ACCOUNTING Principles I

Grades 10–12 · College · 8 pages

The accounting equation · debits and credits · the accounting cycle · journal entries · adjusting entries · depreciation · closing · the four financial statements · merchandising and inventory · cash and bank reconciliation · receivables · payroll · liabilities and owner's equity · ratios · GAAP · common errors

1 Accounting equation · 2 Debits & credits · 3 Cycle & journal · 4 GAAP · 5 Adjusting entries · 6 Depreciation · 7 Worksheet & closing · 8 Financial statements · 9 Key ratios · 10 Merchandising · 11 Inventory costing · 12 Cash & receivables · 13 Payroll · 14 Liabilities & owner's equity · 15 Common errors

1 THE ACCOUNTING EQUATION

A lemonade stand's first week

Event	Cash	Supplies	Stand	= Payable	+ Owner's equity
Invest $50 of savings	+50				+50 *investment*
Buy a stand and pitchers	−30		+30		
Buy lemons and cups on credit		+20		+20	
Sell lemonade for cash	+65				+65 *revenue*
Use up supplies		−14			−14 *expense*
Pay the grocer	−20			−20	
Take $10 home	−10				−10 *drawing*
Balance	**55**	**6**	**30**	**0**	**91**

Assets 55 + 6 + 30 = **91** = Liabilities 0 + Owner's equity 91. Every row keeps both sides equal.

The equation and its expanded form

Assets: what the business owns. **Liabilities**: what it owes. **Owner's equity**: the owner's claim, A − L. Revenue − expenses = **net income**.

Assets = Liabilities + Owner's Equity

A = L + Capital − Drawing + Revenue − Expenses

Revenue value earned by delivering goods or services

Expense cost of assets used up or services consumed to earn revenue

Drawing assets the owner takes out; lowers owner's equity, **not** an expense

"For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?" (Luke 14:28, KJV)

MEMORY TRICK

The owner is last in line

Creditors are paid first; the owner keeps what is left. So owner's equity is the **remainder**: A − L.

2 DEBITS, CREDITS & T-ACCOUNTS

Assets		=	Liabilities		+	Capital		−	Drawing		+	Revenue		−	Expenses	
Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit
+	−		+	+		+	+		+	−		+	+		+	−
normal: debit			*normal: credit*			*normal: credit*			*normal: debit*			*normal: credit*			*normal: debit*	

Left (debit) side increases: Assets, Drawing, Expenses. Right (credit) side increases: Liabilities, Capital, Revenue.

Debit (Dr) **left** side; from Latin *debere*, to owe

Credit (Cr) **right** side; from Latin *credere*, to trust

Not good or bad debit and credit mean **left** and **right**, nothing more

Contra account balance opposite its partner: Accumulated Depreciation, Allowance for Doubtful Accounts, Sales Discounts

MEMORY TRICK **DEALER (Traditional)**

Drawing, **E**xpenses, **A**ssets: debit balances. **L**iabilities, owner's **E**quity (capital), **R**evenue: credit balances. In a corporation the D is **Dividends**.

MEMORY TRICK **Bank talk is backward**

The bank "credits" your deposit because it now **owes** you. In **your** books cash went up: a **debit**.

Cash (101)

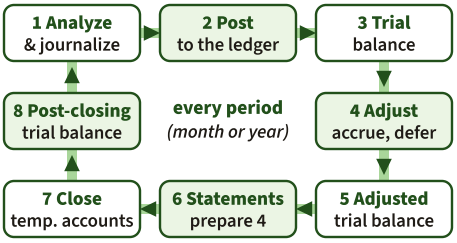
Debit (Dr)		Credit (Cr)	
Jun 1	20,000	Jun 1	6,000
Jun 5	1,500	Jun 1	1,200
Jun 29	400	Jun 2	1,800
Jun 30	6,400	Jun 15	1,200
		Jun 25	500
		Jun 28	1,000
		Jun 30	1,100
footing	28,300	*footing*	12,800
Balance	**15,500**		

Bright Day's June Cash, posted from the journal (section 3). **Foot** each side; the balance sits on the larger side.

3 THE ACCOUNTING CYCLE & THE JOURNAL

Worked month: Bright Day Laundromat (owner M. Grant), June 2026; the note is due in 2031

Transaction	Debit	Credit	$
Jun 1 Owner invests cash	Cash	Grant, Capital	20,000
Jun 1 Buys machines: $6,000 down, 6% note	Equipment	Cash, Notes Payable	6,000 + 30,000
Jun 1 Pays 12 months' insurance	Prepaid Insurance	Cash	1,200
Jun 2 Pays June rent	Rent Expense	Cash	1,800
Jun 3 Buys supplies on account	Supplies	Accounts Payable	800
Jun 5 Motel prepays 3 months' service	Cash	Unearned Revenue	1,500
Jun 15 Pays wages	Wages Expense	Cash	1,200
Jun 20 Bills a café for linens	Accounts Receivable	Laundry Revenue	900
Jun 25 Pays supplier on account	Accounts Payable	Cash	500
Jun 28 Owner withdraws cash	Grant, Drawing	Cash	1,000
Jun 29 Collects from the café	Cash	Accounts Receivable	400
Jun 30 June coin and card revenue	Cash	Laundry Revenue	6,400
Jun 30 Pays utilities	Utilities Expense	Cash	1,100



Journalize, then post

- From a **source document**: debits first, credits indented, an explanation. 3+ accounts: a **compound entry**.
- **Post** each amount to the same side of its ledger account; the PR columns make the **audit trail**.

Chart of accounts

No.	Type	Example
100s	Assets	101 Cash
200s	Liabilities	201 Accounts Payable
300s	Owner's equity	301 Capital
400s	Revenue	401 Laundry Revenue
500s	Expenses	510 Rent Expense

Assets in order of **liquidity**, Cash first.

Cash basis revenue when cash comes in; expense when cash goes out

Accrual basis revenue when **earned**, expense when **incurred**; **GAAP** requires it

General journal format

Account	Debit	Credit
Jun 1 Equipment	36,000	
Cash		6,000
Notes Payable		30,000
Bought equipment; $6,000 down, 5-year 6% note		
Jun 20 Accounts Receivable	900	
Laundry Revenue		900
Billed Corner Café, terms n/30		

4 GAAP: PRINCIPLES & ASSUMPTIONS

Principles and constraints

Principle	Means
Historical cost	record assets at what was paid
Revenue recognition	record revenue when goods or services are delivered (earned)
Matching (expense recognition)	record expenses in the period of the revenue they helped earn
Full disclosure	tell readers everything that would change their judgment (notes)
Consistency	same methods each period; disclose changes
Materiality (constraint)	amounts too small to change a decision may be handled simply
Conservatism (prudence)	in real doubt, do not overstate assets or income

Four assumptions

Assumption	Means
Economic entity	business books apart from the owner's
Going concern	the business will keep operating
Monetary unit	record only what dollars can measure
Periodicity	report by month, quarter, year

Revenue (ASC 606) contract → obligations → price → allocate → recognize when each is met

Qualities **relevant** and **faithfully represented**

Rule makers FASB (1973) writes U.S. GAAP; the SEC oversees public companies; most other countries use IFRS

MEMORY TRICK

Every Good Man Prays

The four assumptions: **E**ntity, **G**oing concern, **M**onetary unit, **P**eriodicity.

5 ADJUSTING ENTRIES

Bright Day's seven adjustments

	Kind	Why (June 30)	Entry	$
(a)	Deferral (prepaid)	Insurance used: $1,200 ÷ 12	Dr Insurance Expense; Cr Prepaid Insurance	100
(b)	Deferral (prepaid)	Supplies: $800 − $350 counted	Dr Supplies Expense; Cr Supplies	450
(c)	Depreciation	($36,000 − $3,600) ÷ 120 months	Dr Depreciation Expense; Cr Accumulated Depreciation	270
(d)	Deferral (unearned)	One of 3 months earned	Dr Unearned Revenue; Cr Laundry Revenue	500
(e)	Accrued expense	Wages earned Jun 26–30, unpaid	Dr Wages Expense; Cr Wages Payable	600
(f)	Accrued expense	Interest: $30,000 × 6% × 1/12	Dr Interest Expense; Cr Interest Payable	150
(g)	Accrued revenue	Café linens washed, not yet billed	Dr Accounts Receivable; Cr Laundry Revenue	200

Net effect: revenue +700, expenses +1,570. Skipping them would overstate June's net income by **870** (3,200 instead of 2,330).

The four kinds (plus depreciation)

Type	Cash moved…	Adjusting entry
Prepaid expense	before the expense	Dr Expense, Cr Prepaid (asset)
Unearned revenue	before the revenue	Dr Unearned (liability), Cr Revenue
Accrued expense	after the expense	Dr Expense, Cr Payable
Accrued revenue	after the revenue	Dr Receivable, Cr Revenue
Depreciation	when the asset was bought	Dr Depreciation Exp., Cr Accum. Depreciation

Three rules

- Every adjusting entry has **one income-statement** account and **one balance-sheet** account.
- **Cash is never** in an adjusting entry.
- Use the amount **used** or **earned**, not the amount on hand.

Book value cost − accumulated depreciation: 36,000 − 270 = **35,730**

Reversing entry optional, first day of the next period: undoes an accrual

MEMORY TRICK

Deferral = cash first; accrual = cash later

Deferral: the cash moved first; you defer the revenue or expense until it is earned or used.
Accrual: the work came first; the cash will follow.

6 DEPRECIATION

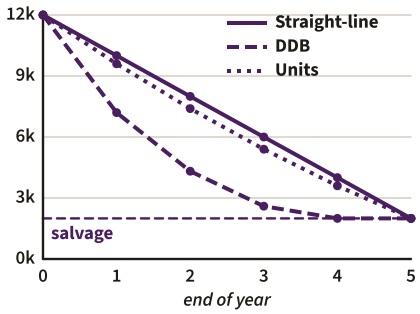
A $12,000 washer-extractor: salvage $2,000, life 5 years or 50,000 wash cycles

Year	Straight-line: expense	SL book value	DDB: rate × start BV	DDB expense	DDB book value	Cycles run	Units-of-prod. expense	UOP book value
1	2,000	10,000	40% × 12,000	4,800	7,200	12,000	2,400	9,600
2	2,000	8,000	40% × 7,200	2,880	4,320	11,000	2,200	7,400
3	2,000	6,000	40% × 4,320	1,728	2,592	10,000	2,000	5,400
4	2,000	4,000	40% × 2,592	592	2,000	9,000	1,800	3,600
5	2,000	2,000	40% × 2,000	0	2,000	8,000	1,600	2,000
Total	**10,000**			**10,000**		**50,000**	**10,000**	

Year 4 DDB: 40% × 2,592 = 1,036.80 would drop book value below salvage, so the expense stops at **592**; year 5 is 0. All three methods charge the same **10,000** in total.

Three formulas

- **Straight-line** = (cost − salvage) ÷ life: (12,000 − 2,000) ÷ 5 = **2,000** a year.
- **DDB** = (2 ÷ life) × book value at the start of the year: 40% × 12,000 = **4,800**. Ignore salvage in the multiply; never go below it.
- **Units of production** = (cost − salvage) ÷ total units × units used: $0.20 × 12,000 = **2,400**.



Book value falls to the same salvage line by every method.

Selling the washer after 3 years (SL) WORKED

Book value = 12,000 − 6,000 = **6,000**

Sold for 5,500: **loss 500** *cash − book value*

Dr Cash 5,500; Dr Accum. Depr. 6,000; Dr Loss 500; Cr Equipment 12,000

Rules of thumb

- **Land** is never depreciated.
- Cost includes price, freight, installation and testing (**capital expenditure**); routine repairs are expenses.
- Part year: SL × months used ÷ 12.
- Depreciation allocates **cost**; it does not measure market value.

7 TRIAL BALANCE, WORKSHEET & CLOSING

Bright Day Laundromat · Worksheet · June 30, 2026

Account	Trial balance Dr	Trial balance Cr	Adjustments Dr	Adjustments Cr	Adjusted TB Dr	Adjusted TB Cr
101 Cash	15,500				15,500	
112 Accounts Receivable	500		(g) 200		700	
126 Supplies	800			(b) 450	350	
130 Prepaid Insurance	1,200			(a) 100	1,100	
157 Equipment	36,000				36,000	
158 Accumulated Depreciation				(c) 270		270
201 Accounts Payable		300				300
210 Notes Payable		30,000				30,000
220 Unearned Revenue		1,500	(d) 500			1,000
230 Wages Payable				(e) 600		600
240 Interest Payable				(f) 150		150
301 Grant, Capital		20,000				20,000
302 Grant, Drawing	1,000				1,000	
401 Laundry Revenue		7,300		(d) 500 (g) 200		8,000
510 Rent Expense	1,800				1,800	
520 Utilities Expense	1,100				1,100	
530 Wages Expense	1,200		(e) 600		1,800	
540 Insurance Expense			(a) 100		100	
550 Supplies Expense			(b) 450		450	
560 Depreciation Expense			(c) 270		270	
570 Interest Expense			(f) 150		150	
Totals	**59,100**	**59,100**	**2,270**	**2,270**	**60,320**	**60,320**

Finishing the worksheet

- **Extend** each adjusted balance: revenue and expenses to the Income Statement columns; assets, liabilities, capital and **drawing** to the Balance Sheet columns.
- The difference in the IS columns is **net income** (2,330); enter it on the debit side of the IS columns and the credit side of the BS columns. Then all four pairs balance.

A trial balance proves only equality

- It **will not** catch: an entry left out or posted twice; the right amount in the wrong account of the same side; two errors that offset.
- It **will** catch: a one-sided posting, a wrong total, a balance in the wrong column, a transposed or slid figure (section 15).

MEMORY TRICK **REID (Traditional)**

Close in order: **R**evenue, **E**xpenses, **I**ncome Summary, then **D**rawing (or **D**ividends).

⚠ Do not close

- Accumulated Depreciation, Unearned Revenue, Allowance for Doubtful Accounts: they are **permanent**.
- Drawing into Income Summary.

June 30 closing entries	Debit	Credit
(1) Laundry Revenue	8,000	
Income Summary		8,000
(2) Income Summary	5,670	
Rent Expense		1,800
Utilities Expense		1,100
Wages Expense		1,800
Insurance Expense		100
Supplies Expense		450
Depreciation Expense		270
Interest Expense		150
(3) Income Summary	2,330	
Grant, Capital		2,330
(4) Grant, Capital	1,000	
Grant, Drawing		1,000

(1) revenue to Income Summary; (2) expenses to Income Summary; (3) net income to capital; (4) drawing **straight to capital**, never through Income Summary.

Income Summary

Debit (Dr)		Credit (Cr)	
Expenses	5,670	Revenue	8,000
To capital	2,330		
footing	8,000	*footing*	8,000
Balance	0		

Income Summary lives only during closing, then returns to zero.

Post-closing trial balance	Debit	Credit
Cash	15,500	
Accounts Receivable	700	
Supplies	350	
Prepaid Insurance	1,100	
Equipment	36,000	
Accumulated Depreciation		270
Accounts Payable		300
Notes Payable		30,000
Unearned Revenue		1,000
Wages Payable		600
Interest Payable		150
Grant, Capital		21,330
Totals	**53,650**	**53,650**

Only permanent accounts remain. Capital = 20,000 + 2,330 − 1,000 = **21,330**.

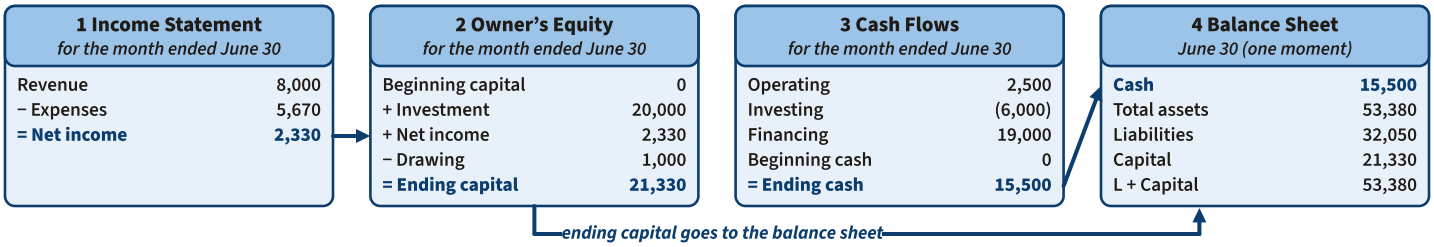
Why close?

- **Temporary** accounts (revenue, expense, drawing) measure **one period**; closing zeroes them and moves net income and drawing into **capital**.
- A **net loss**: debit Capital, credit Income Summary.

MEMORY TRICK **Three trial balances**

Prove the books **three times**: before you adjust, after you adjust and after you close.

8 THE FOUR FINANCIAL STATEMENTS



Income Statement · month ended June 30		
Laundry Revenue		8,000
Rent Expense	1,800	
Utilities Expense	1,100	
Wages Expense	1,800	
Insurance Expense	100	
Supplies Expense	450	
Depreciation Expense	270	
Interest Expense	150	
Total expenses		5,670
Net income		**2,330**

Balance Sheet · June 30, 2026		
Current assets		
Cash	15,500	
Accounts Receivable	700	
Supplies	350	
Prepaid Insurance	1,100	17,650
Equipment	36,000	
Less: accum. depreciation	(270)	35,730
Total assets		**53,380**
Current liabilities		
Accounts Payable	300	
Wages Payable	600	
Interest Payable	150	
Unearned Revenue	1,000	2,050
Notes payable (long-term)		30,000
Total liabilities		32,050
Grant, Capital		21,330
Total liabilities and capital		**53,380**

Statement of Cash Flows (indirect) · June		
Operating activities		
Net income	2,330	
Add: depreciation	270	
Increase in AR, supplies, prepaid	(2,150)	
Increase in current liabilities	2,050	
Net cash from operating		2,500
Investing: equipment		(6,000)
Financing: 20,000 − 1,000		19,000
Net increase in cash		**15,500**

Noncash: equipment for a 30,000 note. Direct method: 8,300 − 5,800 = **2,500**.

MEMORY TRICK **I-O-B-C**
Prepare in order: **I**ncome, **O**wner's equity, **B**alance sheet, **C**ash flows; each borrows a number from the one before.

Cash-flow groups

Operating customers, suppliers, workers
Investing long-term assets
Financing owners and lenders

9 KEY RATIOS

Liquidity, activity, solvency, profitability

Ratio	Formula	Hilltop Vending (year)
Current ratio	current assets ÷ current liabilities	9,000 ÷ 3,600 = **2.50**
Quick (acid-test)	(cash + short-term investments + AR) ÷ current liabilities	6,000 ÷ 3,600 = **1.67**
Working capital	current assets − current liabilities	**5,400**
Receivables turnover	net credit sales ÷ average AR; days = 365 ÷ turnover	12,000 ÷ 1,000 = **12.0**; **30.4 days**
Inventory turnover	COGS ÷ average inventory; days = 365 ÷ turnover	22,600 ÷ 2,260 = **10.0**; **36.5 days**
Debt ratio	total liabilities ÷ total assets	12,000 ÷ 30,000 = **40%**
Debt-to-equity	total liabilities ÷ owner's equity	12,000 ÷ 18,000 = **0.67**
Times interest earned	operating income ÷ interest expense	11,500 ÷ 900 = **12.8×**
Gross margin	gross profit ÷ net sales	28,800 ÷ 51,400 = **56.0%**
Net profit margin	net income ÷ net sales	10,600 ÷ 51,400 = **20.6%**
Return on assets	net income ÷ average total assets	10,600 ÷ 29,000 = **36.6%**
Return on owner's equity	net income ÷ average owner's equity	10,600 ÷ 17,000 = **62.4%**

Hilltop, Dec 31: cash 4,800, AR 1,200, inventory 2,400, prepaid 600; assets 30,000 = liabilities 12,000 + owner's equity 18,000.

DuPont

- **ROE = net margin × asset turnover × (avg. assets ÷ avg. owner's equity)**
- Asset turnover = sales ÷ avg. assets = **1.77**; 20.6% × 1.77 × 1.71 ≈ **62.4%**.

Using ratios well

- Compare with **last year** and **similar businesses**.
- Unpaid owner work is not an expense, so small-business returns look high.
- **EPS** = (net income − preferred dividends) ÷ avg. common shares.

MEMORY TRICK **L-A-S-P**
Four questions in order: **L**iquidity (pay this year?), **A**ctivity (how fast?), **S**olvency (survive the long run?), **P**rofitability (worth it?).

"Be thou diligent to know the state of thy flocks, and look well to thy herds." (Proverbs 27:23, KJV)

10 MERCHANDISING

Perpetual vs periodic entries

Event (Hilltop Vending)	Perpetual system	Periodic system
Buy 300 bags at $0.60 on account, 2/10, n/30	Dr Merchandise Inventory 180; Cr Accounts Payable 180	Dr Purchases 180; Cr Accounts Payable 180
Pay within 10 days (2% off)	Dr AP 180; Cr Inventory 3.60; Cr Cash 176.40	Dr AP 180; Cr Purchase Discounts 3.60; Cr Cash 176.40
Pay freight in	Dr Merchandise Inventory 15; Cr Cash 15	Dr Freight-In 15; Cr Cash 15
Sell for $1,050 cash (cost $420)	Dr Cash 1,050; Cr Sales Revenue 1,050 **and** Dr Cost of Goods Sold 420; Cr Inventory 420	Dr Cash 1,050; Cr Sales Revenue 1,050 only
Refund $3 (jammed machine)	Dr Sales Returns and Allowances 3; Cr Cash 3	same
Period end	count; shrinkage: Dr COGS, Cr Inventory	count; compute COGS

Periodic COGS = beginning inventory + net purchases − ending inventory WORKED

Net purchases = 23,230 + 400 − 300 − 450 = **22,880**

Goods available = 2,120 + 22,880 = **25,000**

COGS = 25,000 − 2,400 = **22,600**

count: 2,400 left

MEMORY TRICK

Perpetual never sleeps

Perpetual updates inventory and COGS with every sale (a scanner does it). **Periodic** waits for the count.

Multi-step income statement · Hilltop Vending · year

Sales revenue	52,000
Less: sales returns and allowances	(600)
Net sales	51,400
Cost of goods sold	(22,600)
Gross profit	28,800
Operating expenses (itemized on the statement)	(17,300)
Operating income	11,500
Interest expense	(900)
Net income	**10,600**

Expenses: commissions 5,200, van 6,400, depreciation 3,000, other 2,700. Gross margin **56.0%**.

Terms of trade

Term	Meaning
2/10, n/30	2% off if paid in 10 days; full amount due in 30
FOB shipping point	buyer owns the goods once shipped; buyer pays freight
FOB destination	seller owns them until delivered; seller pays freight
Sales discounts, returns and allowances	contra-revenue: subtract from sales to get **net sales**
Shrinkage	theft, damage, error: records − count

11 INVENTORY COSTING

Same goods, three answers

Method	Cost of goods sold	$	Ending inventory	Gross profit
FIFO	200 × 0.50 + 300 × 0.60 + 200 × 0.70	420	300 × 0.70 = 210	630
LIFO	500 × 0.70 + 200 × 0.60	470	100 × 0.60 + 200 × 0.50 = 160	580
Weighted average	700 × 0.63	441	300 × 0.63 = 189	609

Each method splits the same **630**: COGS + ending inventory = goods available. Weighted-average unit cost = 630 ÷ 1,000 = **$0.63**.

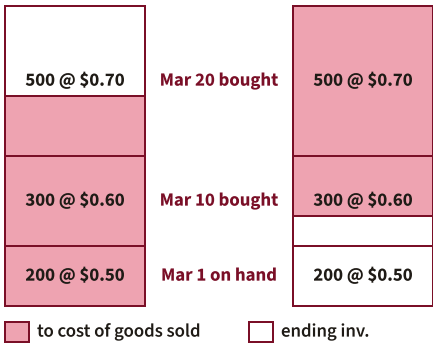
Hilltop Vending: one snack, March (periodic)

Layer	Units	Unit cost	Total
Mar 1 on hand	200	0.50	100
Mar 10 bought	300	0.60	180
Mar 20 bought	500	0.70	350
Goods available	**1,000**		**630**

Sold **700** units at $1.50 = **1,050** of sales.

When costs rise	FIFO	LIFO
COGS	lowest	highest
Net income, taxes	highest	lowest
Ending inventory	near current cost	old, low costs
Allowed	GAAP and IFRS	GAAP only; not IFRS

Weighted average falls between. Prices falling? The order flips.



FIFO sends the oldest layers to COGS; LIFO the newest.

⚠ Inventory errors

- Ending inventory **overstated** → COGS too low → net income **too high** this year and **too low** next year. The two offset, but both years are wrong.

More rules

- **Specific identification**: each unit's actual cost (cars, jewelry).
- **Consistency**: keep one method; disclose a change. **LIFO conformity**: LIFO for taxes means LIFO in the books.
- **Lower of cost and net realizable value** (FIFO, average): write inventory down when worth less than cost.
- Perpetual FIFO = periodic FIFO; perpetual LIFO and average can differ.

MEMORY TRICK

First in, first out the door

FIFO: the oldest snacks leave first, so the shelf holds the newest costs. **LIFO**: last in, first out; the oldest costs stay on the shelf.

12 CASH & RECEIVABLES

Bank reconciliation, March 31

Hilltop Vending	$		$
Bank side		**Book side**	
Balance per bank, Mar 31	3,420	Balance per books	3,813
+ Deposit in transit	860	+ Interest earned	5
− Outstanding check #211	(240)	− Service charge	(15)
− Outstanding check #214	(395)	− NSF check (host site)	(140)
		− Error: check #212 for 86 recorded as 68	(18)
Adjusted cash	**3,645**	**Adjusted cash**	**3,645**

Entries (book side only)	Debit	Credit
Cash	5	
Interest Revenue		5
Bank Service Charge Expense	15	
Cash		15
Accounts Receivable	140	
Cash		140
Repairs Expense	18	
Cash		18

Bank-side items need **no entry**: the bank will catch up. 86 − 68 = 18, a transposition (divisible by 9).

MEMORY TRICK

Who hasn't heard the news?

Deposits in transit and outstanding checks are news the **bank** hasn't heard. Fees, NSF checks and interest are news **you** hadn't heard: only these get entries.

Petty cash: replenish a $100 fund	Debit	Credit
Postage Expense	28	
Supplies Expense	41	
Delivery Expense	17	
Cash Short and Over	2	
Cash		88

Receipts 86; the box holds 12, not 14: **2 short**. A check for 88 refills it to **100**.

Internal control

- **Separate duties**: whoever handles cash does not record it or reconcile the bank; deposit daily.
- **Fraud triangle**: pressure, opportunity, excuse; controls remove the opportunity.
- "Providing for honest things, not only in the sight of the Lord, but also in the sight of men." (2 Corinthians 8:21, KJV)

Allowance method

Event	Entry	NRV
Estimate (aging)	Dr Bad Debt Expense 350; Cr Allowance 350	7,530
Write off a $90 account	Dr Allowance 90; Cr Accounts Receivable 90	7,530 (no change)
It pays after all	Dr AR 90; Cr Allowance 90; then Dr Cash 90; Cr AR 90	7,440 + cash 90

Aging schedule

Age (Bright Day, Dec 31)	Balance	Rate	Estimate
Not yet due	5,000	1%	50
1–30 days past due	1,800	5%	90
31–60 days	900	20%	180
Over 60 days	300	50%	150
Total	**8,000**		**470**

Need **470**; the allowance already has a 120 credit, so the entry is **350**.

Percent of sales computes the **expense**: credit sales 40,000 × 1% = **400**, whatever the balance

Aging computes the **ending allowance**; a debit balance first? add it: 470 + 60 = **530**

Net realizable value AR − allowance: 8,000 − 470 = **7,530**

Direct write-off expense only at write-off; not GAAP when bad debts are material

MEMORY TRICK

Write-off changes nothing

A write-off lowers **both** AR and the allowance: net realizable value and net income do not move. The expense came with the **estimate**.

13 PAYROLL BASICS

One week, one attendant WORKED

Regular: 40 × 16.00 = 640.00

Overtime: 6 × (16.00 × 1.5) = 144.00 *1½× over 40 hours*

Gross pay = 784.00

Social Security 6.2% = 48.61; Medicare 1.45% = 11.37 *withheld*

Income tax withheld (IRS and state tables) = 60.00 *given*

Net pay = 664.02 *take-home*

"for the labourer is worthy of his hire." (Luke 10:7, KJV)

Record the payroll	Debit	Credit
Wages Expense	784.00	
Social Security Tax Payable		48.61
Medicare Tax Payable		11.37
Income Taxes Payable		60.00
Cash (or Wages Payable)		664.02

Who pays what

Tax (2026)	Worker	Employer	Wage cap
Social Security	6.2%	6.2%	$184,500
Medicare	1.45%*	1.45%	none
FUTA	—	0.6% net	$7,000
SUTA	—	by state	varies

*Plus 0.9% over $200,000. FUTA: 6.0% less up to 5.4% state credit. Rates change yearly.

Employer's payroll taxes	Debit	Credit
Payroll Tax Expense	85.85	
Social Security Tax Payable		48.61
Medicare Tax Payable		11.37
FUTA Tax Payable		4.70
SUTA Tax Payable		21.17

Employer **matches** FICA; FUTA 0.6% × 784 = 4.70; SUTA at a sample 2.7% = 21.17.

MEMORY TRICK

Three piles from one paycheck

Gross pay splits into what the worker **keeps**, what the government **gets** (a liability) and what the worker **chose** to save. Employer taxes sit on top.

14 LIABILITIES & OWNER'S EQUITY

Three forms of ownership

	Sole proprietorship	Partnership	Corporation
Owner's equity accounts	Capital	a Capital account per partner	Common Stock, Additional Paid-in Capital, Retained Earnings
Cash to owners	Drawing	Drawing (each partner)	Dividends, declared by the board
Statement	owner's equity	partners' equity	retained earnings
Owners' liability	unlimited	unlimited (general partners)	**limited** to the investment
Income tax	owner	partners	corporation, then stockholders on dividends

Notes and interest WORKED

30,000 × 6% × 1/12 = **150** a month *I = P × r × t*

90-day note: 4,000 × 9% × 90/360 = **90**

360-day year

Repay: Dr Notes Payable 4,000; Dr Interest Expense 90; Cr Cash 4,090

Issue stock; pay a dividend WORKED

1,000 shares, $1 par, at $12: Dr Cash 12,000; Cr Common Stock **1,000**; Cr Paid-in Capital **11,000**

Declare $0.50 a share: Dr Retained Earnings 500; Cr Dividends Payable 500

record date: no entry

Pay: Dr Dividends Payable 500; Cr Cash 500

Bonds, simply WORKED

10-year, 100,000 face, 5%, paid semiannually

Cash interest = 100,000 × 5% × ½ = **2,500**

Sold at 98 (market rate above 5%): discount 2,000 ÷ 20 = 100

straight-line

Interest expense = 2,500 + 100 = **2,600**

Current due within a year: payables, unearned revenue, current part of long-term debt

Long-term notes, mortgages, bonds, most leases over 12 months

Contingent record if **probable** and **estimable**; else disclose if reasonably possible

Retained earnings

4,000 + 3,200 − 500 = **6,700**. Retained earnings are **not cash**.

Beginning RE + Net income − Dividends

Splitting partnership income WORKED

Net income 30,000; salaries A 10,000, B 8,000

5% on capital: A 1,000; B 500

Remainder 10,500 split equally: 5,250 each

A 16,250; B 13,750 *total 30,000*

"Owe no man any thing, but to love one another" (Romans 13:8, KJV)

15 COMMON ERRORS & FIXES

Ten common slips

Slip	Right way
Withdrawal recorded as an expense	Dr Drawing; it never touches the income statement
Owner investment recorded as revenue	Cr Capital
Depreciating land	land is never depreciated
Crediting Equipment for depreciation	credit **Accumulated Depreciation**
Cash in an adjusting entry	adjustments never touch Cash
Supplies expense = supplies on hand	expense = supplies **used**
Paying a bill on account as an expense	Dr Accounts Payable; the expense was recorded with the bill
Balance sheet dated "For the year ended"	one date: "December 31, 2026"
Outstanding checks on the book side	they go on the **bank** side
Debiting Bad Debt Expense at write-off (allowance method)	Dr Allowance; the expense came with the estimate

Finding the difference

Trial balance off by…	Look for
the amount of one entry	a posting left out, or one side not posted
twice an amount (÷ 2)	a debit posted as a credit, or the reverse
a multiple of 9 (÷ 9)	**transposition** (540 as 450: off by 90) or **slide** (1,250 as 125: off by 1,125)
a round 10, 100, 1,000	an addition error

"A false balance is abomination to the LORD: but a just weight is his delight." (Proverbs 11:1, KJV)

Correcting entry WORKED

Utility bill 1,100 was debited to Rent Expense

already posted

Dr Utilities Expense 1,100; Cr Rent Expense 1,100

move it

Never erase a posted entry: the correction leaves an **audit trail**

MEMORY TRICK

Balanced is not the same as right

A trial balance can balance with the wrong account, a missing entry or two offsetting errors. **Trace** the source document.

Check before you hand it in

- Every entry: debits = credits, with an explanation.
- Trial balance, adjusted trial balance and post-closing trial balance all balance.
- Net income on the income statement = the figure in the statement of owner's equity.
- Balance sheet balances; ending cash = cash-flow statement's ending cash.