AN INTRODUCTION TO ELEMENTARY ACCOUNTING

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BY

A. C. LITTLETON, A. M., C. P. A.
ASSOCIATE IN ACCOUNTANCY
UNIVERSITY OF ILLINOIS

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I

PURPOSE OF ACCOUNTING

We may study accounting intending to follow it as a profession or to use it as a stepping stone to other things in business, or we may study it in order as superintendents, managers, proprietors, to use intelligently the accounting results which others will furnish us. But whether we expect to "keep books" or to have them kept for us, it is highly necessary to understand thoroughly the language and methods of accounting.

Financial Condition. Accounting has for its principal aim the presentation of the vital facts concerning the *financial condition and progress of a business.* One of the most important documents containing vital business facts that is placed before the business executive or proprietor is the statement of his financial condition, called the Balance Sheet. Herein is a tabulation of all he possesses in the way of *business property* and of any *claims* there may be against that property.

If the proprietor owns all the property he holds, the statement is as follows:

BALANCE SHEET—H. R. WELLS

Property Possessed		Claims Against Property	
Cash	$ 7,000		
Land & Bldg.	9,000		
Furniture	800		
Delivery Car	1,500	H. R. Wells, Propr.	$18,300
	$18,300		$18,300

If, however, Mr. Wells holds an automobile delivery car worth $1,500, but has paid only $1,000 on it, some one else (the seller) has a legal claim against the car until the $500 is paid as well. Indeed, the seller would have a claim against any or all of the property up to the amount of the unpaid debt. In order to present the true condition under these circumstances, the statement will have to be as follows:

BALANCE SHEET—H. R. WELLS

Property		Claims	
Cash	$ 7,000	Blank Auto Co.	$ 500
Land & Bldg.	9,000		
Furniture	800		
Delivery Car	1,500	H. R. Wells, Propr.	17,800
	$18,300		$18,300

The above statement clearly shows that the proprietor claims whatever portion of the property is ***not claimed*** by outsiders. In fact, one of the great services of this statement of financial condition is to show the value of the proprietor's interest in the property. This value (often called Present Worth or Net Worth) is the difference between the total property and the total of claims by persons *outside* the business. It is to be noted as a result of this principle that the total of the claims column in the Balance Sheet will always be equal to the total of the property column.

Business on Credit. We have seen that the unpaid portion of the automobile's purchase price constitutes a debt to be paid later, and gives the seller, who trusted Mr. Wells, a claim against the latter's property until the obligation is discharged by payment. We must see, also, that Mr. Wells may sell as well as buy on credit (i. e., on trust). Assuming that he has done so, and that certain persons owe him $2,200 for goods sold them, then the Balance Sheet would be as follows:

BALANCE SHEET—H. R. WELLS

Property		Claims	
Cash	$ 7,000	Debts Payable	$ 500
Debts Receivable	2,200		
Land & Bldg.	9,000		
Furniture	800		
Delivery Car	1,500	H. R. Wells, Propr.	20,000
	$20,500		$20,500

Two points are to be noticed in this last statement. Under the new conditions, there was total property of $20,500, and there were claims by outsiders of $500, leaving $20,000 as the Present Worth of the business. Then there is introduced the terms Debts Receivable and Debts Payable.* They are easily explained. If we sell on credit, the transaction gives rise to a debt which is *receivable* by us in cash at some later date; if we buy on credit, the transaction gives rise to a debt *payable* by us at some later date.

The fact that Mr. Wells owes for part of his delivery car leads to the suggestion that the statement would be more interesting to the proprietor if the names of the people owed were shown. It is important that he know to whom he owes money, as well as to know the total amount; it is equally important to know from whom to expect payments, as well as to know the total owed to him. Another revision will therefore be made in the Balance Sheet:

BALANCE SHEET—H. R. WELLS

Property			Claims	
Cash		$ 7,000	Debts Payable:	
Debts Receivable:			Blank Auto Co............$	500
M. Y. Jones.......$1,700				
P. J. Frank........	500	2,200		
Land & Bldgs........		9,000		
Furniture		800		
Delivery Car.........		1,500	H. R. Wells, Propr...........	20,000
		$20,500		$20,500

Use of the Balance Sheet. With this statement before him, the Proprietor can view his business in perspective, so to speak. He can see how his property is divided between Cash, Debts, Land, Furniture, etc.; how outsiders have claims against a part of his property; how much property is free from outside claims, and therefore is his own. Because this statement shows the business man just *how he stands financially,* it is regarded as a very important document. Without knowing periodically just how he stands, the business man runs grave risks in undertaking large purchases or in incurring large debts. Should he buy beyond his ability to pay he would soon fail in business. He would be wise to look over his statement before buying heavily, and consider the debts he already has, and the extent of the property at hand that could be used in paying them or any new ones.

Profit and Loss. There is another statement the business man likes to have presented periodically; one that permits him to see the Profits or the Losses the business has experienced.

*The terms here used will be replaced at the proper time by a more technical phraseology.

Profit comes to the merchant in buying at one price and selling at a higher. The man who deals in large ventures, like buying and selling residence and business real estate, may calculate his profits on each transaction. His statement of profits and losses might be as follows:

Sold 5th Street Property for	$10,000	
Fifth Street Property cost	7,000	
Profit		$3,000
Sold 7th Street Property for	8,000	
Seventh Street Property cost	6,000	
Profit		2,000
Total Profits		$5,000

But the retail merchant selling clothing, groceries, or hardware can not follow the real estate man's example. The retailer buys many small and different articles, and sells them, generally, one by one. He can not hope to keep records so that he could calculate the profit on each separate article sold. So his Profit and Loss Statement must consist of totals instead of details. If, in a given period, he sells goods to the total value (at selling price) of, say, $7,000, and finds that these goods cost $4,000 when purchased, there is a difference of $3,000, which is profit. In statement form the facts would be arranged thus:

STATEMENT OF PROFIT AND LOSS

Total Sales	$7,000
Total Cost of Purchases*	4,000
Difference, Profit	$3,000

Stated in another way, Profit is the portion of the sales price remaining after the purchase cost has been recovered. When some one buys of us $7,000 worth of merchandise, he is *repaying* us what we paid for the articles and *something more*—a profit for the service we render him in supplying the goods.

Expense. If the proprietor employs a clerk to wait upon customers, the selling price of goods must be sufficient to repay the proprietor not only the cost of the goods themselves, but the clerk's

*The assumption is here made that all of the goods bought have been sold; later the case will be considered in which all of the purchases are not sold.

wages also, before there can be any profit. Rent of store would be like wages in this respect. The proprietor pays Rent and Wages, perhaps, before any sale is made. He must get back *from the customers* enough to reimburse him for these payments before the business can be said to yield him any profit.

When a business man buys goods to sell, and pays wages, rent, etc., he pays out money which he expects later to recover through selling goods to customers. In making these payments he is not buying permanent things like buildings or land, which last many years. He is, in a way, only putting his money into goods, rent, etc., temporarily; he soon gets it back. Such payments may be called by the distinctive title of "Recoverable Outlays", i. e., money "laid out" or paid out to be recovered later.

We have to note two classes of Recoverable Outlays, namely, Purchases and Expenses. By Purchases we understand, "purchases of merchandise to be resold." If a delivery car were bought, it could not properly be classed as "Purchases". Although it was purchased (bought), it is for *use* and not for sale. To a dealer in automobiles, however, it might well enough be classed as "Purchases", for in that case it would be an article in his stock in trade, bought for the express purpose of resale.

By Expenses we understand payments made for *services* (as of clerks, buildings, light plants, lawyers, telephones), and for *articles consumed* in operating the business (as paper, coal, gasoline).

The cost of both classes of outlay must be recovered before there can be any profit for the proprietor, and the only source from which the costs can be recovered is sales. So, in arranging the facts to form a Statement of Profit and Loss, one begins with the Sales and deducts, first, the Purchases, to show that outlay recovered, and then, from the remainder, deducts the Expenses, to show those outlays also recovered. When all Recoverable Outlays have been deducted, there remains the proprietor's profit. Accordingly the Statement takes this form:

STATEMENT OF PROFIT AND LOSS—H. R. WELLS

Sales	$ 7,000
Purchases	4,000
Gross Profit	3,000
Expenses	800
Net Profit	2,200

Note the terms used in the above statement. Gross Profit means,