Example's Employee</u> | PER <u>Joe Driver</u> DATE <u>11-17-22</u> |

(This Bill of Lading is to be signed by the shipper and agent of the carrier issuing same.)

FIGURE 3-3
Cash Receipts — Actions and Related Documents



* currency, check, and electronic payments

| ACTIONS | DOCUMENTS |
|--|---|
| <p>Receive cash – The starting point for recording cash, regardless of its source, is its receipt. Customers and other outsiders typically pay with a check or an electronic payment. Electronic payments are often called ACH (Automated Clearing House) payments. Generally accepted accounting principles require recognition of cash as an asset at the receipt date rather than the date of deposit or date of mailing/initiating by the sender.</p> | <p>Remittance advice – A document that accompanies the sales invoice mailed to the customer and can be returned to the seller with the cash payment. It is used to indicate the customer name, the sales invoice number, and the amount of the related invoice when the payment is received. The primary purpose of a remittance advice is to make sure that the proper customer is credited for the proper amount of cash received. Companies whose cash receipts are easily associated with specific sales transactions often do not use remittance advices.</p> <p>The remittance advice can be an extra copy of the sales invoice sent to the customer with the original. The extra copy would probably be stamped “Please return this copy with your payment.” When a remittance advice is not returned by the customer, a clerk will prepare one. Remittance advices facilitate the immediate deposit of the cash.</p> <p>When customers pay on the basis of monthly statements, rather than individual invoices (such as company credit cards), the remittance advice is for the total balance due rather than an individual invoice.</p> <p><i>(continued on the following page)</i></p> |

| ACTIONS | DOCUMENTS |
|---|--|
| | <p>Cash receipts prelist – A list prepared when cash is received, which lists each cash receipt. This document is used later to verify whether cash received was recorded and deposited at the correct amounts and on a timely basis.</p> |
| <p>Deposit cash – Currency and checks should be deposited in the bank as quickly as is practical, usually daily. The reasons are to make it available for company use and to reduce the likelihood of accidental loss or theft. For electronic payments, the company's bank typically notifies the company when an electronic payment has been received. Often, this notification is in e-mail form.</p> | <p>Bank deposit slip – A document prepared to accompany bank deposits of currency and checks, which lists each check and all currency being deposited. A separate bank deposit slip is prepared for each deposit. Usually banks require one to reduce the likelihood of bank errors. They are also helpful in recording cash receipts and preparing bank reconciliations. Deposit slips are especially helpful when company or bank personnel have made an error.</p> <p>The bank keeps the original and returns a validated deposit receipt to the depositor, indicating the amount and date of the deposit.</p> |
| <p>Record in cash receipts journal and subsidiary ledger – The cash receipts journal is the record of original entry for cash receipts transactions. It should look almost the same as the sales journal except for differences in the account titles. The subsidiary ledger is the same record described as a part of sales.</p> | <p>Cash receipts journal – A journal for recording cash receipts from collections, cash sales, and all other cash receipts. It indicates total cash received, the credit to accounts receivable at the gross amount of the original sale, sales discounts taken, and other debits and credits. The daily entries in the cash receipts journal are supported by remittance advices.</p> <p>The accountant must use care in recording the credit to accounts receivable in the cash receipts journal so that it is consistent with the recording of the original sale. Assume, for example, a sale for \$100 with a 2% cash discount allowed. If the receivable was originally recorded at \$100 and \$98 cash was received, the credit to accounts receivable in the cash receipts journal must be \$100, not \$98, if the discount was granted. The credit to accounts receivable in the subsidiary ledger must also be for \$100, not \$98. The \$2 discount is recorded as a debit to the sales discounts taken account.</p> <p>Accounts receivable subsidiary ledger – See Sales (page 37).</p> |
| <p>Summarize cash receipts journal and post to general ledger – The concepts are the same for this action as for sales and are not repeated.</p> | <p>General ledger – See Sales (page 37).</p> |

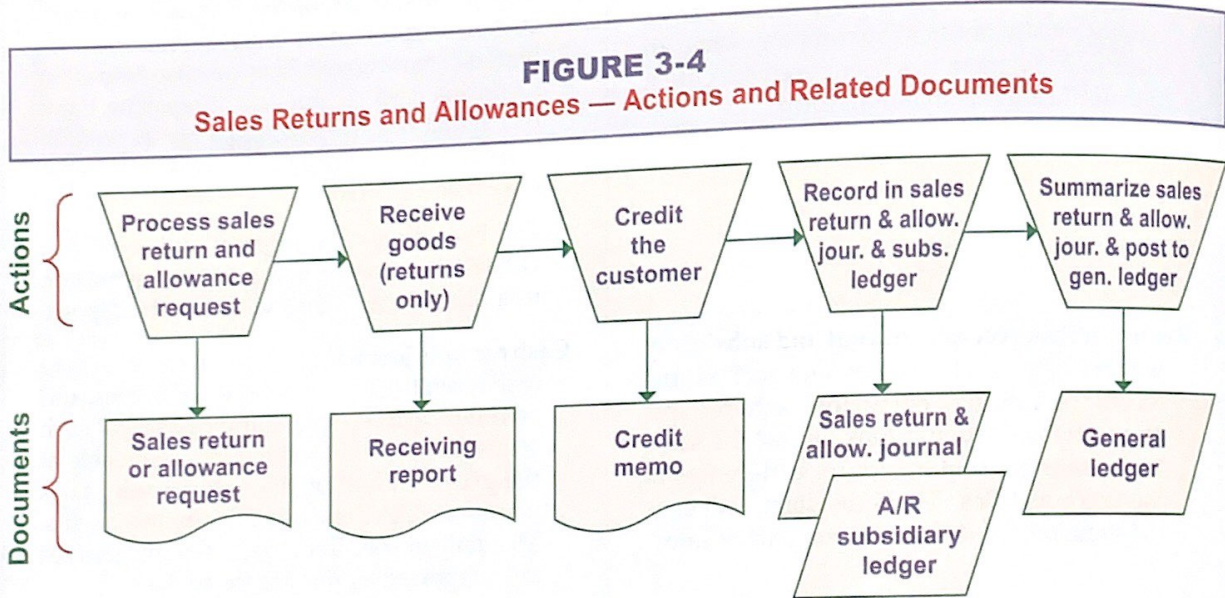
CHAPTER 3

Sales Returns and Allowances – Actions and Related Documents

Sales returns are the returns of merchandise to the seller for such reasons as the incorrect product being sent, defective merchandise, and the customer no longer needing the goods. For sales allowances, the customer keeps the goods purchased but is granted a reduction in the selling price.

The actions and recording of sales returns and allowances are nearly the same as for sales, but instead of a bill to the customer, a credit is granted. A major difference between sales and sales returns and allowances is that sales returns and allowances are often immaterial.

Figure 3-4 shows the actions and related documents for sales returns and allowances business activity. More detailed discussion of the activities and information in Figure 3-4 follows.



| ACTIONS | DOCUMENTS |
|---|---|
| <p>Process sales return and allowance request – Receipt of a request from a customer to return goods or for an allowance is the starting point for recording the sales return or allowance. Typically, it is approved by a salesperson or sales manager. It is common for the parties to negotiate the amount of the credit.</p> | <p>Sales return request – A document requesting authority to return goods. A document is not normally used for allowances. Figure 3-5 (page 42) shows an example of a sales return request received from one of Simple Example Company's customers, Taylor Products. When the sales return request was received from Taylor Products, the last four columns were blank. The handwritten information in these columns was completed by Simple Example Company when the returned goods were received from Taylor Products. This information is later used to prepare a credit memo for the sales return transaction. Credit memos are discussed shortly.</p> |

| ACTIONS | DOCUMENTS |
|---|---|
| <p>Receive goods (returns only) – Generally accepted accounting principles require the recognition of sales returns and allowances in the same accounting period that the original sale was made, rather than the period of the actual receipt of the goods. For convenience, many companies recognize returns when the goods are actually received back from customers. An adjustment can be made later for material returns.</p> | <p>Receiving report – A document prepared at the time the goods are received showing the description of the goods received, quantity, and date received. This document serves the same function as a shipping document. Receiving reports are discussed more fully in Chapter 4 as part of the purchases and cash disbursements cycle.</p> |
| <p>Credit the customer – The credit to the customer performs the same function as billing—to inform the customer of the amount of the credit. It is important in issuing credits for returns and allowances to have agreement from the customer on the amount of the credit. It is not always for the full amount of the sale, even for returned goods.</p> | <p>Credit memo – A document prepared indicating the amount and terms of the return or allowance. The original is sent to the customer and one or more copies are retained. It is also the document used for recording sales returns and allowances in the accounting records.</p> |
| <p>Record in sales returns and allowances journal and subsidiary ledger – The sales returns and allowances journal is the record of original entry for both sales returns and allowances. It can be a separate journal or a part of the sales journal.</p> | <p>Sales returns and allowances journal – A journal for recording sales returns and allowances. Many companies record returns and allowances in the sales journal. If they are recorded in the sales journal, a separate column is used. A separate journal is used only when there are many sales returns and allowances transactions.</p> <p>Accounts receivable subsidiary ledger – See Sales (page 37).</p> |
| <p>Summarize sales returns and allowances journal and post to general ledger – The concepts are the same for this action as for sales and are not repeated.</p> | <p>General ledger – See Sales (page 37).</p> |

FIGURE 3-5
Example of a Sales Return Request

REQUEST TO RETURN FROM →

| Vendor: SIMPLE EXAMPLE COMPANY 19100 Stewart Avenue Battle Creek, Michigan 49015 | | Taylor Products 5005 Territorial Boulevard East Lansing, Michigan 48826 | | Ret. Request No. 3498 Date of Request 11-29-22 | | | | | | |
|---|------------|--|----------------|---|-------------|--------------|------------|------------|---------------|---------------|
| RETURN CODES: A Overstock B Damaged C Defective D Wrong product billed & shipped E Correct product billed but wrong product shipped F Other | | All returns will be clean, in saleable condition, and shipped prepaid. A prompt reply will be greatly appreciated. Thank you for your cooperation. | | | | | | | | |
| <input type="checkbox"/> Cash Refund - Please <input checked="" type="checkbox"/> Credit to Account - Please Account No. 1008 Request by <u>CJA</u> | | For Clarification Contact Name <u>Sue Hinske</u> Phone <u>(517) 222-7900</u> | | | | | | | | |
| DEPT. | QUAN. REQ. | PRODUCT NUMBER | DESCRIPTION | RETURN CODE | INVOICE NO. | INVOICE DATE | QUAN. RET. | LIST PRICE | COST OR DISC. | EXTENSION |
| | 10 | TX201 | Photo Album | A | 138 | 11-17-22 | 10 | 7.95 | — | 79.50 |
| | 5 | DF844 | Digital Camera | A | 138 | 11-17-22 | 5 | 129.75 | — | 648.75 |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | TOTAL | 728.25 |

Return Authorized by Simple Example's Employee Date 12-1-22

1. Customer number and name.
2. Total balance due from the customer. In some cases, the balance may be a credit. An example is when a customer has received a credit for returned goods after the receivable has been paid.
3. Aging. The aging is determined on the basis of the date of any sale for which collection has not been made. Usually the date for sales and cash receipts is indicated in the subsidiary ledger. Ordinarily, cash receipts are assumed to apply to the oldest outstanding receivables. For example, assume a November sale in the amount of \$400, a December sale in the amount of \$300, and December collection of \$500. The remaining receivable of \$200 is assumed to be for the December sale unless there is a dispute over the November sale.

Internal Controls

Chapter 1 includes a general introduction of internal controls affecting all cycles. The purpose of this section is to examine specific controls for the sales and cash receipts cycle. The most important controls for the cycle follow.

Adequate documents and records. The documents used in sales, sales returns and allowances, and cash receipts transactions should be pre-numbered and designed for the purpose intended. For example, the use of prenumbered shipping documents is an essential element to the controls that ensure that all goods shipped have been billed. Similarly, the use of prenumbered sales invoices is desirable to make sure that billings have been recorded. The special characteristics of properly designed documents and records were discussed in Chapter 1.

Authorization of transactions. There are five authorizations for sales and cash receipts transactions, each of which should be indicated by initialing the appropriate document:

1. Approval of credit before shipment takes place.
2. Shipment of the goods.
3. Determination of appropriate price to charge for the goods. Price includes terms and freight.
4. Approval of credits to accounts receivable for such things as sales returns and allowances or write-off of uncollectible accounts.
5. Determining cash discounts allowed for customers' payments made before the discount date.

Separation of the custody of assets from accounting. The person responsible for shipping goods or receiving cash should have no accounting responsibility. Without adequate segregation of duties, the potential for fraud increases.

Independent checks on performance. There are several appropriate types of internal verification, including:

- Account for all prenumbered shipping documents. This control helps ensure that all shipments have been billed.
- Account for all prenumbered sales invoices. This control helps to ensure that all sales invoices have been recorded.
- Compare prices on invoices charged to customers for shipments to a price list approved by management.
- Check the mathematical accuracy of the journals and records.
- Reconcile the accounts receivable control account to the related subsidiary ledger.
- Prepare a monthly bank reconciliation. One of the most important controls used by accountants is a bank reconciliation. This control is discussed in greater detail in Chapter 4.

| ACTIONS | DOCUMENTS |
|---|--|
| <p>Process cash disbursement – Checks: The preparation, signing, and mailing of a check are essential actions in the cash disbursements subcycle. The delivery or mailing date of the check is the cash disbursement cutoff date according to generally accepted accounting principles.</p> <p>Electronic payment: Companies often pay their obligations electronically through ACH (Automated Clearing House) payments. The preparation and approval of an ACH payment authorization form are also essential. The date that the electronic payment leaves the company’s bank account is typically the cash disbursement cutoff date, but electronic payments can still be outstanding on the month-end bank reconciliation.</p> <p>The check or ACH payment authorization form is prepared from the information on the vendor’s invoice, receiving report, and purchase order. When these documents do not exist (services) other documents or records are used to indicate when payment is due.</p> | <p>Check – A document prepared to pay for a purchase when payment is due. After the check is signed by an authorized person, it is an asset. When cashed by the vendor and cleared by the client’s bank, it is referred to as a cancelled check. The check must include the payee, amount, and date. Some companies prepare one or more copies for record keeping.</p> <p>ACH payment authorization – A document prepared to initiate and approve an electronic payment for a purchase when payment is due. After an ACH payment authorization form is completed and approved, an authorized person (typically the person who signs the form) initiates the electronic payment online with the company’s bank. The ACH payment authorization typically includes the payee, amount, and date of the electronic payment. The form is used to enter the payment in the cash disbursements journal and is then kept in a temporary file until the monthly bank reconciliation process.</p> |
| <p>Record in cash disbursements journal and subsidiary ledger – The cash disbursements journal is the record of original entry for cash disbursement transactions. This journal should look almost the same as all other journals except for differences in the account titles. The only subsidiary ledger usually affected by cash disbursements is accounts payable.</p> | <p>Cash disbursements journal – A journal for recording cash disbursements. It indicates total cash paid, the debit to accounts payable at the gross amount of the original purchase, cash discounts taken, and other debits and credits. The daily entries in this journal are supported by copies of checks or other documents such as vendors’ invoices. Like for accounts receivable, the accountant must use care in recording the debit to accounts payable so that it is consistent with the recording of the original purchase. When an account payable is fully paid, the accounts payable subsidiary ledger must reflect a zero balance.</p> <p>Accounts payable subsidiary ledger – See Purchases (page 55).</p> |
| <p>Summarize cash disbursements journal and post to general ledger – The concepts are the same for this action as for purchases and are not repeated.</p> | <p>General ledger – See Purchases (page 55).</p> |

CHAPTER 4

intended. For example, the use of prenumbered receiving reports is essential to help a company be sure that all merchandise receipts have been recorded. The special characteristics of properly designed documents and records were discussed in Chapter 1.

Authorization of transactions. There are four key authorizations for purchases and cash disbursements, each of which should be indicated by initialing the appropriate document.

1. Authorization to order goods or services, including quantity – A person at the appropriate level should approve all purchases to prevent overbuying or buying goods or services that are not needed.
2. Authorization of price – To assure buying goods at the lowest cost, given the quality and service needs of the buyer. Many companies use a purchasing department.
3. Authorization to receive the goods or services – When the goods or services are delivered, approval is needed to be sure the appropriate items have been received.
4. Authorization to disburse cash – The signing of a check by an authorized person is the approval for payment. That person should examine supporting documentation to make sure that payment is appropriate.

Separation of the custody of assets from accounting. The person responsible for receiving goods or signing checks should have no accounting responsibility. Without adequate segregation of duties, the potential for fraud increases.

Independent checks on performance. There are several appropriate types of independent checks, including:

- Account for all receiving reports. This control helps ensure that all accounts payable have been recorded.
- Check prices actually paid for goods against those available from local stores, catalogs, and price lists. The purpose is to determine that prices paid for goods and services are reasonable.

- Check the mathematical accuracy of journals and records.
- Reconcile all control accounts to the related subsidiary ledgers. Examples include accounts payable and fixed assets.
- Prepare a monthly bank reconciliation. One of the most important controls used by companies is a bank reconciliation. When performed by a person independent of those who handle the cash or are responsible for accounting records involving cash, the bank reconciliation is useful in uncovering both unintentional errors and fraud. This control is of sufficient importance to merit study in more detail.

Bank Reconciliation

A bank reconciliation is the determination of the reasons for the differences (reconciling items) between the cash in the bank balance as stated on the bank statement and on the general ledger at a point in time. Common causes of the differences include:

- Deposits recorded in the books in one period but not deposited until the next period (deposits in transit).
- Checks and electronic payments recorded and sent in one period but not clearing the bank until the next period (outstanding checks).
- Bank service charges not recorded in the books until the period following the bank's deduction of them from the bank balance.

A bank reconciliation can also be used to locate errors or fraud in the accounting records and bank errors. There are several types of errors or fraud that a carefully prepared bank reconciliation should uncover. Examples include:

- A check recorded at a different amount from the actual amount of the check.
- A deposit to the bank that the bookkeeper forgot to record in the cash receipts journal.
- The theft of cash by not depositing money. The bank reconciliation will uncover this only if the receipt of cash was recorded

in the cash receipts journal.

- The bank debiting a customer's account for a larger amount than the amount of the check (bank error).
- An error in adding the cash receipts column in the cash receipts journal.
- Posting the wrong total of the cash disbursements column in the cash disbursements journal to the general ledger.

Preparation of a bank reconciliation. A bank reconciliation should be prepared only after all accounting transactions for the month have been recorded and posted to the general ledger, and the bank statement has been received from the bank. An example of a bank reconciliation for

Jones Co. is included in Figure 4-7.

The form of the bank reconciliation in Figure 4-7 shows a distinction between two types of reconciling items: timing differences and items requiring adjustment of the general ledger balance.

Timing differences result from the bank and company processing transactions at a different time. There are three common types of timing differences: deposits in transit, outstanding checks, and errors by the bank that they will correct. Only timing differences are included in the left column of the bank reconciliation. In Figure 4-7 there are two types of timing differences: deposits in transit and outstanding checks.

FIGURE 4-7
Bank Reconciliation and Related Adjusting Journal Entries

| Bank Reconciliation—Jones Co. November 30, 2022 | | |
|---|-----------------------|-----------------------|
| | <u>Bank Statement</u> | <u>General Ledger</u> |
| Unadjusted balance 11-30-22 | \$ 326.10 | \$ 378.00 |
| Add: Deposits in transit | | |
| <u>Amount</u> | | |
| 11-29-22 \$ 75.00 | | |
| 11-30-22 25.00 | | |
| Total | 100.00 | |
| Deduct: Outstanding checks | | |
| <u>Check #</u> <u>Amount</u> | | |
| 267 \$ 6.37 | | |
| ACH #5490 21.14 | | |
| 282 8.59 | | |
| Total | (36.10) | |
| Adjustments: | | |
| Recording error (Ck. #306) | | 20.00 |
| Bank service charge | | (8.00) |
| Adjusted balance 11-30-22 | <u>\$390.00</u> | <u>\$390.00</u> |
| Adjusting Journal Entries November 2022 | | |
| | <u>Dr.</u> | <u>Cr.</u> |
| 1. Cash in bank | 20.00 | |
| Accounts payable | | 20.00 |
| Error in recording check #306. \$57.25 recorded in CD journal less \$37.25 check amount = \$20.00 error. | | |
| 2. Bank service charges | 8.00 | |
| Cash in bank | | 8.00 |
| To record November bank service charges. | | |

CHAPTER 4

Items requiring adjustment of the general ledger are receipts and disbursements processed by the bank, but not yet recorded, and errors by the company. Bank service charges, unrecorded checks, and checks recorded at the wrong amounts are examples. Only items requiring adjustment are included in the right column of the bank reconciliation.

An adjusting entry is also required for each error adjustment included in the general ledger column. The bank reconciliation in Figure 4-7 includes one adjustment for a recording error and one for an unrecorded bank service charge.

To prepare a bank reconciliation, the following documents and records for a given period are required.

- Bank statement, including scans of all cancelled checks and deposit slips for the period or a list of cancelled checks and deposits.
- Cash receipts journal.
- Cash disbursements journal.
- Cash-in-bank general ledger account.
- Prior month's bank reconciliation.

A description of the reconciliation procedure follows with references to the bank reconciliation in Figure 4-7 in parenthesis:

1. Begin the reconciliation by writing in the ending balance on the bank statement and the general ledger balance for cash on the bank reconciliation (\$326.10 and \$378.00).
2. Trace all cash receipts transactions from (a) deposits in transit in the prior month's bank reconciliation and (b) the current period cash receipts journal to the current period bank statement.

Any amounts that have not been deposited are deposits in transit. They are listed on the bank reconciliation (two totaling \$100.00).

Deposits included in the bank statement but not recorded or differences between

the amount of recorded cash receipts and the recorded deposits must be investigated. Either the bank is in error or an adjustment is required to the company's records.

3. Trace all cash disbursement transactions from the list of (a) outstanding checks/electronic (ACH) payments on the prior month's bank reconciliation and (b) the current period cash disbursements journal to the list of checks or actual checks/ACH payments clearing the bank. For each transaction, compare the check/ACH payment number, payee, and amount.

All cancelled checks and ACH payments clearing the bank statement must be matched with their recorded entries in the cash disbursements journal. Prior month's outstanding checks/ACH payments and other recorded checks/ACH payments that have not cleared are outstanding and must be listed on the bank reconciliation (three totaling \$36.10).

Checks/ACH payments clearing the bank that have not been recorded or checks/ACH payments clearing the bank for a different amount must be investigated. Either the bank is in error or an adjustment is required to the company's records (\$20.00 error).

4. Account for all items in the beginning-of-the-period bank reconciliation, cash receipts and disbursements journals, and bank statement that have not already been accounted for in steps 2 and 3. Common examples of additional reconciling items on the bank statement are bank service charges and collections by the bank of notes receivable credited directly to the bank account. These items will require adjusting entries (\$8.00 adjustment for bank service charge).
5. Make the adjusting journal entries for the adjustments to the general ledger balance (two adjusting entries).

6. Foot the bank reconciliation and compare the adjusted bank balance to the general ledger after the adjustments have been made. If the balances do not agree, there is an error in preparing the bank reconciliation, a math error in totaling the journals or general ledger, a bank error, or possibly even a theft of cash. (In Figure 4-7, both totals foot to \$390.00.)

Summary

Chapter 4 is a study of:

- The nature of the transactions in the purchases and cash disbursements cycle.
- The documents and records used to record and summarize transactions in the cycle.
- A method of recording purchases and cash disbursements transactions.
- Common internal controls for the cycle.
- Bank reconciliations.

To better understand the chapter material, a comprehensive example of the relationships among the different parts of the cycle is provided in Figure 4-8 (pages 66 and 67). Four simple transactions are used to illustrate the most common documents and records in the cycle, and the way the documents are used to record transactions.

A suggested method of studying the material in Figure 4-8 is to trace each transaction from its source to its final recording in the general ledger. Special emphasis should be placed on examining the source of the accounts payable report and its relationship to the subsidiary ledger and control account.

After the documents, records, and recording methods in Figure 4-8 are understood, the totals in each general ledger account should be traced to the year-end worksheet in Figure 1-8 on page 18. Notice that the shaded portion of each general ledger account shows the adjusting entries. The balance above the shaded area will therefore be in the unadjusted trial balance columns and the final ledger balance will be in the adjusted trial balance columns in Figure 1-8.

| ACTIONS | DOCUMENTS |
|---|---|
| | <p>Deduction authorization form – A form prepared by an employee authorizing payroll withholding for such items as income taxes, union dues, and retirement savings.</p> |
| <p>Receive employee services – Some employees work on a monthly basis. Frequently they are paid for overtime. Other employees are paid on an hourly, commission, or piece-rate basis.</p> | <p>Time card/time report – A document prepared by an employee indicating the time an employee started and stopped working each day and the number of hours worked. This document is usually generated by a scan of each employee's ID card or by a time clock.</p> |
| <p>Pay for employee services – There are four elements of paying for employee services:</p> <ol style="list-style-type: none"> 1. Summarize the time cards/time reports and calculate the gross pay, withholdings, and net pay for each employee. 2. Prepare and distribute payroll checks. 3. Make disbursements for withholdings from employees. 4. Calculate and pay employer payroll taxes and benefits. | <p>Payroll check – A document prepared to pay an employee for employment services performed. The check is for the net pay, after deducting withheld taxes and other items such as medical insurance and union dues. After the check is cashed and returned to the company by the bank, it is referred to as a cancelled payroll check.</p> <p>Checks to others – Documents prepared to pay the federal or state government, union, or other organization for payroll-related services. These are of two types:</p> <ul style="list-style-type: none"> • Withholdings from employees. • Employer payroll taxes and benefit expenses. <p>These checks are usually paid from the general cash account rather than the payroll account.</p> |
| <p>Record in payroll journal and subsidiary ledger – The payroll journal is the record of original entry for payroll transactions. Every payroll check disbursement must be recorded in the payroll journal, individually or in summary form. Every payroll transaction must also be recorded in the employee earnings subsidiary ledger. The company is responsible for keeping records to enable it to prepare employee W-2 forms annually and to demonstrate it has complied with federal and state employment regulations.</p> | <p>Payroll journal – A journal for recording payroll disbursements. It frequently has separate columns to indicate regular pay, overtime pay, each type of withholding, net pay, check number, and the account classification.</p> <p>Employee earnings subsidiary ledger – A ledger for recording accumulated payroll information for each employee. The same information shown in the payroll journal is also included in the subsidiary ledger. The difference is that an employee earnings subsidiary ledger (accumulated payroll record) is prepared for each employee for the year. A new earnings record is started for an employee each year.</p> |
| <p>Summarize payroll journal and post to general ledger – The concepts are the same as for all other journals.</p> | <p>General ledger – See Sales (page 37) and Purchases (page 55).</p> |