

HUBBARD COMMUNICATIONS OFFICE  
Saint Hill Manor, East Grinstead, Sussex

Finance Bureau            HCO POLICY LETTER OF 14th NOVEMBER 1970  
Hats                                    Issue VI  
Asst. Guard. Fin.  
Org Exec Secs  
Treasury Hats

THE THEORY OF BOOK KEEPING AND ACCOUNTANCY - Part 3  
PREPARATION OF INCOME AND EXPENDITURE ACCOUNT AND BALANCE SHEET

Now let us take a normal series of transactions undertaken by The Organization, record the BOOK KEEPING for these transactions, and then prepare the Income and Expenditure Account and Balance Sheet from them.

EXAMPLE 30

John Smith starts a Franchise on 1st January and the following transactions were made in the three month period to 31st March. It is required that BOOK KEEPING entries be made to record these transactions and that an Income and Expenditure Account and Balance Sheet then be prepared. Full formal BOOK KEEPING, with the use of Personal Accounts, is to be kept whenever practical.

Note: An Income and Expenditure Account and Balance Sheet is usually drawn up for a financial period of one year, but here, for the sake of brevity, I take a smaller period of three months.

The following transactions occurred in the three month period:

Training and Processing Sold - OUTFLOW of SERVICES

1.	1st Jan	Able is invoiced for a 25 hour intensive at cost	\$300.00
2.	14th "	Beal is invoiced for an HSDC at cost	500.00
3.	12th Feb	Cutts is invoiced for 10 hours of Review auditing at cost	200.00

Books and Meters sold - OUTFLOW of MEST

4.	17th Jan	10 copies of DMSMH sold for \$5.00 each to Jinks. Jinks paid the \$50.00 immediately to cashier	
5.	12th Mar	2 E-Meters sold to Jenkins for \$140.00 each. Jenkins paid the \$280.00 immediately to cashier.	

Suppliers Bills Received - INFLOW of MEST and SERVICES

6.	11th Jan	Received Rates Bill from East Grinstead Urban District Council for 6 month period to 30th June	200.00
7.	12th "	Received Bill from Pubs Org as follows: 100 DMSMH delivered at \$3.00 each            300.00 10 E Meters delivered at \$80.00 each <u>800.00</u>	1100.00
8.	29th "	Received Stationery Bill from Godstone for	80.00
9.	11th Mar	Received Bill for Rent for 3 months period to 31st March from Bigwood & Co.	250.00
10.	17th Mar	Received Electricity Bill from the Electric Co. for supply for the months of January and February	70.00

11.	17th Mar	Received Bill for Simons & Co. for Furniture for Franchise delivered and installed on 1st January	500.00
12.	31st Mar	Received Bill for Telephone from the Telephone Co. for the period to 31st March	60.00

MONEY Disbursed - OUTFLOW of MONEY

13.	19th Jan	Paid Rates Bill to East Grinstead Urban District Council	200.00
14.	31st "	Paid to Pubs Org on Account	100.00
15.	" "	Paid Wages for staff member Silwell for the month of January	40.00
16.	17th Feb	Paid Rent Bill to Bigwood & Co.	250.00
17.	28th "	Paid cheque for 'cash' for John Smith's own personal expenses	100.00
18.	" "	Paid Wages for staff member Silwell for the month of February	40.00
19.	20th Mar	Paid electric Bill to the Electricity Co.	70.00
20.	27th "	Paid Simons on Account of Furniture	250.00

MONEY Received - INFLOW of MONEY

21.	1st Jan	Received from Able for intensive	300.00
22.	17th "	Received from Jinks for 10 DMSH	50.00
23.	21st "	Received from Beal on Account of HSDC	200.00
24.	31st "	Received from John Smith (the owner) to provide capital for the Franchise	1500.00
25.	28th Feb	Received on Account from Beal	200.00
26.	12th Mar	Received from Jenkins for 2 E Meters	280.00
27.	" "	Received from Cutts for Review Auditing	200.00
28.	29th "	Received Advance Payment from Sprake for HSDC to be commenced on 10th April	500.00

Note that in recording the BOOK KEEPING for the above transactions four main groupings of Accounts or types of Accounts are made. Thus Impersonal Accounts are grouped into one Section; Personal Accounts relating to Suppliers are grouped in another Section; Personal Accounts relating to Students and Prelears for Sales of SERVICES are in another section; and finally the Personal Account of John Smith, the owner, is placed in a section of its own.

In the normal Scientology Organization it can be seen that the Personal Accounts with Suppliers are kept as a separate section by the preparation of the MONTHLY Bills Summary by the Department of Disbursements. Similarly, it can be seen that the Personal Accounts relating to Students and Prelears are kept as a separate section by the Department of Income.

You will note that each of the above example transactions are numbered 1 through to 28 and these numbers are used again when making the BOOK KEEPING entries below in order to help identification of the double entry recording of each transaction.

IMPERSONAL ACCOUNTS

Bank Account

21.	1st Jan	Received from Able	300.00	13.	19th Jan	Paid to East	
22.	17th "	Received from Jinks				Grinstead U.D.C. Rates	200.00
		for books	50.00	14.	31st Jan	Paid to Pubs	
23.	21st "	Received from Beal	200.00			on Account	100.00
24.	31st "	Received from John		15.	31st Jan	Paid Wages to	
		Smith - Capital	1500.00			Silwell	40.00
25.	28th Feb	Received from Beal	200.00	16.	17th Feb	Paid Bigwood	
26.	12th Mar	Received from Jenkins				for Rent	250.00
		for E Meters	280.00	17.	20th Feb	Personal	
27.	11th "	Received from Cutts	200.00			Expenses for John Smith	100.00
28.	29th "	Received from		18.	28th Feb	Paid Wages to	
		Sprake	500.00			Silwell	40.00
				19.	20th Mar	Paid to	
						Electricity Company	70.00
				20.	27th Mar	Paid to Simons	
						on Account	250.00
			<u>3230.00</u>				<u>1050.00</u>
					31st Mar	Balance	2180.00
			<u>3230.00</u>				<u>3230.00</u>
	31st Mar	Balance	2180.00				

PURCHASES of Books and Meters Account

7.	12th Jan	Books and Meters			31st Mar	Transfer to	
		received from Pubs Org	1100.00			Income and Expenditure	
						Account	1100.00
			<u>1100.00</u>				<u>1100.00</u>

Wages Account

15.	31st Jan	Bank Account	40.00		31st Mar	Transfer to	
18.	28th Feb	" "	40.00			Income and Expenditure	
						Account	80.00
			<u>80.00</u>				<u>80.00</u>

Rates Account

6.	11th Jan	E.G.U.D.C. rates			31st Mar	Transfer to	
		for six months to 30th June	200.00			Income and Expenditure	
						Account	200.00
			<u>200.00</u>				<u>200.00</u>

Rent Account

9.	11th Mar	Bigwood & Co rent for			31st Mar	Transfer to	
		3 months to 31st Mar	250.00			Income	
						and Expenditure Account	250.00
			<u>250.00</u>				<u>250.00</u>

Electricity Account

10.	17th Mar Electricity Bill for January & February	70.00	31st Mar Transfer to Income and Expenditure Account	70.00
		<u>70.00</u>		<u>70.00</u>

Telephone Account

12.	31st Mar Telephone Bill to 27th March	60.00	31st Mar Transfer to Income and Expenditure Account	60.00
		<u>60.00</u>		<u>60.00</u>

Stationery Account

8.	29th Jan Stationery Supplies from Godstone & Co.	80.00	31st Mar Transfer to Income and Expenditure Account	80.00
		<u>80.00</u>		<u>80.00</u>

Furniture Account

11.	17th Mar Furniture received on 1st January from Simons and Co.	500.00		
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Sales of Training and Processing Account

			1.	1st Jan Intensive Delivered to Able	300.00
31st Mar Transfer to Income and Expenditure Account	1000.00		2.	14th Jan HSDC delivered to Beal	500.00
			3.	12th Feb Review delivered to Cutts	200.00
		<u>1000.00</u>			<u>1000.00</u>

Sales of Books and Meters Account

31st Mar Transfer to Income and Expenditure Account	330.00		22.	17th Jan Bank Account - Jinks	50.00
			26.	12th Mar Bank Account - Jenkins	280.00
	<u>330.00</u>				<u>330.00</u>

PERSONAL ACCOUNT - OWNER

John Smith Personal Account

17.	20th Feb Bank Account - MONEY received from The Organization	100.00	24.	31st Jan MONEY paid to The Organization	1500.00
31st Mar Balance	1400.00				
	<u>1500.00</u>				<u>1500.00</u>
			31st Mar Balance		<u>1400.00</u>

PERSONAL ACCOUNTS - SUPPLIERS

Ruba Org Account

14.	31st Jan MONEY received from The Organization	100.00	7.	12th Jan Books and Meters delivered to The Organization	1100.00
	31st Mar Balance	1000.00			
		<u>1100.00</u>			<u>1100.00</u>
				31st Mar Balance	1000.00

East Grinstead Urban District Council Account

13.	19th Jan MONEY received from The Organization	200.00	6.	11th Jan Rates SERVICE delivered to The Organization for six months to 30th June	200.00
		<u>200.00</u>			<u>200.00</u>

Digwood & Co. Account

16.	17th Feb MONEY received from The Organization	250.00	9.	11th Mar Rent SERVICE delivered to the Organization for 3 months to 31st Mar.	250.00
		<u>250.00</u>			<u>250.00</u>

Electricity Co. Account

19.	20th Mar MONEY received from The Organization	70.00	10.	17th Mar Electricity SERVICE supplied to The Organization for Jan. and Feb.	70.00
		<u>70.00</u>			<u>70.00</u>

Telephone Co. Account

11.	31st Mar Telephone SERVICE supplied to The Organization for the period to 31st March	60.00
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Godstone & Co. Account

8.	29th Jan Stationery delivered to The Organization	80.00
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Simons & Co.

20.	27th Mar MONEY received from The Organization	250.00	11.	1st Jan Furniture supplied to The Organization	500.00
	31st Mar Balance	250.00			
		<u>500.00</u>			<u>500.00</u>
				31st Mar Balance	250.00



PERSONAL ACCOUNTS - STUDENTS AND PRECLEARS

Able's Account

1. 1st Jan Received SERVICE of 25 hour intensive	300.00	21. 11th Jan MONEY paid to The Organization	300.00
	<u>300.00</u>		<u>300.00</u>

Beal Account

2. 14th Jan Received SERVICE of HSIC	500.00	23. 21st Jan MONEY paid to The Organization	200.00
	<u>500.00</u>	25. 28th Feb ditto	200.00
		31st Mar Balance	100.00
	<u>500.00</u>		<u>500.00</u>
31st Mar Balance	100.00		

Cutts Account

3. 12th Feb Received SERVICE of 10 hours Review	200.00	27. 11th Mar MONEY paid to the Organization	200.00
	<u>200.00</u>		<u>200.00</u>

Sprake Account

28. 29th Mar MONEY paid to The Organization	500.00
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Note: All the above BOOK KEEPING was kept by full formal BOOK KEEPING, i.e. with the use of Personal Accounts except in the case of four items which were recorded by abbreviated BOOK KEEPING.

The first two of these items were:

22. 17th Jan Received MONEY from Jinks for 10 DMSM	50.00
26. 12th Mar Received MONEY from Jenkins for 2 E Meters	280.00

Since the MONEY for these Sales was received immediately then the Personal Accounts of Jinks and Jenkins were ignored and bypassed and no recording was made of the OUTFLOW of the MFST as shown by transaction number '4' and '5' respectively. The entry made therefore was to debit Bank Account with the above receipts of MONEY and credit these sums to Sales of Books and Meters Account. Examples of 25 and 26 also demonstrated the use of abbreviated BOOK KEEPING for this type of transaction.

The other two items dealt with by abbreviated BOOK KEEPING were:

15. 31st Jan Paid MONEY to Silwell for Wages	40.00
18. 28th Feb ditto	40.00

Since these wages were paid immediately then the only entry made was to credit Bank Account and debit Wages Account. The Personal Account of Silwell was ignored. Again, this type of transaction was demonstrated in Example 27.

Notes: You will observe that certain of the Impersonal Accounts have been closed off with an entry marked "Transfer to Income and Expenditure Account." Now this entry should be ignored at this stage because it is made later in the sequence than we are currently at. You should therefore look at the above BOOK KEEPING at this stage as though the above entries had not been made and, later in this example, the correct time and sequence for the above entries are indicated.

Now having completed the double entry BOOK KEEPING for each of the transactions we simply list down all the balances on each Account to show as either a debit or a credit balance. This listing is sometimes called a Trial Balance since it proves the arithmetical accuracy of the BOOK KEEPING.

The proof of this accuracy is that the list of debit balances equals the list of credit balances and as long as the double entry has been correctly recorded for each transaction then we must balance.

It also should be observed what is meant by either a 'debit balance' or a 'credit balance' on an Account. A 'debit balance' on an Account simply means that the sum of the debit entries on that Account exceeds the sums of the credit entries. The Bank Account in this example shows debit entries of \$3230.00 and credit entries of \$1050.00 and this gives a debit balance of \$2180.00. You will observe the method of striking the balance on the Account and the fact that the debit balance does appear finally on the debit side.

A 'credit balance' is the reverse and occurs when the sum of the credit entries exceeds the sums of the debit entries. Pubs Org Account in this example shows credit entries of \$1100.00 and debit entries of \$100.00 to give a credit balance of \$1,000.00. Again you will note the method of striking the balance and the fact that the credit balance does appear finally on the credit side.

<u>TRIAL BALANCE</u>		<u>Debit</u>	<u>Credit</u>
<b>IMPERSONAL ACCOUNTS -</b>			
Purchases of Books & Meters		1100.00	
Wages		80.00	
Rates		200.00	
Rent		250.00	
Electricity		70.00	
Telephone		60.00	
Stationery		80.00	
Sales of Training & Processing			1000.00
Sales of Books & Meters			330.00
<hr/>			
Furniture		500.00	
Bank Account		2180.00	
<b>PERSONAL ACCOUNTS SUPPLIERS -</b>			
Pubs Org	1,000.00		
Telephone Co	60.00		
Godstone	80.00		
Simons & Co.	<u>250.00</u>		
			1390.00
<b>PERSONAL ACCOUNTS - STUDENTS and PRECLEARS</b>			
Beel		100.00	
Sprake			500.00
<b>PERSONAL ACCOUNT OWNER John Smith</b>			
		<u>4620.00</u>	<u>4620.00</u>

Observations on the Trial Balance

1. If you follow through all the Accounts above you will observe that we have simply listed down onto the Trial Balance all debit balances and all credit balances shown on the various Accounts. Again it must be stressed that those entries marked "Transfer to Income and Expenditure Account" must be ignored at this stage since they occur later in the sequence of actions.

You will observe that the debit balances listed do equal the credit balances and so the arithmetical accuracy of the BOOK KEEPING is proven.

2. If you look at the debit balances on the Trial Balance you will observe that a debit balance should equal either:

- a. The cost of MEST or SERVICES used up in the period
- or b. An Asset.

If you look at those debit items above the line drawn you will observe that these should represent the cost of MEST or SERVICES used up in the Period. And if you look at those debit balances below the line you will observe that these are Assets, i.e. Furniture, Bank Account, Debt due from Beal.

3. If you look at the credit side of the Trial Balance you will observe that a credit balance equals either:

- a. The value earned in the Period
- b. A liability.

If you look at the items above the line drawn on the Trial Balance you will observe that these represent the value earned by The Organization. And if you look at the items below the line you will observe that these are Liabilities.

4. All the debit and credit balances shown above the line go into and compose the Income and Expenditure Account since this shows the value earned by The Organization against the cost of MEST and SERVICES used up by The Organization in the Period. The resulting balance on the Income and Expenditure Account represents either Profit or Loss and is carried to the Balance Sheet.

5. All the items shown below the line drawn go into the compose the Balance Sheet since the Balance Sheet is simply a list of Assets and Liabilities. To these is added the balance from the Income and Expenditure Account and this, as noted above, represents either an Asset or Liability according to whether it is a Loss or a Profit.

6. The next thing to realize is that the Income and Expenditure Account and Balance Sheet are one complete report. You cannot complete one without the other and it must be appreciated that the Balance Sheet is not a separate document all on its own.

It is the Income and Expenditure Account and Balance Sheet which give the complete financial report for the Period and together they represent all the BOOK KEEPING and Accounts.



7. The actions now necessary are:

- a. Take all the items above the line and place into the Income and Expenditure Account as shown below.
- b. Strike the balance on the Income and Expenditure Account and bring into the Balance Sheet as either profit or loss.
- c. Take all the items below the line and bring into the Balance Sheet.
- d. Obviously your Balance Sheet must now balance since the Trial Balance balanced in the first instant.

All we have done is to take those items above the line and summarize their result in the Income and Expenditure Account. This result (representing either profit or loss) is then carried down to join those items below the line on the Balance Sheet. Quite obviously this must balance.

Now, let us prepare the Income and Expenditure Account and Balance Sheet in accordance with the above.

John Smith - Franchise

Income and Expenditure Account for the three months to 31st March

Purchases of Books & Meters	1100.00	Sales of Training and Processing	1,000.00
Wages	80.00	Sales of Books and Meters	330.00
Rates	200.00	Loss for the Period carried to Balance Sheet	510.00
Rent	250.00		
Electricity	70.00		
Telephone	60.00		
Stationery	80.00		
	<u>1840.00</u>		<u>1,840.00</u>

Balance Sheet as at 31st March

<u>Assets</u>		<u>Liabilities</u>	
Furniture	500.00	John Smith - Capital Account	1400.00
Balance at Bank	2160.00	Amounts due to Suppliers	1390.00
Debt due to The Organization	100.00	Advance Payment	500.00
Income and Expenditure Account			
- Loss for the Period	510.00		
	<u>3290.00</u>		<u>3290.00</u>

Observations on the Income and Expenditure Account and Balance Sheet:

1. The Income and Expenditure Account is composed of Accounts which are terminatedly handled for the Period concerned, i.e. as representing either the value earned by The Organization or the value of MEST or SERVICES used up in the Period.

Thus the final BOOK KEEPING entry on each of the Accounts placed into the Income and Expenditure Account is one marked "Transfer to Income Expenditure Account." The effect of this entry is merely to transfer the balance on each of the Accounts concerned to one Large summarizing Account The Income and Expenditure Account. This final BOOK KEEPING entry has the effect of permanently closing off each of the Accounts concerned as far as that period is concerned.

The entry "Transfer to Income and Expenditure Account" has been shown above on all the Impersonal Accounts so transferred to the Income and Expenditure Account.

But it should now be appreciated that the time at which this entry is made is when preparing the Income and Expenditure Account. Thus the Trial Balance is extracted first to prove the arithmetical accuracy of the BOOK KEEPING and then on preparation of the Income and Expenditure Account the relevant Accounts are closed off with the entry "Transfer to Income and Expenditure Account."

2. The Balance Sheet is composed of all the other Accounts representing either Assets or Liabilities. These Accounts are not terminatedly handled at the Balance Sheet date and so remain as "Balances." Hence the term "Balance" Sheet - it is simply a sheet of paper listing down all those Accounts not terminatedly handled and therefore still showing a "Balance."

3. The Income and Expenditure Account shows a debit balance or Loss for the Period of \$510.00 and this is carried to the debit side of the Balance Sheet as representing an Asset.

It is an Asset because it means that the owner, John Smith, owes this amount to The Organization.

However since The Organization already owes John Smith \$1400.00 on his Capital Account then the usual showing of this Loss is to deduct it from this sum owing to Smith.

Thus the Balance Sheet would record it as follows:

John Smith -- Capital Account	1400.00	
Loss Loss for the Period	<u>510.00</u>	890.00

Thus the Loss of \$510.00 disappears from the Assets side of the Balance Sheet and, on the Liabilities side, the debt due to Smith is reduced to \$890.00 as shown above. Obviously we still balance since all that has been done is to reduce the Asset side and the Liability side of the Balance Sheet by \$510.00 each.

4. On the Asset side of the Balance Sheet you will note that the debt due by Beal of \$100.00 is shown as "Debt due to the Organization." This could also have been described as "Sundry Debtor" or else "Account Receivable."

5. On the Liabilities side of the Balance Sheet the amounts due to Suppliers are collectively shown in the total of \$1390.00. Such amounts due to Suppliers could also have been described as "Sundry Creditors" or else "Accounts Payable."

6. The Liability due to Sprake of \$500.00 for his advance payment is described as this, i.e. "Advance Payment."

A NOTE ON BANK ACCOUNTS

In example 30 above, the Bank Account maintained by The Organization shows a debit balance of \$2180.00. This is an Asset and means that The Organization has that much MONEY in the Bank.

Now the fact that a debit balance on The Organization's Bank Account, as above, means that The Organization owns that much MONEY sometimes causes confusion.

This confusion arises because when the Bank, with whom The Organization deals, presents its Statement of the Bank Account, it will show a credit balance of \$2180.00 - not a debit balance. In other words the Bank in presenting its Statement shows the complete reverse of the situation as shown by The Organization's BOOK KEEPING.

Now this is perfectly correct and is understandable if you realize that the Bank is presenting its own BOOK KEEPING records; these are different BOOK KEEPING records to those kept by The Organization.

And when the Bank holds \$2180.00 of The Organization's MONEY then, factually, it owes this MONEY to The Organization. Therefore the credit balance of \$2180.00, as shown by the Bank Statement, reflects the liability of the Bank to The Organization.

If you work out the BOOK KEEPING records that the Bank would keep you will see how this arises. You will see that when The Organization banks MONEY that the Bank must, in its BOOK KEEPING, credit the Account of The Organization because it owes The Organization this much MONEY. From the Bank's point of view the Account maintained by it for The Organization is a Personal Account of an Outside Person, and it must credit that Account with all MONIES that The Organization banks.

And, reversely, the Bank will debit the Account of The Organization for all cheques disbursed by The Organization.

In summation therefore if you realize that the Bank Statement presented by the Bank represents its BOOK KEEPING record of the Personal Account that it keeps for The Organization then the matter becomes clear. Therefore the Bank Statement prepared by the Bank is always the complete reverse to that maintained in The Organization's BOOK KEEPING.

And when the Bank Manager tells you that The Organization is "in credit" to the amount of \$2180.00 then he is telling you that the Bank owes that much MONEY to The Organization.

Of course the complete reverse would apply if The Organization Bank Account was overdrawn. If we were to assume that in Example 30 that The Organization had disbursed \$3230.00 and received \$1050.00 then The Organization's records would show a credit balance on its Bank Account of \$2180.00. This credit balance would mean that The Organization had a liability of this amount since it owed this sum to the Bank.

The Bank, in presenting its bank Statement would show a debit balance of \$2180.00. Again, this is perfectly correct, since the Bank is presenting its BOOK KEEPING records and the debit balance on the Bank statement means that the Bank has an asset of this amount because The Organization owes this amount to it. Therefore when the Bank manager tells the Organization that it has a 'debit balance' on its Bank Account he means that The Organization owes this amount of MONEY to it.

Derek Field  
Accountant WW

for

Denny Gogerly  
Treasurer WW

for

Herbie Parkhouse  
D/Guardian Finance WW

for

Jane Kember  
The Guardian WW

for

Mary Sue Hubbard  
The Controller

for

L. RON HUBBARD  
FOUNDER