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Classification and definitions of ledger accounts

Boston Chamber of Commerce. Bureau of Commercial and Industrial Affairs. Committee on Industrial Accounting and Executive Reports

CLASSIFICATION AND DEFINITIONS OF LEDGER ACCOUNTS

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PREFACE

The classification of ledger accounts appearing on the following pages is not intended to fit the accounts of any one particular firm, or, in fact, of any one industry. It is at best only a broad treatment of representative accounts used in manufacturing industries. Likewise, the definitions are not intended to apply specifically to accounts found in any one ledger, but are intended to point out the particular group in which any account would fall. In using this classification, it should be remembered that the individual accounts will have to be set up according to the needs of each different business. With the foregoing in mind, it is hoped that this treatment of ledger accounts will meet the general interest of those who are anxious to standardize this phase of accounting practice.

The Committee on Industrial Accounting and Executive Reports acknowledges the valuable services rendered by Mr. F. R. Carnegie Steel of Boston in reading and criticizing the manuscript of this report.

Classification and Definitions of Ledger Accounts

"Classification and Definitions of Ledger Accounts" is supplementary to a report on Balance Sheets and Profit and Loss Statements also issued by the Bureau of Commercial and Industrial Affairs of the Boston Chamber of Commerce. Both these reports were prepared by the Chamber's Committee on Industrial Accounting and Executive Reports, the personnel of which appears on a preceding page.

I.—Assets and Deductions from Assets

A. Current Assets.

1. Cash
   - (a) Petty Cash
   - (b) Cash on Hand
   - (c) Demand Deposits in Banks
     1. Domestic
     2. Foreign
2. Liquid Investments
   - (a) Time Deposits
   - (b) Certificates of Deposit
   - (c) Negotiable Stocks
   - (d) Negotiable Bonds
3. Receivables
   - (a) Accounts Receivable
     1. Customers
     2. Sundry Debtors
   - (b) Amounts due from parent, subsidiary or affiliated companies. (As a bona-fide receivable, this item is subject to qualifications — see definition of terms, page 14).
   - (c) Personal Accounts
     1. Officers
     2. Partners
     3. Employes

(d) Notes Receivable
  1. Customers
  2. Sundry Debtors

(e) Inter-Company Notes Receivable
  (These are subject to same qualification referred to under (3b) above)

(f) Personal Notes Receivable
  1. Officers
  2. Partners
  3. Employes

(g) Acceptances
  1. Trade
  2. Bank

4. Inventories

(a) Raw Material

(b) Supplies
  1. Factory
  2. Commercial

(c) Work in Process
  1. Stock
  2. Special Order

(d) Finished Product
  1. Stock
  2. Special Order

(e) Purchases for Resale

(f) Perishable Equipment

B. Fixed Assets

1. Real Estate

(a) Operating
  1. Land
  2. Land Improvements
  3. Buildings
    (a) Buildings Proper
    (b) Plumbing and Sanitary Fixtures
    (c) Heating and Ventilating Equipment
    (d) Wiring and Piping

(b) Non-Operating
  1. Tenements
  2. Club Houses
  3. Parks and Recreation Grounds
  4. Miscellaneous

2. Power Equipment
    (a) Plant
    (b) Transmission
3. Machinery
4. Tools
    (a) Machine
    (b) Hand
5. Transportation Equipment
6. Furniture
    (a) Plant
    (b) Office
7. Non-Operating Equipment
    (a) Equipment of Tenements and Club Houses
    (b) Lunch Room and Hospital Equipment
    (c) Miscellaneous Non-Operating Equipment
8. Other Tangible Property
    (a) Patterns
    (b) Drawings
    (c) Miscellaneous
9. Miscellaneous Equipment

C. SECURITIES

(a) For Investment
    1. Bonds
    2. Stocks
    3. Leases
    4. Mortgages
(b) For Control
    1. Stocks
    2. Subsidiary Securities

D. INTANGIBLE ASSETS

1. Patents
2. Trade Marks
3. Good Will

E. MISCELLANEOUS ASSETS AND DEFERRED ACCOUNTS

1. Deferred Charges to Operations
    (a) Unexpired Insurance
    (b) Prepaid Rent
    (c) Prepaid Interest
    (d) Other Prepaid Accounts

2. Cash Value of Life Insurance (see definition on page 19)
3. Accrued Earnings
   - (a) Interest Receivable
   - (b) Rent Receivable
4. Claims Receivable
   - (a) Insurance
   - (b) Damages
5. Organization Expenses
6. Capital Deficit (Deductions from Net Worth)

F. Allowances for Depreciation of Fixed and Real Assets

1. Depreciation (deductions from corresponding assets)
   - (a) Buildings
     1. Buildings Proper
     2. Plumbing and Sanitary Fixtures
     3. Heating and Ventilating Equipment
     4. Wiring and Piping
   - (b) Non-Operating Property
     1. Tenements
     2. Club Houses
     3. Parks
     4. Miscellaneous
   - (c) Power Equipment
     1. Plant
     2. Transmission
   - (d) Machinery
   - (e) Tools
     1. Machine
     2. Hand
   - (f) Transportation Equipment
   - (g) Furniture
     1. Plant
     2. Office
   - (h) Non-Operating Equipment
     1. Equipment of Tenements and Club Houses
     2. Lunch Rooms and Hospital Equipment
     3. Miscellaneous Non-Operating Equipment
   - (i) Other Tangible Property
     1. Patterns
     2. Drawings
     3. Miscellaneous
   - (j) Miscellaneous Equipment
2. Miscellaneous Allowances affecting other Assets

II.—Liabilities

A. CURRENT LIABILITIES

1. Accounts Payable
2. Notes Payable
3. Dividends Payable
4. Interest Payable
5. Other Payables
6. Accrued Expenses
   - (a) Wages
   - (b) Taxes
   - (c) Insurance
   - (d) Interest
   - (e) Rent
   - (f) Others

B. FUNDED LIABILITIES

1. Long-time Notes
   - (a) Secured
   - (b) Unsecured
2. Mortgages Payable
3. Bonds
4. Debentures

C. CAPITAL LIABILITIES

1. Stock
   - (a) Par
     1. Preferred
     2. Common
   - (b) No-par
   - (c) Premium Surplus and (or) Capital Surplus
2. Surplus
   - (a) General
3. Undivided Profits

D. RESERVES TO MEET EXPECTED LOSSES OR EXPECTED LIABILITIES

1. Bad Debts
2. Claims
3. Taxes
4. Interest
5. Foreign Deposits
6. Losses in Inventory
7. Miscellaneous

E. Treasury Stock
   1. Preferred
   2. Common

F. Sinking Fund Investments and Debits to Funded Debt
   1. Pledged Assets
   2. Miscellaneous

G. Contingent Liabilities
   1. Purchase Commitments
   2. Accounts Receivable Discounted
   3. Notes Receivable Discounted
   4. Guaranteed Bonds and Notes of Subsidiaries

III.—Profit and Loss

A. Sales
   1. Gross Sales
   2. Returns
   3. Rebates
      (a) Shortages
      (b) Damages
      (c) Factory Errors
      (d) Commercial Office Errors
      (e) Salesmen's Errors
      (f) Transportation Claims
      (g) Policy Allowances (Customers' Errors)
      (h) Miscellaneous Reasons
   4. Collected Discounts
   5. Transportation Deductions
      (a) F. O. B. Allowances
      (b) Miscellaneous Allowances
      (c) Prepaid Charges (Deductions from Sales)
         1. Freight
         2. Express
         3. Miscellaneous

B. Cost of Goods Sold
   1. Processed Products
      (a) When cost of product is determined by dependable cost system:

1. Having a Controlled Operating Ledger
2. Having the Accounts Carried in the General Ledger

(b) When Cost is Determined by the Inventory Plan

2. Purchases for Resale

C. Selling Expenses

Use Either One

1. First Alternative (Expense Classification)
   (a) Salaries
      1. Officers and Department Heads
      2. Selling Force
      3. Engineering and Drafting Force
      4. Clerical Force
      5. Other Employees
   (b) Rent, Light, Heat and Power
   (c) Office Equipment, Alterations, Repairs and Replacements
   (d) Traveling and Entertainment Expenses
   (e) Telephone and Telegraph Expenses
   (f) Postage
   (g) Stationery and Office Supplies
   (h) Advertising
   (i) Miscellaneous Expense Accounts
2. Second Alternative (Responsibility Classification)
   (a) By Functions
   (b) By Location
   (c) By Products

D. Other Income

1. Income from Investments
2. Income from Outside Buildings, Tenements, and Miscellaneous Properties
3. Interest from Notes Receivable
4. Income from Miscellaneous Sources

E. Charges to Other Income

1. Taxes, Maintenance and Depreciation of Outside Buildings, Tenements, and Miscellaneous Properties
2. Collection Charges
3. Miscellaneous Charges

F. General Expenses

1. Administrative Expenses not Previously Apportioned
2. Interest Paid and Accrued
    - (a) Interest on Funded Debt
    - (b) Interest on Other Obligations
3. Neglected Discounts
4. Losses on Bad Debts
5. Miscellaneous Expenses

G. Loss and Gain

1. Adjustment Accounts
    - (a) Inventory Adjustment Accounts
    - (b) Idleness Accounts
    - (c) Miscellaneous Adjustment Accounts
2. Income Taxes
3. Profit and Loss Account
    - (a) Monthly Profit and Loss Account
    - (b) Cumulative Profit and Loss Account (for the year only)

DEFINITIONS OF TERMS

I.—Assets and Deductions from Assets

Assets, as used in accounting practice, represent property capable of being applied to the payment of the obligations of a firm, or are of value in carrying on the business as a going concern.

A. CURRENT ASSETS comprise cash and those assets which can be converted into cash within a short period in the ordinary course of business. All assets subject to liens or preferences should be so stated.

1. *Cash* represents currency on hand, together with demand bank deposits.
   - (a) *Petty Cash* is a small sum of money kept on hand to pay minor expenses.
   - (b) *Cash on Hand* is currency or negotiable instruments payable on demand, in readiness for immediate deposit in banks in the ordinary course of business.
   - (c) *Demand Deposits in Banks* are those funds upon which checks may be drawn at any time.
     1. *Domestic* is a generic term for demand deposits in this country.
     2. *Foreign* is a generic term for demand deposits in foreign countries expressed in United States currency at a given rate of exchange.
2. *Liquid Investments* are those investments which may usually be turned into cash within a few days.
   - (a) *Time Deposits* are those deposits in banks upon which interest is being drawn and which may require an advance notice of withdrawal.
   - (b) *Certificates of Deposit* are special forms of time deposits.
   - (c) *Negotiable Stocks* are those stocks which may be sold readily without sacrifice.
   - (d) *Negotiable Bonds* are those bonds which may be sold readily without sacrifice.
3. *Receivables*—A term which represents all rights to receive cash except rights in bonds and similar funded items. Reserves for bad and doubtful items, discounts, allowances, etc., should be deducted. All receivables subject to liens or preferences should be separately stated.

(a) *Accounts Receivable* arising in the ordinary course of the businesss include the amounts due from:

1. Customers.
2. Sundry Debtors.

(b) *Amounts Due from Parent, Subsidiary, or Affiliated Companies* are receivable when the payment of the amounts due is intended. These items under any conditions should not be included with receivables defined under (a) above, but should be separately stated.

(c) *Personal Accounts,* which should be separately stated, represent temporary loans or advances to:

1. Officers.
2. Partners.
3. Employes.

(d) *Notes Receivable* arising in the ordinary course of the business include notes given by:

1. Customers.
2. Sundry Debtors.

(e) *Inter-Company Notes Receivable,* which are notes due from parent, subsidiary, or affiliated companies, should not be included with receivables defined under (d) above, but should be separately stated.

(f) *Personal Notes Receivable,* which should be separately stated, represent temporary loans or advances to:

1. Officers.
2. Partners.
3. Employes.

(g) *Acceptances*—Used here as a heading for the following:

1. *Trade Acceptance*—A draft drawn by the seller on the buyer acknowledging a debt for value, having a definite maturity, and payable in dollars in the United States without qualifications, and signed by the buyer across the face. It differs from an open account only in having a negotiable value to the seller.
2. *Bank Acceptances* may be defined as "drafts or bills of exchange, the acceptor of which is a bank or trust company or firm, person or corporation or company engaged in the business of granting bankers' acceptances or credit."

4. *Inventories* as used here include all classes of trading goods such as raw material, supplies, work-in-process, and finished product. Merchandise ordered and delivered the title to which has passed to the buyer should be also included as inventory, and if not invoiced the liability therefor brought into the accounts. Any part of the inventories subject to liens or preferences should be duly noted.

   (a) *Raw Materials* are those portions of the inventory which have been secured to enter into the manufacture and assembly of the finished product.

   (b) *Supplies*—Here used as a heading for the following:
      1. *Factory Supplies* are those materials used in the factory which cannot be allocated directly to the product.
      2. *Commercial Supplies* are those used in the commercial end of the business.

   (c) *Work in Process* represents all materials in the process of manufacture which have not been turned into finished goods.
      1. *Stock* (work in process) is that portion of unfinished goods intended for storage until orders are received.
      2. *Special Order* (work in process) is that portion of unfinished goods which is being made up especially for customers. It may be either a standard or special line.

   (d) *Finished Product* may be defined as the material which has been completed and is ready for sale or shipment.
      1. *Stock* (finished product) is that portion of finished goods in storage or ready for storage.
      2. *Special Order* (finished product) represents goods ready for shipment to special order customers.

   (e) *Purchases for Re-Sale* represent finished merchandise which has been bought to complete a line or to be used as a side line.

   (f) *Perishable Equipment* includes such machine parts or equipment as are prorated to the product, but are carried in this equipment account until charged off.

B. FIXED ASSETS—A term taken to include all holdings of real property, buildings, and equipment; all such assets subject to mortgages or liens should be so stated.

1. *Real Estate* includes land, buildings, and all other property attached to the land.
   - (a) *Operating* is the heading which is used to include all real estate which is used in the plant proper for industrial purposes.
     1. *Land*—This title needs no explanation.
     2. *Land Improvements*—Used to include all improvements to the original plot of land, such as sidewalks, trees, etc.
     3. *Buildings* may be one single account, or may be the general heading for the following accounts:
        - (a) *Buildings Proper*—This account would be used for the buildings without any of of the following fixtures or equipment: Plumbing and Sanitary Fixtures, Heating and Ventilating Equipment, and Wiring and Piping.
        - (b) *Plumbing and Sanitary Fixtures* hardly need an explanation.
        - (c) *Heating and Ventilating Equipment* — This title is self-explanatory.
        - (d) *Wiring and Piping*—The name of another account which does not require a definition.
   - (b) *Non-Operating Property* is used here to include the real estate which is not used directly for industrial purposes, such as:
     1. Tenements.
     2. Club Houses.
     3. Parks and Recreation Grounds.
     4. Miscellaneous.
2. *Power Equipment* would include the following:
   - (a) *Equipment* such as the machinery and appurtenances used in power generation.
   - (b) *Transmission* equipment consists of transmitting lines and other gear used in carrying the power to the point at which it is utilized.
3. *Machinery* is an account embracing such engines, lathes, presses, and other fixed equipment used in production.

4. *Tools* are here divided into two classes:
   (a) *Machine* tools are those cutting or shaping parts of a machine which wear out quickly, such as shears, bits, and dies. (It is sometimes preferable to include Machine Tools under Machinery.)
   (b) *Hand* tools include such implements as hammers, saws, planes, etc., used to facilitate mechanical operations.

5. *Transportation Equipment* is used here to classify all carrying agents such as trucks, wagons, boats, railroads, and conveyors.

6. *Furniture* consists of the following divisions:
   (a) *Plant* furniture is an account representing the desks, chairs, typewriters, and other plant office furnishings.
   (b) *Office* furniture includes the same items used in the general office.

7. *Non-Operating Equipment* is that equipment which is for use in connection with the non-operating real estate, and will consist of:
   (a) *Equipment of Tenements and Club Houses.*
   (b) *Lunch Room and Hospital Equipment.*
   (c) *Miscellaneous Non-Operating Equipment.*

8. *Other Tangible Property.*
   (a) *Patterns* and *Drawings* are assets which will continue valuable during the life of the business. Their value should be adjusted for wear and tear or for other forms of depreciation arising from operations.
   (b) *Miscellaneous Tangible Property* is included here to provide for those assets that cannot be grouped under the above headings.

9. *Miscellaneous Equipment* is included here to provide for any omissions that cannot be grouped under some of the above headings or accounts.

C. SECURITIES—As used here a heading for two groups of accounts: first, Investments which are intended to be permanent, but which cannot be classed as physical property, and second, such items as are of value to the going concern, but otherwise of doubtful value. Under the first group will be found the following:

(a) *For Investment,* consisting of:
  1. *Bonds,* which are interest bearing certificates, issued by a government or corporation. Corporation bonds, except Debentures, are usually secured by a mortgage.
  2. *Stocks* here represent capital ownership in other companies.
  3. *Leases* as here used mean the right to use property for a definite or determinable period.
  4. *Mortgages* are conveyances of property, under condition, as security of a debt or the performance of a duty, and to become void upon payment or performance.

(b) *For Control,* consisting of:
  1. *Stocks,* which are capital ownership in other companies for governing purposes.
  2. *Subsidiary Securities* here represent investments in subordinate companies for controlling purposes.

Under *Intangible Assets* will be found such accounts as the following:

D. INTANGIBLE ASSETS.

1. *Patents*—These give the owner the right to use an invention to the exclusion of all others for a definite or determinable period.
2. *Trade Marks* are a peculiar device or symbol used to designate a company's goods. The symbol when well established will carry with it a certain prestige that represents value to the company.
3. *Good Will* here denotes the value attached to the name of a concern or its products which can be expected to attract business.

E. MISCELLANEOUS ASSETS AND DEFERRED ACCOUNTS—A term used in this classification to include the following various headings and accounts:

1. *Deferred Charges to Operations* represent such prepaid expenses as:
   (a) *Unexpired Insurance* is the amount of the unexpired insurance premiums paid, but chargeable to the succeeding accounting period or periods.
   (b) *Prepaid Rent* is the amount of rent paid, but chargeable to the succeeding accounting period or periods.

(c) *Prepaid Interest* is interest paid in advance.
(d) *Other Prepaid Accounts* are such accounts as wages paid in advance to employes, salesmen's traveling expenses, etc.

2. *Cash Value of Life Insurance* is the sum that can be realized by surrendering the policy or policies. (If advantage is to be taken of the surrender feature of the policy, it should be grouped with current assets.)
3. *Accrued Earnings*—A term used to include those accrued accounts which have not been paid at the time of making up a financial statement.
   (a) *Interest Receivable* is the amount of interest accrued on notes, bonds, etc., which will be paid at the due date.
   (b) *Rent Receivable* includes rentals which have been earned and which will ordinarily be paid in full at the regular collection date.
4. *Claims Receivable* represent title to certain values which have not yet been received. They include:
   (a) *Insurance* under the heading of claims; this is intended to mean insurance collectible where the only question is at most a matter of time.
   (b) *Damages,* as here used, is the right to receive remuneration for injuries. All claims, however, should be conservatively valued or provided for in a corresponding reserve.
5. *Organization Expenses*—That part of the organization outlay which is still of value to the concern. It should, however, be written off as the value diminishes. It has no value as an asset from a financial point of view.
6. *Capital Deficit:* When shown on the asset side of the balance sheet, means that the original investment of the proprietor or stockholders in the business has decreased in value to the amount of the deficit. This item is preferably shown as a deduction from the proprietor's interest in arriving at the net worth of the business.

F. ALLOWANCES FOR DEPRECIATION OF FIXED AND REAL ASSETS are accounts representing deductions from corresponding assets. These accounts are set up in cases where it is the policy of the company to preserve the original asset figures. In the financial statements the amount of these allowance accounts appears as deducted from their corresponding asset accounts. As here used, these accounts are for depreciation, and consist of the following:

1. *Depreciation* of
    - (a) *Buildings.*
        1. *Buildings Proper.*
        2. *Plumbing and Sanitary Fixtures.*
        3. *Heating and Ventilating Equipment.*
        4. *Wiring and Piping.*
    - (b) *Non-Operating Equipment.*
        1. *Tenements.*
        2. *Club Houses.*
        3. *Parks.*
        4. *Miscellaneous.*
    - (c) *Power Equipment.*
        1. *Plant.*
        2. *Transmission.*
    - (d) *Machinery.*
    - (e) *Tools.*
        1. *Machine.*
        2. *Hand.*
    - (f) *Transportation Equipment.*
    - (g) *Furniture.*
        1. *Plant.*
        2. *Office.*
    - (h) *Non-Operating Equipment.*
        1. *Equipment of Tenement and Club Houses.*
        2. *Lunch Room and Hospital Equipment.*
        3. *Miscellaneous Non-Operating Equipment.*
    - (i) *Other Tangible Property.*
        1. *Patterns*
        2. *Drawings.*
        3. *Miscellaneous.*
    - (j) *Miscellaneous Equipment.*

2. *Miscellaneous Allowances Affecting Other Assets*—Intended here to provide a place for any other allowances that may seem desirable. An allowance that might come under this heading is one for the difference in the value of foreign deposits, but it is believed that a better policy would be to write off this account or increase it as the occasion demanded.

II.—Liabilities

Liabilities, as the term is used in accounting terminology, include all claims against the assets of a business.

A. CURRENT LIABILITIES are short-time or current obligations of an enterprise, maturing within the current fiscal period, if not at once. These liabilities are those for which funds must be immediately available for their liquidation at the time of maturity.

1. *Accounts Payable* include liabilities for machinery, equipment, merchandise, raw materials, factory and office supplies, etc. In a more restricted sense, the term is used to represent only unpaid invoices for merchandise purposes. In reality, however, it includes also the aggregate of unsettled credits for purchases of merchandise, materials, supplies, and other articles whether they are to be sold in their present form or used in the manufacture of other articles.

2. *Notes Payable* are promises to pay in the form of drafts or ordinary promissory notes due on demand or at some future date. They are usually given in the ordinary course of the business for machinery, equipment, merchandise, materials, supplies, etc., or other articles purchased for use in the business. The term, however, should also include all similar notes payable negotiated by branches or agents, acting for the concern or corporation; and also for money borrowed from banks, bankers, or from other persons or corporations for use in the business or for other purposes.

3. *Dividends Payable*—The title for a liability account created through the declaration of a dividend and ranking with other liabilities, viz., the assets of the corporation are applicable to dividend liability to its stockholders equally with liabilities to outside creditors. Where there is more than one class of stock outstanding, it is advisable to keep separate accounts for each class.

4. *Interest Payable* is a charge which must be paid by the borrower for that which he borrows. The charge is a price or rate premium per unit of time which is known as the interest rate.

5. *Other Payables* may represent any liabilities which cannot be grouped under any of the above mentioned headings or accounts.

6. *Accrued Expenses* are charges whose value has been utilized in advance of the time for actual payment of the particular items. These expenses consist of the following:

   (a) *Wages*, by which is meant that part of the payroll which has accumulated, but has not been paid at the time of making a financial statement.

   (b) *Taxes*, although they must be paid at a stated time, should be, and usually are, shown as accruals when a statement is made of assets and liabilities.

   (c) *Insurance*, although not usually allowed to accumulate in advance of payment, is included here to provide for cases where this accrued liability is placed on the books. Such an example might be an arbitrary amount for compensation insurance, the exact amount of which is not known until the payroll is made up.

   (d) *Interest* here includes the amount of interest accrued at the time of the financial statement, and which will not have to be paid until some later time.

   (e) *Rent* here means the amount accumulated against this account since the last payment of this item.

   (f) *Other* accrued expenses may be telephone charges or any account not coming under one of the above groups.

B. Funded Liabilities are here used to include those obligations the payment of which is ordinarily considered to be in the somewhat distant future—at least a year or longer time will elapse before such payments are due.

1. *Long Time Notes* are created when a company or firm issues a promise to pay, either for goods or to secure a loan.

   (a) *Secured* notes are those for which some specific property is pledged for the payment at maturity.

   (b) *Unsecured* notes are those which have no property pledged as security for payment. These notes, in cases of insolvency, will not be paid until all secured liability claims have been satisfied.

2. *Mortgages Payable* represent notes secured by the pledge of the real estate, so that if a note is not paid the property may be taken and sold to supply the necessary amount for payment.

3. *Bonds* are used here to include certain types of obligations issued by corporations and not usually by private proprietorship. They are virtually only promissory notes running for a long term, but commonly having mortgage features attached.

4. *Debentures* represent money borrowed on the security of a trustee deed, sometimes called a covering deed, by which the property of the company is vested in the trustees. It is an English form of security. All liabilities, whether current or funded that are secured by a lien or preference, should be so stated.

C. CAPITAL LIABILITIES are obligations to the proprietor or stockholders, and represent ownership. They may have originated as investments in the business, or as profits held in the operation of the business.

1. *Stock* is intended to mean the face value of all outstanding stock certificates, which are held by individuals known as stockholders. (If the face value of all authorized stock is shown on the books and on the balance sheet, and it is not the same as the amount outstanding, there should appear as a deduction from the authorized stock shown on balance sheet an item for "Unissued Stock" or "Treasury Stock." "Treasury Stock" differs from "Unissued Stock" in that the former represents stock actually issued by a corporation and subsequently acquired by it, whereas "Unissued Stock" is stock that has never been issued by the corporation.)

   (a) *Par* represents all capital stock which has a definite face value.

      1. *Preferred* stock represents all stock which usually has first claim to dividends and assets up to a certain definite percentage. This stock usually has preference over common in the distribution of assets in case of dissolution.

      2. *Common* stock represents a proprietary interest to assets after claims of creditors, bondholders, and preferred stockholders are satisfied. Dividends should be declared on this stock only in case the profits for the fiscal period are sufficient to meet the dividend requirements of preferred stock, and to provide a liberal surplus.

(b) No-par stock is all stock which does not have a face value; the owner of this class of stock certificates is a part owner in the enterprise, and is entitled to a certain proportion of its declared dividends, and also, in case of dissolution, to a certain proportion of net assets.

(c) *Premium Surplus*—"Stock subscribed for at a premium introduces a new element. Since the amount of stock issued is less than the amount to be paid, and the capital stock account should register only the face value of certificates issued, another credit must be found. As a matter of fact, this extra amount is as much capital investment as is the amount of par value paid: that is, if stock is issued at 110, the last ten dollars is as much investment of a stockholder as is the first one hundred, and it must be shown as investment. It is in no sense profit: it is no more profit than is the first ten dollars; it must be shown on the books, then, as capital. Since it cannot go to Capital Stock, it should go to Capital Surplus—or Premium Surplus. Since the latter term shows the exact origin of the surplus, it is preferable to the former. Good accounting requires that the amount shall remain permanently on the books as long as the business keeps its entity, for that amount of capital is to be accounted for. Even though there be operating losses, and hence accumulated deficits, these should not be allowed on the books to wipe out premium surpluses — or, rather, premium surpluses should not be used to wipe out operating losses."*

Capital Surplus which might properly be consolidated with premium surplus would arise from any write up in the book value of assets.

2. *Surplus* is used as a general heading for all accounts which represent the excess of net assets over the total face value of its shares.

(a) *General* surplus is an account which shows the value of the equity belonging to the stockholders over and above the par value of outstanding shares and Contingency Reserves.

*William Morse Cole, "Accounts—Their Construction and Interpretation," p. 342.

3. *Undivided Profits* is an account for the accumulation of profits, not yet distributed or allocated, but which may be disposed of at a later date.

D. RESERVES TO MEET EXPECTED LOSSES OR EXPECTED LIABILITIES are accounts arising from a charge to the profit and loss account of the current period. The reserves for losses should be deducted from the corresponding assets, and not shown on the liability side of the balance sheet.

1. *Bad Debts*—A reserve account for expected losses on outstanding debts due to the company.
2. *Claims*—A reserve account for Claims may be set up to provide for any losses in collecting the face value of outstanding claims.
3. *Taxes*—This reserve account would be established to provide for expected expenditures due to taxes.
4. *Interest Reserve*—An account for expected losses in collecting interest due the company.
5. *Foreign Deposits*—A reserve account for foreign deposits would be set up to provide for such losses as bank failure or other similar emergencies.
6. *Losses in Inventory* is a reserve account for anticipated reduction in the present market value of the inventories on hand.
7. *Miscellaneous* would include all other reserve accounts.

E. DEBITS TO CAPITALIZATION are subtractions from the authorized value of capital stock.

1. *Treasury Stock* account represents stock once issued and fully paid for, but now held in the treasury as an asset.

F. SINKING FUND INVESTMENTS AND DEBITS TO FUNDED DEBT—a general heading for all accounts having corresponding liabilities, and if specifically held for Sinking Fund purposes might properly be short-extended on the liability side of the balance sheet as a reduction from corresponding liabilities. On the other hand, it is proper to show them on the asset side of the balance sheet.

1. *Pledged Assets* represent pledges for payment of specific liabilities.
2. *Miscellaneous* represents all other accounts not listed under (F).

G. CONTINGENT LIABILITIES represent endorsements of the officers of a concern of guarantees or of unfilled contracts. In particular, a contingent liability is one that may become an actual, or direct, liability upon the happening of a certain event. The bank should be advised of the existence of the guarantee or any other liability dependent upon such contingencies.

1. *Purchase Commitments* are commitments of purchases ordered but not yet received.
2. *Accounts Receivable Discounted* represent contingent liabilities which would become real liabilities in case any of the accounts are defaulted.
3. *Notes Receivable Discounted*—This account does not need defining, since it is of the same nature as Accounts Receivable Discounted.
4. *Guaranteed Bonds and Notes of Subsidiaries*—Also self-explanatory.

III.—Profit and Loss

Profit and Loss, as used in this section of the classification of ledger accounts, is not any one particular account, but rather the general heading for all those accounts which measure increases or decreases in the value of the property held by a company.

A. Sales. This is not a ledger account in the sense that it is used in this classification, but the name for that sub-division of the classification which includes all accounts which are used in determining the net sales billed. In preparing the income sheet, all returns, rebates, collected discounts, and transportation deductions are subtracted from the gross sales account in order to obtain net sales billed.

1. *Gross Sales* billed represents the total invoice price of the company's sales minus all corrections for clerical errors.
2. *Returns*—The name for that account to which the value of all merchandise returned by customers is collected.
3. *Rebates*—The general heading for the following accounts:
   - (a) *Shortages*—An account for keeping all shortages reported by customers.
   - (b) *Damages*—An account for collecting all charges due to defects in the product caused by breakage or other injury which lessen the value of the merchandise to the customer.
   - (c) *Factory Errors*—An account for deductions from the customer's bill for all mistakes attributable to the factory.
   - (d) *Commercial Office Errors*—An account for all mistakes in the customer's order attributable to the commercial office.
   - (e) *Salesmen's Errors* — This account is for all errors made by the salesmen in transmitting a customer's order.
   - (f) *Transportation Claims*—An account for collecting all claims made by the customer in regard to transportation matters.
   - (g) *Policy Allowances* (*Customer's Errors*)—This account is used for those rebates which the company makes to customers for matters of policy. For instance, if a customer makes a claim which the company feels to be wrong, they will allow this claim in many cases in order to prevent antagonizing the customer.

(h) *Miscellaneous Reasons*—The rebate account to which all rebates not entered above are collected.

4. *Collected Discounts*—An account for all discounts neglected by the customer. "The proper treatment of these discounts, then, would shift the point of view commonly held. Since no one is absolutely sure, at the time a bill is sent out or received, whether the discount will be taken or not, the goods must be entered at full price. In any case, whether the discount will be taken or not, the amount should ultimately be reduced by the discount, for the billing price includes an item not properly called merchandise, as has been shown. The only question is concerning the account ultimately responsible or creditable. If the buyer takes the discount, the amount goes to his account on the seller's books and to the seller's account on the buyer's books; if he does not take it, the discount may be entered to Neglected Discounts on the buyer's books and to Collected Discounts on the seller's books."*
5. *Transportation Deductions*—This section of the classification includes all those accounts which collect the expenses to a product after it leaves the door of the seller.
   (a) *F. O. B. Allowances* are those allowances for freight which the buyer is permitted to deduct from the invoice price of his purchase.
   (b) *Miscellaneous Allowances* are deductions for duty, lighterage, local delivery, etc. These charges would be deducted from the customer's bill, in case it was the policy of the company to permit the above deductions by the buyer.
   (c) *Prepaid Charges* (*Deductions from Sales*) represents those charges for outward transportation and shipping expenses on merchandise which is delivered free to its destination.
      1. *Freight*—This account is self-explanatory.
      2. *Express*—An account which is also self-explanatory.
      3. *Miscellaneous* may include transfer, broker's and consular's fees and similar charges.

B. COST OF GOODS SOLD is a general heading for this section of the classification. The total cost up to the warehouse door of all products which have been sold is considered as the "Cost of Goods Sold."

*William Morse Cole, "Accounts—Their Construction and Interpretation," p. 402.

1. *Processed Products*—This title is not an account, but is used as a means of differentiating between products which are processed and those which have been purchased for re-sale.

   (a) *When Cost of Product is Determined by a Dependable Cost System*—There are two general methods for determining the Cost of Goods Sold: first, by having a dependable cost system (any cost system which is not dependable should not be used); and second, by the Inventory Plan, which is at the best only an estimate of the actual cost.

      1. *Having a Controlled Operating Ledger*—Under this plan, the cost of all goods sold is determined through a cost system which is built upon the principle of a controlling ledger. Direct labor, direct materials, and manufacturing overhead accounts are not listed here, since they would be controlled by the factory ledger.

      2. *Having Accounts Carried in the General Ledger*—This system of cost accounting is built on the principle of co-ordinate instead of control ledgers. Otherwise, the cost of the products is determined in a similar manner to the first system.

      NOTE: An inventory adjustment account for over and under charges should be included as part of the manufacturing overhead under both (a) (1) and (2), since this debit or credit logically belongs to the Cost of Goods Sold rather than to the Loss and Gain section. Idleness Adjustment may be included among the manufacturing overhead accounts, if it is the policy of the company to hold the sales department responsible for idleness in the factory. An Overtime Adjustment account may be included as a complement to Idleness Adjustment. This last account is not absolutely necessary, however, since it must be remembered that a credit balance in the Idleness account would indicate that the factory had been running overtime during the last fiscal period.

(b) *When Cost is Determined by the Inventory Plan,* the following procedure is adopted: All overhead expenses for the current period and all purchases of materials and labor during the period are added to the inventories for the beginning of the period, and from this sum the inventories at the end of the period are subtracted. The result obtained would be the Cost of Goods Sold. All accounts from which the above figures are obtained would be included in this section of the account.

2. *Purchases for Re-Sale,* as used at this point, are not intended to include inventory accounts, which are found in the Asset group of accounts, but only those Purchases for Re-Sale which have been sold during the past period. The charges to these accounts include the actual cost of the purchases plus the handling charges.

C. SELLING EXPENSES are all expenses which may be allocated directly to the commercial departments of a business. In this section, the following plans are given:

1. *First Alternative* (*Expense Classification*)—The first classification is for the executive who wishes his selling expenses classified according to the nature of the various expenses; such as Salaries, Traveling and Entertainment Expenses, and Advertising.

   (a) *Salaries*—The smaller companies may find it inexpedient to maintain several salary accounts. Where desirable, all salaries may be distributed to one account, with sub-distribution to selling and administration.

   1. *Officers and Department Heads*—An account which includes compensation for the sales manager, his assistants, managers of sales divisions, sales office manager, and advertising manager.

   1. *Selling Force*—This account is for all compensation, including commissions paid in lieu of salaries, for services of salesmen, inside salesmen, specialists, solicitors, and demonstrators.

   3. *Engineering and Drafting Force*—An account which includes compensation for services of engineers in general and local offices, not connected with designing, performing technical services and otherwise assisting the selling department.

4. *Clerical Force* represents an account for compensation for the services of clerks, stenographers, typists, and other minor employes of a similar nature engaged in clerical work for the selling department.

5. *Other Employes*—This account includes compensation for services of office boys, messengers, office equipment and repair men, janitors, cleaners, elevator operators, watchmen, and other similar employes in the selling department.

(b) *Rent, Light, Heat and Power* includes rentals for sales offices, taxes on such rented property, insurance on the property of this department, expense of light, heat and power not included in the rental charges.

(c) *Office Equipment, Alterations, Repairs and Replacements* on the above equipment is self-explanatory.

(d) *Traveling and Entertainment Expenses*—The expense account for the salesmen while on the road; this account also includes the expenses of entertaining customers.

(e) *Telephone and Telegraph Expenses*—That expense account to which are charged only the selling department's share of the above costs.

(f) *Postage* is the cost of all postage used in the selling department.

(g) *Stationery and Office Supplies* include the cost of all stationery and office supplies used in the selling department.

(h) *Advertising* is an account which includes all the costs of advertising, with the exception of salaries of the men in the advertising department and other expenses listed above, during the fiscal period.

(i) *Miscellaneous Expense Accounts* include accounts for all other expenses not listed above which may be charged to the selling department.

2. *Second Alternative* (*Responsibility Classification*) — The Second Alternative is for the executive who wishes the expenses in the selling department to be classified according to functional responsibility. This classification may be made in the three following ways:

(a) *By Functions,* we mean a system of accounts which are set up for each division of the selling department; such as Selling, Merchandise Engineering, Advertising, Finance, Accounting, and Office. The above accounts may be controlled by an account called Administration, which would place all the charges in the selling department in an account showing the efficiency of the head of this department.

(b) *By Location,* we mean one expense account for the main office, and one account each for the different branch offices.

(c) *By Products*—In the last case, an expense account would be kept for each product. This set-up would only be used in case a different man had charge of the sales of each product.

D. OTHER INCOME is a general heading for those accounts which include all income not made in the regular line of business. Some executives might prefer Other Income and Charges to other Income after the group of accounts entitled General Expenses, but since the General Expenses are common to the whole business rather than to any particular division or part, it is thought that they should follow the two groups mentioned above.

1. *Income from Investments* is an account for all income received from securities held by the company.
2. *Income from Outside Buildings, Tenements and Miscellaneous Property*—These accounts represent all income, such as rent, received from all physical property owned or rented by the company.
3. *Interest from Notes Receivable* is an account which is self-explanatory.
4. *Income from Miscellaneous Sources* includes accounts for all income not listed above.

E. CHARGES TO OTHER INCOME—Accounts for all expenses which may be charged directly to Other Income.

1. *Taxes, Maintenance, and Depreciation of Outside Buildings, Tenements and Miscellaneous Property* are accounts which do not need any further explanation.
2. *Collection Charges*—This account includes all charges incurred in collecting Other Income. Lawyers' fees would come under this heading.

3. *Miscellaneous Charges*—An account for all charges to Other Income not listed above.

F. GENERAL EXPENSES—The heading for all expense accounts not listed above. All expenses which can not be charged to any division or part of the business are included here.

1. *Administrative Expenses Not Previously Apportioned* may be considered as general expenses and included at this point.
2. *Interest Paid and Accrued* may be divided into the following classes of accounts:
    (a) *Interest on Funded Debt*—An account which includes all interest paid or accrued on the company's funded debt.
    (b) *Interest on Other Obligations*—An account for all interest paid or accrued on all other obligations.
3. *Neglected Discounts*—This account includes all discounts lost by the company in not paying its bills promptly. See discussion under Collected Discounts.
4. *Losses on Bad Debts*—Self-explanatory.
5. *Miscellaneous Expenses* include all expense accounts not enumerated above.

G. LOSS AND GAIN, a term covering accounts which represent losses and gains for the current period; this group of accounts may be divided as follows:

1. *Adjustment Accounts* are those suspense accounts which are used as a clearing house for such charges as idleness or inventories losses or gains.
    (a) *Inventory Adjustment Accounts* — These accounts may be carried in the Cost of Goods Sold section of the classification.
    (b) *Idleness Account*—Here are collected all charges for idleness during the current period. Overtime Adjustment accounts may be included as a complement of the Idleness Accounts.
    (c) *Miscellaneous Adjustment Accounts* represent all adjustment accounts not mentioned above.
2. *Income Taxes*—This account is included in this section of the classification, since income taxes are paid out of profits.

3. *Profit and Loss Accounts* may be divided into the following sub-divisions.

   (a) *Monthly Profit and Loss Account*—This account is only used by those companies which close their books monthly.

   (b) *Cumulative Profit and Loss Account* (For the Year only)—This account collects the profits or losses for the year. The Cumulative Profit and Loss Account is closed into Undivided Profits or into Surplus. Dividends may be declared, in which case the amount of profits going to Surplus would be correspondingly reduced.

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