

Accounting Systems

OPENING COMMENTS

Chapter 5 introduces new concepts and new forms. The new concepts relate to accounting system design, computerized accounting, e-commerce, and subsidiary ledgers. The new forms introduced are the special journals for a service business: revenue journal, cash receipts journal, purchases journal, and cash payments journal.

The transactions that will be recorded in special journals are the same as those that were covered in Chapters 1–4; only the journal format has changed. But beware—students frequently get lost in the barrage of new forms.

In this chapter, it is especially obvious that there is no substitute for practice. Students need the opportunity to try recording and posting transactions in a setting where they can ask questions. Group learning activities are very effective.

The chapter ends with a description of segment analysis and a discussion of how horizontal and vertical analysis can be used to evaluate the operating performance of a company.

After studying the chapter, your students should be able to:

1. Define and describe an accounting system.
2. Journalize and post transactions in a manual accounting system that uses subsidiary ledgers and special journals.
3. Describe and illustrate the use of a computerized accounting system.
4. Describe the basic features of e-commerce.
5. Use segment analysis in evaluating the operating performance of a company.

KEY TERMS

accounting system
accounts payable subsidiary ledger
accounts receivable subsidiary ledger
cash payments journal
cash receipts journal
controlling account
e-commerce
general journal
general ledger
internal controls
invoice
purchases journal
revenue journal
special journals
subsidiary ledger

STUDENT FAQS

- Why do we need to know how to design a manual accounting system if most accounting systems are computerized?
- How can you be assured that a current balance in subsidiary ledger accounts is correct in a manual system when the control account entries are not posted until the end of the month?
- What is the advantage of using special journals in a computerized accounting system?
- In e-commerce, what are the advantages of making accounting entries on someone else's server instead of your own server?
- Why do we need both subsidiary ledgers and the general ledger? Doesn't the use of subsidiary ledgers result in more work and recording transactions twice?
- Why can't all purchases (cash and on account) be recorded in the purchases journal?
- Why can't all revenue (cash and on account) be recorded in the revenue journal?
- Remind me again of the difference between a ledger and a journal?
- Why can't you wait until the end of the month to post to the control accounts as well as the subsidiary ledgers?
- This seems very labor intensive—isn't there a simpler way to do this?
- Why do companies not keep track of cash customers?
- The text says that businesses may be segmented by region, by product or service, or by type of customer. Are there other ways of segmenting? What would they be, and how do they help managers evaluate the company's performance?

OBJECTIVE 1

Define and describe an accounting system.

SYNOPSIS

Objective 1 describes how a basic accounting system is designed with the specific user in mind. This three-step process includes analyzing the user's needs, designing the system to meet those needs, and then implementing the system. The system includes internal controls and information processing methods.

Key Terms and Definitions

- **Accounting System** - The methods and procedures used by a business to collect, classify, summarize, and report financial data for use by management and external users.
- **Internal Controls** - The policies and procedures used to safeguard assets, ensure accurate business information, and ensure compliance with laws and regulations.

SUGGESTED APPROACH

An accounting system consists of the methods and procedures for collecting, classifying, summarizing, and reporting a business's financial and operating information. This objective presents the basic principles that should be considered when designing an accounting system. The following Brainstorming Exercise will help stimulate interest in the topic.

BRAINSTORMING EXERCISE—Accounting Systems

Pose the following scenario to your class, which is also shown in Handout 5-1 at the end of the chapter:

You have decided to open a bookstore that sells textbooks and competes with the campus bookstore. You have chosen a location and have received a list of textbooks used by the college. What other decisions will you have to make regarding the operations of your business?

As your students call out operational concerns, list them on the board. While they will come up with many decisions to be made (e.g., operating hours, personnel requirements, advertising strategy), they may not mention the design of an accounting system.

This will give you the opportunity to remind them that an owner must consider how information needed to prepare financial statements and tax returns will be collected and processed. An entrepreneur cannot simply operate a business by throwing every receipt in a box and hoping that at the end of the year, his or her accountant can figure out what happened.

Likewise, whenever information must be changed within a company, management must review how the new information will be recorded and reported. For example, when the accounting pronouncement requiring companies to prepare a statement of cash flows was issued, one of the first concerns that many companies addressed was how to collect the information needed to prepare this financial statement.

Management must design an accounting system that does the following:

1. Balances costs with benefits
2. Produces effective (useful) reports
3. Is able to adapt to future needs
4. Has adequate internal controls

Ask students to identify information that would be useful in running the day-to-day operations of the bookstore described above. List these on the board. Much of this information (such as which merchandise is selling best, which merchandise customers are returning, and which merchandise is still on hand) can be obtained from a well-planned accounting system.

Although students may be tempted to discuss inventory procedures as part of this exercise, merchandising businesses will be discussed in detail in Chapter 6. Limit the discussion to accounting operations and making the right decisions for collecting, classifying, summarizing, and reporting a business's financial and operating information.

OBJECTIVE 2

Journalize and post transactions in a manual accounting system that uses subsidiary ledgers and special journals.

SYNOPSIS

This objective describes a manual accounting system. Understanding manual accounting is useful in identifying relationships between accounting transactions and how this information is reported. The system used in previous chapters is simple to use when there is a small number of transactions. When a business has a large number of similar transactions, it is more efficient to use special journals and subsidiary ledgers. Large numbers of accounts with common characteristics can be grouped together in a subsidiary ledger. A subsidiary ledger is represented in the general journal by a controlling account. The balance in the subsidiary ledger must match the balance in the controlling account. The accounts receivable subsidiary ledger and the accounts payable subsidiary ledger are the most common subsidiary ledgers to use. To process similar transactions efficiently in a manual system, special journals may also be used. They are used to record transactions that occur frequently. The most common special journals used are the revenue journal, cash receipts journal, purchases journal, and cash payments journal. The all-purpose two-column journal is then called the general journal.

The revenue journal is illustrated in Exhibit 2 and is used when fees are earned on account. Cash fees earned would be recorded in the cash receipts journal. When the business sends an invoice to the customer, the transaction is recorded in the revenue journal. Since the accounts receivable amount is the same as the revenue, only a single column is used to record the amount. Also entered are the date, invoice number, and account to be debited. Posting from this account requires four steps. The transaction is posted to the appropriate general and subsidiary ledgers as shown in Exhibit 3. The cash receipts journal is used to record all transactions that involve the receiving of cash. Exhibit 4 shows this journal as a three-column journal. To record a cash receipt, the date, the account credited, the amount credited to Accounts

Receivable, and the amount debited to Cash are recorded as shown. At the end of the month, the debits and credits in the journal must equal; if not, the error must be found and corrected. The posting process involves six steps. These steps are illustrated in Exhibit 4. At the end of the month, after the posting of the revenue journal and the cash receipts journal is complete, the balances in the two subsidiary ledgers and the controlling accounts in the general ledger should be compared. If the amounts do not agree, an error has occurred and must be corrected.

If a purchases journal is utilized, all purchases on account are recorded in it. Cash purchases would be recorded in the cash payments journal. The purchases journal uses the Accounts Payable Credit column and other columns as necessary. To record a transaction, the date, the account credited, the accounts payable credit, and the account debited are written in the journal. This entry is shown in Exhibit 5. The posting process involves six steps. These steps are illustrated in Exhibit 5. All transactions that involve the payment of cash are recorded in a cash payments journal. The journal shown in Exhibit 6 has three columns: two debit columns and a credit column for cash being paid out. The date, check number, account to be debited, amount to be debited, and the cash credit are used to complete the entry. The debit and credit columns must equal or there is an error in the journal. The six steps to complete the posting of the journal are illustrated in Exhibit 6. After the posting is complete, the balances in the subsidiary ledger and the controlling account in the general ledger are compared. If they do not match, the errors must be found and corrected.

Key Terms and Definitions

- **Accounts Payable Subsidiary Ledger** - The subsidiary ledger containing the individual accounts with creditors (suppliers).
- **Accounts Receivable Subsidiary Ledger** - The subsidiary ledger containing the individual accounts with customers.
- **Cash Payments Journal** - The special journal in which all cash payments are recorded.
- **Cash Receipts Journal** - The special journal in which all cash receipts are recorded.
- **Controlling Account** - The account in the general ledger that summarizes the balances of the accounts in a subsidiary ledger.
- **General Journal** - The two-column form used for entries that do not “fit” in any of the special journals.
- **General Ledger** - The primary ledger, when used in conjunction with subsidiary ledgers, that contains all of the balance sheet and income statement accounts.
- **Invoice** - The bill that the seller sends to the buyer.
- **Purchases Journal** - The journal in which all items purchased on account are recorded.
- **Revenue Journal** - The journal in which all sales and services on account are recorded.
- **Special Journals** - Journals designed to be used for recording a single type of transaction.
- **Subsidiary Ledger** - A ledger containing individual accounts with a common characteristic.

Relevant Example Exercises and Exhibits

- Exhibit 1 – General Ledger and Subsidiary Ledgers
- Exhibit 2 – Revenue Journal
- Exhibit 3 – Revenue Journal and Postings
- Example Exercise 5-1 – Revenue Journal
- Exhibit 4 – Cash Receipts Journal and Postings
- Example Exercise 5-2 – Accounts Receivable Subsidiary Ledger

- Exhibit 5 – Purchases Journal and Postings
- Example Exercise 5-3 – Purchases Journal
- Exhibit 6 – Cash Payments Journal and Postings
- Example Exercise 5-4 – Accounts Payable Subsidiary Ledger

SUGGESTED APPROACH

Under this learning objective, you need to introduce students to subsidiary ledgers and special journals. Although these topics are traditionally presented as one package, your students' comprehension may be increased by explaining subsidiary ledgers in a two-column journal environment before moving on to the special multicolumn journals. It may be beneficial to explain that subsidiary ledgers are the details behind the balances in general ledger accounts. For example, accounts receivable in the general ledger provides a total owed to the business, but does not provide any details as to who owes what amount. The subsidiary ledger will provide that detail. An example can show various accounts in a subsidiary ledger with account balances owed by individual customers. Add these individual account balances in an accounts receivable schedule to show that the sum total of all accounts receivable subsidiary ledger accounts will equal the total accounts receivable in the general ledger—the details behind the general ledger account.

GROUP LEARNING ACTIVITY—Subsidiary Ledgers

As an attention-getter, pose the following scenario to your class:

Let's say that you called _____ (name of a local service business) and purchased \$200 of its services on account. You knew that the business kept track of the fact that someone owed \$200 as an account receivable, but it didn't record who owed the \$200. Therefore, the business couldn't send out bills at the end of the month; it simply relied on its customers to remember how much they owed and send in their payment on time. Do you think most people would pay the amount of money they owed on time?

In reality, this is the type of accounting system that your students have been using. In the first four chapters of the text, they recorded that someone owes money to a business by making entries to an accounts receivable account for all services performed on account. But they have not formally recorded who owed money. This is accomplished by using a subsidiary ledger.

Transactions to illustrate the accounts receivable subsidiary ledger are presented in Handout 5-2. Handout 5-3 is a journal page to be distributed to your students for use in recording these transactions. There are also a few general ledger and accounts receivable subsidiary ledger accounts in T account format.

Divide the class into small groups and ask your students to record the transactions from Handout 5-2 in the journal provided. After each transaction is recorded, instruct them to post the entry both to the general ledger accounts and the appropriate subsidiary ledger account. Each entry to Accounts Receivable will be posted to two different accounts: Accounts Receivable in the general ledger and the appropriate customer account in the subsidiary ledger. As a result, the Post. Ref. column in the journal will have two markings for each entry to Accounts Receivable—an account number to show that the entry was posted to the general ledger and a check mark to show that the entry was posted to the subsidiary ledger.

You may want to record and post the first entry as an example before asking students to work on their own. After students have finished recording and posting these transactions, ask them to add the balances of the customer accounts in the accounts receivable subsidiary ledger. Stress that the total of the customer accounts in the subsidiary ledger must equal the total of Accounts Receivable in the general ledger. Also point out that the individual accounts in the accounts receivable ledger provide a complete credit history for each customer. The solution to this exercise is shown in Handout 5-4.

Remind students that it is also necessary to maintain an accounts payable subsidiary ledger. This allows a company to keep track of those who are owed money. Note to students that many businesses use subsidiary ledgers for other accounts such as an equipment subsidiary ledger to keep track of each item of equipment purchased, its cost, location, and other data.

WRITING EXERCISE—Subsidiary Ledgers

Ask your students to write answers to the following questions:

1. What is the purpose of an accounts receivable subsidiary ledger?
2. What information would be included in a subsidiary ledger for a company's fixed asset account? Do you think it would be helpful to keep a fixed asset subsidiary ledger? Explain your answer.

Possible responses: (1) The accounts receivable subsidiary ledger will provide the details behind the accounts receivable general ledger account. It will show which customers owe money and the balance owed. This ledger can also facilitate invoicing and collections and provide a history of the customer activity to determine the future treatment of the account. (2) A fixed asset subsidiary ledger would include the date of purchase, original cost by item, supplier information, and other details of individual asset acquisition.

GROUP LEARNING ACTIVITY—Special Journals

Begin coverage of special journals by discussing their purpose and the transactions recorded in each of the four types of special journals.

The goal of special journals is to process data in a manual accounting system more efficiently. Efficiency is gained because account titles do not have to be written out for every transaction, and postings to the general ledger are reduced by posting column totals. Special journals also make it easier to divide the work of journalizing and posting entries among a number of accounting clerks. Assigning the task of recording purchases and/or sales to employees who do not record cash payments and/or receipts also enhances internal controls.

The four special journals, and the transactions recorded in each, are as follows:

1. *Revenue journal*—fees earned on account
2. *Cash receipts journal*—any transaction where cash is received (including services performed for cash customers)

3. *Purchases journal*—all items purchased on account
4. *Cash payments journal*—any transaction where cash is paid (including cash purchases of assets such as supplies, insurance, and prepaid rent or the payment of expenses such as advertising expense, wages expense, utilities expense, or any other items)

It is also useful to point out that any transaction that does not “fit” in a special journal is recorded in the general journal. These transactions include adjusting entries and closing entries.

At this point, refer students to the revenue journal shown in Exhibit 2. Explain that only a single column is needed in this journal because it is used to record fees earned on account. The accountant knows that all entries in this journal will be posted to Accounts Receivable and Fees Earned. Explain how the journal is posted to the general and subsidiary ledgers and the meaning of all posting reference markings.

Next, refer students to the cash receipts journal in Exhibit 4. Explain the use of the Other Accounts Credit column in this journal. Emphasize that whenever an entry is made in the Other Accounts Credit column, the title of the ledger account to be credited must be written in the Account Credited column. Explain how this journal is posted to the general and subsidiary ledgers and the meaning of all posting reference markings.

You may also want to review the purchases journal (Exhibit 5) and the cash payments journal (Exhibit 6). However, it will probably suffice to explain that entries to the purchases journal and the cash payments journal are recorded and posted using the same process as the cash receipts journal.

After introducing the special journals, it is helpful to instruct your class to work through a special journal problem as a group learning activity. Although the concepts associated with special journals are relatively easy, these problems require several pages of forms, which can overwhelm students. It is a good idea to get them started in a setting where they can ask questions of their group members or the instructor.

Because special journal problems do require a variety of forms, you will probably want to use a textbook problem and the accompanying working papers for an in-class active learning activity. This will save the duplication of several sheets of paper.

If you take this approach, choose a problem one or two class sessions ahead of time, and instruct students to bring their working papers for that problem with them to class. You may even want to include this instruction in your syllabus.

The following textbook problems are relatively short, making them useful for this purpose:

Revenue and cash receipts journals	Problem 5-2A or 5-2B
Purchases journal	Problem 5-3A or 5-3B

When it is time to work through the chosen problem, divide the class into small groups. Remind them that entries are posted to the subsidiary ledgers daily; however, postings to the general ledger are made only at the end of the month. You may want to demonstrate a few transactions for the class before they begin working on their own.

As an alternative approach, the publisher provides various practice set options, such as the *Fit and Fashionable* practice set, which has students record transactions in specialized journals and that uses subsidiary ledgers for accounts receivable and accounts payable. This practice set is for a merchandising business and provides the instructor the option of combining Chapters 5 and 6 and using this optional practice set to evaluate the students' comprehension of these two chapters as well as the material introduced in Chapters 1–4. This practice set has the students manually record transactions for a merchandising business for an entire accounting cycle and complete all 10 steps of the accounting cycle. It is an excellent wrap up to all the material presented in the first six chapters of the text. It is mentioned in Chapter 5 to allow the instructor time to plan if this approach is taken. The practice set is an additional investment for the student in addition to the text and any other supplemental material that maybe required. It has proven to be an effective learning tool. It should be noted that this exercise is a significant time investment for the student and the instructor; however, the benefits are worth the investment.

WRITING EXERCISE—Special Journals and Subsidiary Ledgers

Ask your students to write answers to the following questions:

1. Why is the revenue journal posted to the accounts receivable subsidiary ledger periodically throughout the month, while it is posted to the general ledger only at the end of the month?
2. Will the balance of the accounts receivable controlling account agree with the balance of the accounts receivable ledger at all times during a month? Why or why not?

Possible responses: (1) The revenue needs to post to the subsidiary ledgers on a regular basis to keep the customer balances up to date. If a customer calls and request a payoff on their account, the subsidiary ledger must be up to date and accurate in order to provide the customer with the proper information. If you wait until the end of the month to update the subsidiary ledgers, you run the risk of improper account balances in the subsidiary ledger. (2) If the posting procedures follow the recommended process in statement 1, the balances will not always agree, due to timing issues of when items are posted. Once the end-of-month postings are completed, the controlling account and subsidiary ledger account balances should be in balance.

OBJECTIVE 3

Describe and illustrate the use of a computerized accounting system.

SYNOPSIS

Today, computerized accounting systems are widely used, even by the smallest businesses. They have three main advantages over manual systems. Journalizing and posting are completed electronically at the same time, they are generally more accurate, and they provide management with current information at any time. Exhibit 7 shows the three steps used in QuickBooks® to complete invoices, record transactions, and prepare reports. The computer also prevents transactions in which debits and credits do not match.

Relevant Exhibit

- Exhibit 7 – Revenue and Cash Receipts in QuickBooks

SUGGESTED APPROACH

Ask your students to give examples of errors they have made while completing homework assignments from the first four chapters of this course, and list these errors on the board. To get this list started, you may have to prompt your students by asking if they have posted any entries to the wrong account or incorrectly added an account balance. After you have a few errors listed, ask students to identify which errors would have been avoided if a computer had processed the accounting data in the homework problems. This will allow you to emphasize one of the main advantages of a computerized accounting system: elimination of many of the math, posting, and journal recording errors made in a manual system.

The Objective 3 text illustrates the revenue and collection cycle in a computerized environment using the popular QuickBooks® accounting software. Use the Lecture Aid below to simulate how the computer processes revenue and collection information.

LECTURE AID—Revenue and Collection Cycle in a Computerized Environment

Ask your students to turn to Exhibit 7 in their textbooks. Refer them to the illustration of the electronic invoice at the top of the page. Ask them to write in their notes the journal entry (two-column journal format) needed when Accessories By Claire, a customer, is billed for \$2,200 for services completed on account. The answer is:

Accounts Receivable—Accessories By Claire.....	2,200	
Fees Earned.....		2,200

Explain that the computer software generates this entry and posts it to the accounts in the general ledger. The software also tracks the balances owed by each customer. The Accessories By Claire account balance is automatically updated by the invoice.

Next, refer your students to the “receive payment” form in the middle of the page. Ask them to write in their notes the journal entry needed when payment is received from the customer previously billed on account. The answer is:

Cash.....	2,200	
Accounts Receivable—Accessories By Claire		2,200

Once again, the computer software generates this entry and posts it to the accounts in the general ledger. The Accessories By Claire accounts receivable balance is also updated.

Ask your students how the software determined the amounts to be reported on the “Accounts Receivable Customer Balances” report. Answer: by adding the invoices sent to each customer and subtracting the

payments received. Also ask how the software determined the amounts to be reported on the “Fees Earned by Customer” report. Answer: by summing the invoices sent to each customer.

Point out that the total shown on the “Accounts Receivable Customer Balances” report is the total for Accounts Receivable in the general ledger. The total shown on the “Fees Earned by Customer” report is the balance of Fees Earned in the general ledger.

OBJECTIVE 4

Describe the basic features of e-commerce.

SYNOPSIS

E-commerce is using the Internet to perform business transactions. E-commerce represents more than 7 percent of all retail sales. When these transactions occur between two businesses, it is termed B2B e-commerce. The Internet is also utilized for business purposes in supply chain, customer relationship, and product life-cycle management.

Key Term and Definition

- **E-commerce** - The use of the Internet for performing business transactions.

SUGGESTED APPROACH

The text defines e-commerce as “using the Internet to perform business transactions.” Many of your students will have already engaged in business-to-consumer (B2C) e-commerce. You may want to ask your students for examples of merchandise they purchased using the Internet.

As the text mentions, fraud is a definite concern for both businesses and consumers engaging in e-commerce. Use the Internet Activity below to introduce students to WebTrust.

INTERNET ACTIVITY—WebTrust

WebTrust is a service developed by the American Institute of Certified Public Accountants that is provided by CPAs with special training. When a company’s website receives the WebTrust seal, it means the site has:

- Been certified by a specially trained and licensed public accounting firm
- Disclosed its business practices
- Been audited to prove the site actually follows those practices
- Met international WebTrust standards for e-commerce

The WebTrust seal should provide consumers with some confidence that they are dealing with a reputable company that clearly describes how it does business and delivers on its promises.

Direct your students to visit the following website for more information on the WebTrust program:

<http://www.webtrust.org>

OBJECTIVE 5

Use segment analysis in evaluating the operating performance of a company.

SYNOPSIS

Computers are often used to report financial and operating information in a variety of ways. In the example, invoices are used to differentiate revenue by different products and services. Horizontal and vertical analyses are shown for Intuit Inc.

Relevant Example Exercise

- Example Exercise 5-5 – Segment Analysis

SUGGESTED APPROACH

Remind students that invoices to customers are used not only to inform customers of amounts due, but they can also provide the information used to analyze if sales are meeting different goals and objectives of the company or to analyze sales data such as popular models by region. This valuable information becomes a management tool to direct future decisions. As an example, for a big clothing manufacturer, ask students to list the information on invoices that could be used for analysis and in what segment the stated information would be used.

Some answers might be: the state in which the sale occurred, to determine which regions of the country experience the most and/or least sales volume; or which items are purchased, to determine which products are most and/or least popular. Both of these answers can be further broken down by date (i.e., annual or seasonal) for comparison purposes to spot trends.

BRAINSTORMING EXERCISE

You have decided to open a bookstore that sells textbooks and competes with the campus bookstore. You have chosen a location and have received a list of textbooks used by the college. What other decisions will you have to make regarding the operations of your business?

ACCOUNTS RECEIVABLE TRANSACTIONS

The following transactions relate to fees earned by Ryan's Computer Consulting Group. All consulting services are performed on account and billed to the customer, who must pay within 30 days.

- June
1. Assisted Milford Tool Co. in upgrading two office computers and making repairs to a printer. Milford Tool Co. was billed \$800 for these services.
 5. Installed a networked computer system in the offices of Rahn Hills Medical Group and trained employees to use the network. Rahn Hills Medical Group was billed \$2,500 for these services.
 24. Installed a modem and software in a home computer for one of the doctors at Rahn Hills Medical Group. This will allow the doctor to access the office network from home. Rahn Hills Medical Group was billed \$500 for this service.
 26. Received \$2,500 payment from Rahn Hills Medical Group.

ACCOUNTS RECEIVABLE TRANSACTIONS

Ryan's Computer Consulting Group

JOURNAL

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT

GENERAL LEDGER

Acct. No. 101 Cash	Acct. No. 105 Accts. Receivable	Acct. No. 401 Fees Earned
_____	_____	_____

ACCOUNTS RECEIVABLE SUBSIDIARY LEDGER

Milford Tool Co.	Rahn Hills Medical Group
_____	_____

ACCOUNTS RECEIVABLE TRANSACTIONS

(Solution)

Ryan's Computer Consulting Group

JOURNAL

DATE		DESCRIPTION	POST. REF.	DEBIT	CREDIT
June	1	Accts. Rec.—Milford Tool Co.	105/√	800	
		Fees Earned	401		800
	5	Accts. Rec.—Rahn Hills Med. Group	105/√	2,500	
		Fees Earned	401		2,500
	24	Accts. Rec.—Rahn Hills Med. Group	105/√	500	
		Fees Earned	401		500
	26	Cash	101	2,500	
		Accts. Rec.—Rahn Hills Med. Group	105/√		2,500

GENERAL LEDGER

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ACCOUNTS RECEIVABLE SUBSIDIARY LEDGER

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