South Valley University
Faculty of Commerce
Accounting Department
©©©©©©©©©©©©©©©©

Lectures in

FINANCIAL ACCOUNTING1

Prepared by

Dr. Ali Abdelkarim Rawy

Ph.D. in Accounting
Hull University-England

2022/2023

IN THE NAME OF ALLAH, THE MOST GRACIOUS, THE MOST MERCIFUL

THIS TEXTBOOK IS DEDICATED TO
THE MEMORY OF MY FATHER AND MY MOTHER
&
MY WIFE AND MY CHILDREN

Preface

Praise to ***Almighty ALLAH*** who gave me the strength, patience, and ability to complete this textbook.

This textbook has been written to provide student with a very comprehensive introduction to Financial Accounting regarding sole proprietorships, which is covered in two issues. The splitting of this textbook between two issues is a recognition of the fact that many students will get all that they require to have a good idea about the nature of accounting and its environment, the theoretical framework of accounting , the accounting cycle and so on, contained in the first issue: Financial Accounting 1. The second issue: Financial Accounting 2 will be devoted to accounting issues, such as the nature of accounting communication, financial statements in commercial and industrial enterprises, financial statements analysis, and other accounting problems that pay the students attention to a more advanced stage in studying financial accounting.

Therefore, this textbook is divided into a variety of chapters intended to put the students, who study business, on the right way towards understanding financial accounting. Chapter one of this issue covers the nature of accounting. Chapter two introduces to the changes in financial position and accounting cycle. Chapter three also discusses the accounting for merchandising operations.

Qena, September 2022.

CHAPTER ONE

THE NATURE OF ACCOUNTING

CHAPTER ONE

THE NATURE OF ACCOUNTING

Chapter Learning Objectives

This chapter aims to:

1) Explain why people other than professional accountants benefit from an understanding of accounting.

2) Define accounting, financial reporting, financial statements, public information, and generally accepted accounting principles.

3) Prepare a balance sheet and describe its content.

4) Describe the accounting principles involved in asset valuation.

5) Indicate the effects of business transactions upon the accounting equation and the balance sheet.

1.1 What is accounting?

Accounting is something that affects people in their affairs and personal lives just as much as it affects small and large firms. In effect, some people think of accounting as a highly technical field which is practiced only by professional and very specialized accountants. However, we all use accounting ideas and actions when we plan what we do and we are going to do with our money and our wealth in general. We have to plan how much of money we have to spend and how much we have to save for future use. Most of us may write down a plan or a note, which is known as a '*budget*', or we may simply keep it in our minds (Wood, 1993).

Actually, almost entirely everyone practice what we call *accounting* in one form or another on nearly daily basis.

Accounting often is termed as or called the '*language of business'* because it is so widely and rightly used in expressing and describing all types of business activities. For instance, every investor, manager, and business decision maker needs a clear and thoroughly understanding of accounting terms and concepts if he/she is to take part or participate and communicate effectively and efficiently in the business community (Meigs, et. al, 1996).

Usually, the main function of a language is to serve as a means of communication among its speakers. Similarly, accounting also serves and performs this function. It communicates the results of business operations to various parties who have some interest or stake in the business, namely the proprietor or owner, creditors, investors, government and other parties. Though, accounting is generally related to business, but it is not only business makes use of accounting. For instance, the person who is responsible for housekeeping and his/her family' affairs has to keep a record of the money received and spent by him/her during a given period. He/she can record his/her receipts of money on one page of the household *diary*, while payments for different items such as food, clothing, bills, rent etc. on some another page or pages of the *diary* in a chronological order. Such a record will help in knowing regarding (Maheshwari, 1996):

1) The sources from which he or she received cash and the purposes for which it was used.
2) Whether his or her receipts are more than his or her payments or *vice-versa*?
3) The balance (the remaining) of cash in hand or deficit, if any at the end of a particular period.

1.2 Do we need accounting?

As mentioned above, in case the person who is responsible for housekeeping and family affairs, he/she can collect valuable data and information regarding the nature of his/her receipts and payments. For example, this person can find out the total amount spent by him/her during a given period, say a year, on different items he/she purchased. Similarly, he/she can find out the sources of his/her receipts such as salary or wages from work, rent received from let property, selling some properties, and so on. Therefore, at the end of such period, he/she can see for himself/herself regarding his/her financial position i.e., what he/she owns and what he/she owes. Such information will help that person in planning his/her future income and expenses to great extent (or preparing a budget).

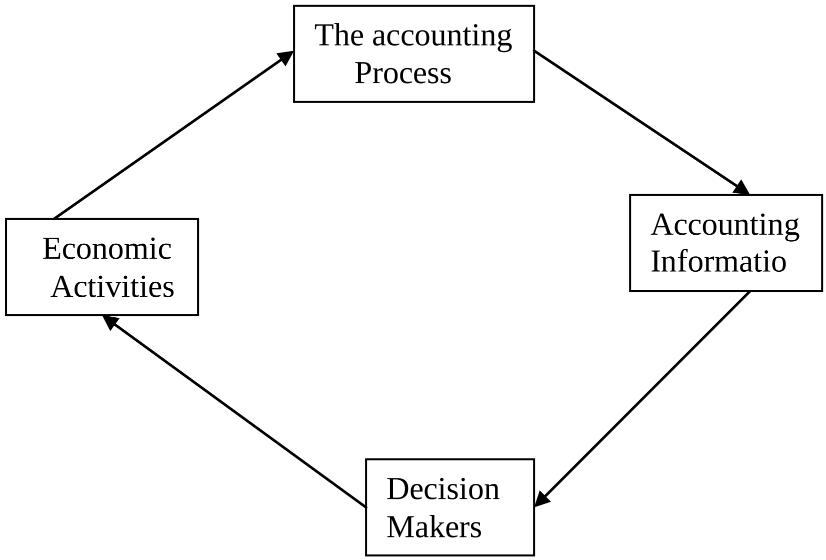
[redacted]

[redacted] Hence, we think that at the level of individual, accounting can have three roles or functions, *i.e.* planning, controlling and decision support. On the other hand, at the level of the enterprise, accounting is used to control the activities of the organization, to plan future activities, to assist in raising finance and to report upon the activities and the extent to which the enterprise is considered successful to interested parties. We will see that the main difference between the two levels is that in case of an enterprise, apart from (in addition to) its uses in planning, controlling and decision making which are all internal activities or functions, accounting also has what we could call an external function, which focuses on providing information to parties outside the enterprise (Berry and Jarvis, 1997).

Therefore, the need for accounting is considered all the more importance for a person who is running or planning to run a business. He/she has to know the following:

a) What he/she owns?
b) What he/she owes?
c) Whether he/she earned a profit or suffered a loss as a result of running a business?
d) What is his/her financial position (whether he/she will be in a position to meet all his/her commitments or obligations in the near future or he/she is in the process of becoming a bankrupt)?

In short, the major purpose of accounting, whether on the level of the individual or on the level of the enterprise, is to provide decision makers with *information useful in making economic decisions*. Accordingly, the inputs or the raw materials to the accounting process are the economic activities and the outputs or products are useful information. This relationship could be illustrated as follows (Meigs, et. al, 1996, adapted):



According to the above diagram, to use accounting information effectively, you must appropriately understand:

- The ***nature of the economic activities*** described in accounting reports.
- The ***assumptions*** and ***measurement techniques*** involved in the accounting process.
- How to ***relate the accounting information*** to the decision at hand (Ibid.).

1.3 Accounting Branches and Information:

Practically and in order to satisfy the various needs of different groups of users and people interested in the accounting information, different branches of accounting have been developed. As there are many types of economic decisions, there are many types of accounting information. To describe the types of accounting information used widely in the business community, many terms of accounting are used; the most prevailing of them are *Financial Accounting, Management Accounting*, and *Tax Accounting*. They are briefly presented as follows:

1.3.1 Financial Accounting:

Financial accounting is the original form of accounting, which is basically confined to the preparation of financial statements for the external users. It is usually interested in providing *general purpose* information. It refers to information describing the financial resources, obligations, and activities of an economic entity, whether it is an organisation or an individual entity.

Basically, financial accounting information is intended and designed to help investors and creditors decide where to place their scare investment resources (FASB, 1999). Such decisions are of great importance to any society, as they determine which enterprises and industries will receive the available financial resources necessary for economic growth.

Moreover, many other decision makers also make a fundamental use of financial accounting information. For example, an enterprise's managers and employees constantly need such information in order to run and control day-to-day business operations. In short, financial accounting information is used to serve so many different purposes that it often is called *general purposes* accounting information.

1.3.2 Management Accounting:

Management (or managerial) accounting is accounting for the management which provides necessary information to the enterprise's management for discharging its functions. Primarily, it involves the development and interpretation of accounting information aimed specifically to assist management in running the business. For example, managers use such information in setting the enterprise's overall goals, evaluating the performance of departments and individuals, deciding whether to introduce a new line of products, and making all types of managerial decisions.

Management accounting covers a variety of areas such as cost accounting, budgetary control, stock or inventory control, statistical methods, internal auditing etc. However, it should be kept in mind the fact that much management accounting information is financial in nature, but has been organised and developed in a manner connected directly to the decision under condition.

1.3.3 Tax Accounting:

Conventionally, the preparation of income tax returns (or declarations) is considered a specialized field within accounting. Actually, tax returns are based, to a great extent, upon financial accounting information. Nevertheless, the information often is adjusted or recognized to confirm with income tax reporting requirements.

The most challenging aspect of tax accounting is not the preparation of an income tax return, but *tax planning.* Tax planning; means anticipating the "***tax effects"*** of business transactions and structuring these transactions in a manner that will minimize the income tax burden.

You have to consider that the fields of financial, management, and tax accounting are ***closely related***.

1.4 Financial Reporting:

Practically, all of the accounting information developed within an organisation is available to management. Nevertheless, much of the company's financial information also is distributed to people *outside* of the organization. These ***"outsiders"*** may include investors, creditors, financial analysts, labour unions, and the general public-even the company's competitors. Each of these groups either supplies money to the business or has some other interest in the company's financial activities.

The process of supplying general-purpose financial information to people outside the organization is termed ***financial reporting.*** *Publicly owned corporations* are ***required by law*** to make much of their financial information ***"public"***–that is, available to everyone. A company is **publicly owned** whenever ownership "*shares*" in the company are offered for sale to the general public.

On the other hand, small businesses are *not* required to provide financial information to the public. However, banks or other major creditors frequently insist upon receiving this information from the business as a condition for making a loan.

1.4.1 Financial Statements:

The basic tool or means of communicating general-purpose financial information to the outsider or external users is a set of accounting reports that termed "**Financial Statements**". The persons or the groups receiving these reports are termed the ***users*** of the financial statements.

Generally, a set of financial statements includes four related accounting reports that summarize in a few pages the financial resources, obligations (or liabilities), profitability, and cash transactions of an enterprise.

Furthermore, a complete set of financial statements should contain several pages of notes, which include additional information which accountants think that it is useful in the interpretation of the financial statements. From the above discussion on financial statements, it is appeared that the basic purpose of financial statements is to help their users evaluate the *financial position*, *profitability* and *future prospects* of an enterprise.

1.4.2 The Functions of an Accounting System:

In the real world, most, if not all, business organizations have an ***accounting system*** for preparing financial statements, income tax declarations, reports to managers, bills to customers, and other types of required accounting information. In its simple form, an accounting ***"system"*** consists of the personnel (staff) procedures, devices, and records used by an entity in developing accounting information and in communicating this information to decision makers. Accounting systems often make use of computers and other electronic devices, as well as handwritten forms and records.

1.4.3 The Transactions Approach to recording Economic Activity:

Accounting reports summarize information which has been recorded in the accounting system. In ***recording*** economic activities, accountants focus upon completed ***transactions***−that is, events that:

1) cause an ***immediate change*** in the financial resources or obligations of the business and,

2) can be ***measured objectively*** in monetary terms.

Examples of such transactions include purchasing or selling goods or services, receiving cash, and making cash payments. Of course, the primary strength of this ***"transactions approach"*** lies in the **reliability** of the information that is recorded. The recorded information is based upon past events, for which the financial effects upon the business can be measured with a reasonable degree of *objectivity*. Accountants use the term **objective** to mean neutral, free from bias, and verifiable in amount. The concept of **objectivity** is a generally accepted accounting principle and has a profound effect upon accounting practices and accounting information.

1.4.4 Annual Reports:

In practice and as a part of the financial reporting process, large business organizations prepare ***annual reports*** for distribution to investors and to anyone requesting a copy. Included in these annual reports are audited financial statements for each of the last several years. These *comparative* financial statements enable users to identify ***trends*** in the company's performance and financial position. Annual reports also include the auditors' reports on the comparative statements and discussions by top management of the company's financial position, profitability, and future prospects. Additionally, they contain much nonfinancial information about the company's objectives, products, and operations.

1.5 Generally Accepted Accounting Principles (GAAP):

Accounting principles can be defined as those rules of action or conduct which are adopted by the accountant universally while recording accounting transactions. They are the ground rules of financial accounting which are based on consensus, but they are not the subject of immutable law. The GAAP provides the general framework determining what information should be included in financial statements, and how this information is to be presented.

The generally accepted accounting principles include the basic objectives of financial reporting, in addition to a variety of broad concepts and many detailed rules. Accordingly, such terms as objectives, standards, concepts, assumptions, methods, and rules often are used in describing specific generally accepted accounting principles.

But, it should be taken into account the fact that there is no comprehensive list of generally accepted accounting principles, as new accounting principles emerge continuously as business organizations enter into new forms of business activity (Meigs, et. al, 1996). The most important accounting concepts (principles) are briefly presented as follows (Maheshwari, 1996, Meigs, et. al, 1996):

1. The Concept of the Business Entity: In accounting, business is considered to be a separate entity from the proprietor (the owner). Thus, the GAAP requires that a set of financial statements describe the affairs of a specific business entity. A **business entity** is an economic unit that engages or involves in specific business activity.

2. The Going Concern Concept (Assumption): According to this concept, it is assumed that the business will continue for a fairly long time to come. Therefore, there is neither the intention nor the necessity to liquidate the particular business in the foreseeable future.

3. Money Measurement Concept: Accounting records only monetary transactions. As a result, events or transactions which cannot be expressed in terms of money do not record in the books of accounts although they may very useful for the business.

4. Cost Concept: This concept is closely related to going concern concept. According to this concept, enterprise's properties are normally entered on the accounting records at the price paid to acquire them and this cost is the basis for all subsequent accounting for these properties.

5. Dual Aspect Concept: This concept is considered one of the most important concepts of accounting. According to this concept, every business transaction has a dual effect.

6. Accounting Period Concept: The idea behind this concept is that the life of the business is divided into appropriate segments or portions for studying the results shown by the business after each segment. According to going concern concept, the life of the business is considered to be indefinite or unlimited and the measurement of income and studying the financial position of the business after a very long period of time would not be helpful in taking right corrective steps at the appropriate time.

7. Periodic Matching of Costs and Revenues: This concept is based upon the accounting period concept. The prime objective of running a business is to earn profit. In order to determine the profit made by the business during a particular period, it is necessary that **revenues** of the period should be matched with the **costs (expenses)** of that period.

8. Realisation Concept: According to this concept, revenues should be recognized only when a sale of goods is actually made.

1.6 The Starting Point in the Study of Accounting:

In practice, the accounting cycle includes three major steps: recording or journalizing accounting transactions, posting recorded events to related accounts in ledger books, and the preparation of financial statements. Accordingly, the preparation of financial statements is considered the last step in such cycle. However, the preparation of financial statements may be considered a logical point to begin the study of accounting.

Financial statements convey a summarized picture of the profitability and financial position of the business to management and to interested outside-users. Financial statements are considered the final product of the accounting cycle, as they summarize the thousands or millions of transactions recorded during the year.

The three most widely used financial statements are the *Balance Sheet,* the *Income Statement,* and the *Statement of Cash Flows*. In the remaining of this chapter we will study or explore the nature of the

Balance Sheet, or **Statement of Financial Position**, which is the other name of the balance sheet, to be familiar with the form and arrangement of the balance sheet and with the meanings of technical terms such as **Assets, Liabilities,** and **owner's Equity.**

The Balance Sheet:

The following balance sheet illustrates the financial position of Luxor Travel Agency at December 31, 2020.

LUXOR TRAVEL AGENCY
Balance Sheet
December 31, 2020

Assets		**Liabilities & Owner's Equity**	
Cash L.E.	225000	*Liabilities:* L.E	
Notes Receivable	100000	Note payable	410000
Accounts receivable	605000	Accounts payable	360000
Supplies	20000	Salaries payable	30000
Land	1000000	Total Liabilities	800000
Building	900000	*Owner's equity:*	
Office Equipment	150000	Amr, Capital	2200000
Total	***3000000***	*Total*	***3000000***

The main features of this balance sheet are presented as follows:

The **Title** (heading) sets forth three things; a) the name of the business entity, b) the name of the financial statement, and c) the balance sheet date. The **Body** of the balance sheet consists of three special sections; *Assets, Liabilities,* and *Owner's Equity.*

In the above balance sheet, also, you will see that cash is listed first among the assets, followed by notes receivable, accounts receivable, supplies, and any other assets that will *soon be converted or transferred to cash or used up in business operations.* Following these relatively **liquid** assets are the more **permanent** assets, such as land, buildings, and equipment. **Liabilities** are presented before owner's equity. Each main type of liability, such as notes payable, accounts payable, and salaries payable, is listed separately, followed by a figure which shows total liabilities. Furthermore, you will see that the amount of total assets (L.E.3000000) is ***equal*** to the total amount of liabilities and owner's equity (L.E.3000000). This relationship ***always exists.*** The *equality of these totals* is one reason that this financial statement is termed a ***balance*** sheet.

According to the concept of the **business entity**, **LUXOR** is a business organization operating as a travel agency. The owner of this organization, Mr. Amr, may have a personal bank account, a house, a car, a computer, and even another business. These items or properties are not involved or worked in the operation of the travel agency and must not show or appear in **LUXOR's** financial statements (i.e. balance sheet). When the owner tries to intermix (intermingle) his/her personal affairs with the transactions of the enterprise or entity, the resulting financial statements would fail to show obviously the financial position and the results of operations of this enterprise.

ASSETS:

Assets are defined as economic resources that are owned by a business enterprise and are expected to benefit or utilize future operations of that enterprise. In effect, assets may have determined or definite (clear) physical form or shape such as buildings, cars, equipment, or an inventory (stock) of goods (merchandise), on one hand. Some assets exists not in physical or tangible (material) form, but in form of valuable legal claims or rights such as amounts due from customers (accounts receivable) and patent rights, on the other.

According to accounting principles, the valuation of most assets in a balance sheet should be at cost, rather than at appraised market values, which is known as the cost principle discussed previously. As such, assets such as land, buildings, cars, and equipment are typical of the many economic resources that will be used in yielding or producing revenues or income for the business. The prevailing accounting point of view is that such assets should be recorded at their original cost. The original cost appeared in the balance sheet of the asset to the business entity means that such asset should be recorded at its ***historical cost***. This amount may be very different from the asset's current market value. For example, when **LUXOR** bought the land paid L.E.1000000 in cash. The amount considered to be entered in the accounting records as the value of the asset was the cost of L.E.1000000. If we assumed that the fair market value of the land 15 years later might be L.E.3000000, although the market or economic value of the land has got up or raised greatly, the accounting value as illustrated in the accounting records and on the balance sheet would continue unchanged at the cost of L.E.1000000.

Another accounting principle or assumption related to cost principle is the **going-concern assumption.** In practice, it will be proper to question why accountants do not change the recorded value of assets to follow or correspond with changing market values of such assets. Perhaps one reason is that the land and building, for example, being used to house the business were obtained or acquired for **use** and not for sale.

LIABILITIES:

Generally, liabilities are debts or obligations and the person or enterprise to whom the debt is owed is termed a *creditor*. In fact, most, if not all, businesses have liabilities; even the largest or biggest and most successful enterprises often purchase goods, supplies, and services on account. The liabilities emerged from such purchases are called *accounts payable*. Many organizations borrow money from financial institutions to finance their expansion or the high-cost assets. Among liabilities is a *note payable*, which is a written promise or commitment to repay the amount owed by a specified date and usually calls for the payment of interest, in addition to its value.

In contrast with notes payable, *accounts payable* require no written promises or commitments and in most cases do not call for interest payments. Therefore, a note payable is considered a **more formal** arrangement. When a business entity has both notes payable and accounts payable, the two types of liabilities are listed separately in the business' balance sheet. Other types of short-term obligations, such as salaries (wages) payable can either be listed separately or combined with the amount presented as accounts payable. The liabilities section of the balance sheet should encompass a subtotal indicating the total amount of liabilities, as we saw in **LUXOR's** balance sheet.

It should be noticed that liabilities represent **claims** against the enterprise's assets. The owner of an enterprise also has claims to the business' assets. But legally, creditors' claims **have priority** over those of the owners. As such, creditors are qualified or entitled to be **paid in full**, even if such payment should cover or exhaust the assets of the enterprise and let nothing for its owners.

OWNER'S EQUITY:

As we might understand from preceding discussion, **owner's equity** represents the *owner's claim* to the assets of the enterprise. As creditors' claims have legal priority over those of the owner, owner's equity is a **remaining or residual amount.** If you are the proprietor of a business, you are qualified to *whatever's left* after satisfying the claims of creditors in full. Hence, owner's equity is always equal to *total assets minus total liabilities.* For instance, consider the data of Luxor Travel Agency, as follows:

Luxor has total assets of ……………. L.E.3000000

And total liabilities of ……………………...... 800000

Accordingly, the owner's equity should be **2200000**

Therefore, owner's equity does ***not*** represent a determined claim to cash or any other specific asset. But, it is the owner's *overall financial interest* in the entire business. Increase in owner's equity in a business comes from two sources:

a) **Investment** by the owner.

b) **Earnings** from profitable operation of the enterprise.

On the other hand, decreases in owner's equity also are occurred or caused in two ways:

a) **Withdrawals of cash or other assets** by the owner.

b) **Losses** from unprofitable operation of the business.

1.7 The Accounting Equation:

In effect, the whole body of financial accounting is based upon a very simple idea which is called **accounting equation.** In other words, a fundamental characteristic of every balance sheet is that the total figure for assets always equals the total of liabilities plus owner's equity. The listing of assets shows us what things the enterprise owns; the listing of liabilities and owner's equity tells us who provided or supplied these resources to the enterprise and how much each group supplied. Anything that an enterprise owns has been supplied to such enterprise either by creditors or by the owner. Accordingly, the total claims of the creditors in addition to the claim of the owner equal the total assets of the enterprise.

The equality of assets on the one hand and of the claims of the creditors and the owner on the other hand can be expressed in the following **accounting equation:**

Assets = Liabilities + Owner's Equity.
L.E.3000000 = L.E.800000 + L.E.2200000.

Notice that the amounts appeared in this accounting equation were obtained from the balance sheet of Luxor Travel Agency. The balance sheet is considered as a detailed statement of this equation. Also, to assert that the owner's equity is a **remaining claim**, secondary to the claims of creditors, it is often helpful to convert or transfer the terms of the equation as presented below:

Assets	**– Liabilities**	**= Owner's Equity**
L.E.3000000	**– L.E.800000**	**= L.E.2200000**

The continuing equality of the two sides of the balance sheet will be highlighted in the next example to observe the effects of various transactions of a new business on its balance sheet.

A Preliminary Illustration:

In this illustration, the effects of business transactions on its balance sheet and the basic accounting concepts and procedures will be considered. A small auto repair will be used as an example.

<u>The Business Entity</u>: Assume that Ahmed Adel, an experienced auto mechanic, starts his special automotive repair business, **Engineer Auto Service**.

<u>Engineer's Accounting Policies:</u> Ahmed Adel has taken several courses in accounting in the Accounting Department, at the Faculty of Commerce, South Valley University and he will maintain Engineer's accounting records himself.

<u>The Business' First Transaction:</u>

Ahmed Adel began his business officially on November 1, 2020, by allocating L.E.800,000 of his personal savings, for his business . This transaction provided Engineer with its first **asset**-Cash - and also created the initial owner's equity in the business entity. A balance sheet indicating the enterprise's financial position after this initial transaction shows below:

ENGINEER AUTO SERVICE
Balance Sheet
November 1, 2020

Assets		**Liabilities & O. Equity**	
Cash L.E.	<u>800000</u>	Ahmed Adel, Capital	<u>800000</u>
Total	*<u>800000</u>*	*Total*	*<u>800000</u>*

Engineer's next two transactions included the acquisition of a suitable site for its business operations.

Purchase (Buying) of an Asset for Cash:

Representing the enterprise, Ahmed Adel negotiated with the City Council of Qena to purchase an abandoned old bus garage that its building is owned by the City Council and its land is owned to some people.

On November 3, Engineer purchased the land from its owner for **L.E.520,000 cash.** The analysis of this transaction revealed that it had two immediate effects on the business' financial position: first, Engineer's cash was reduced by L.E.520,000; and second, the business acquired a new asset-Land. The Enterprise's financial position following this transaction was as follows:

ENGINEER AUTO SERVICE
Balance Sheet
November 3, 2020

Assets		Liabilities & Owner's Equity	
Cash L.E.	280000	Ahmed Adel, capital	800000
Land	520000		
Total	*800000*	*Total*	*800000*

<u>Purchase of an Asset and Financing Part of the Cost:</u> On November 5, Engineer purchased the old garage building from the City Council for **L.E.360,000.** Engineer made a cash down payment of L.E.60,000 and issued a 90-day non-interest-bearing note payable for the **L.E.300,000** balance owed.

Because of this transaction, Engineer had (a) **L.E.60,000** less cash; (b) a new asset, Building, which cost **L.E.360,000**; and (c) a new liability, Note Payable, in the amount of **L.E.300,000.** This transaction is shown in the following balance sheet:

ENGINEER AUTO SERVICE
Balance Sheet
November 5, 2020

Assets		**Liabilities & Owner's Equity**	
Cash L.E.	220000	Notes Payable	300000
Land	520000	<u>Owner's equity</u>	
Building	<u>360000</u>	Ahmed Adel, capital	<u>800000</u>
Total	*<u>1100000</u>*	*Total*	*<u>1100000</u>*

Purchase of an Asset "On Account":

On November 17, Engineer purchased tools and automotive repair equipment from United Tools Group. The purchase price was **L.E.138,000,** due within 60 days. Following this purchase, Engineer's financial position was as follows:

ENGINEER AUTO SERVICE
Balance Sheet
November 17, 2020

Assets		**Liabilities & Owner's Equity**	
Cash L.E.	220000	Notes Payable	300000
Land	520000	Accounts Payable	138000
Building	360000	Owner's equity	
Tools & equipment	138000	Ahmed Adel, capital	800000
Total	*1238000*	*Total*	*1238000*

Sale of an Asset: After taking delivery of the new tools and equipment, Engineer discovered that it had purchased more than it required. Some neighbouring business offered to buy the excess items. On November 20, Engineer sold some of its new tools for **L.E.18,000,** which is equal to Engineer's cost. The purchaser made no down payment, but agreed to pay the amount due within 60 days. A balance sheet after this transaction, as of November 20 appears below:

ENGINEER AUTO SERVICE

Balance Sheet

November 20, 2020

Assets		**Liabilities & Owner's Equity**	
Cash L.E.	220000	Notes Payable	300000
Accounts receivable	18000	Accounts Payable	138000
Land	520000	Owner's equity	
Building	360000	Ahmed Adel, capital	800000
Tools & equipment	120000		
Total	*1238000*	*Total*	*1238000*

Collection of an Account Receivable:

On November 25, Engineer collected **L.E.6,000** as partial settlement of Accounts receivable. This transaction will result in an increase in Engineer's cash and a decrease of the same amount in accounts receivable. In fact, this transaction only converts one asset into another of equal value; there is no change in the amount of total assets. A balance sheet of Engineer as of November 25 appears below:

ENGINEER AUTO SERVICE
Balance Sheet
November 25, 2020

Assets		Liabilities & Owner's Equity	
Cash L.E.	226000	Notes Payable	300000
Accounts receivable	12000	Accounts Payable	138000
Land	520000	Owner's equity	
Building	360000	Ahmed Adel, capital	800000
Tools & equipment	120000		
Total	*1238000*	*Total*	*1238000*

Payment of a Liability: On November 30, Engineer made a partial payment of **L.E.68,000** on its accounts payable. In essence, this transaction reduced Engineer's cash and accounts payable by the same amount, leaving total assets and the total of liabilities in addition to owner's equity equal. Engineer's balance sheet at November 30 may be summarised as follows:

ENGINEER AUTO SERVICE
Balance Sheet
November 30, 2020

Assets		Liabilities & Owner's Equity	
Cash L.E.	158000	Notes Payable	300000
Accounts receivable	12000	Accounts Payable	70000
Land	520000	Total liabilities……	370000
Building	360000	Owner's equity	
Tools & equipment	120000	Ahmed Adel, Capital	800000
Total……	*1170000*	*Total……………*	*1170000*

Summarising the Effects of the Above Transactions Made by Engineer on the Accounting Equation:

As we noted in the preceding discussion, it is appeared that the balance sheet is a detailed expression of the accounting equation, as summarised below:

Assets = Liabilities + Owner's Equity

In the preceding pages, the impacts of Engineer's November transactions upon the balance sheet were illustrated in detail. Now, the impacts of these transactions on the ***accounting equation*** will be presented below:

To remember, Engineer's business transactions during November were as follows:

-November 1 Ahmed Adel started his new business by allocating **L.E.800,000** for his business.

-November 3 Purchased land for **L.E.520,000**, paying by cash.

-November 5 Purchased an old building for **L.E.360,000**, paying **L.E.60,000** in cash and issuing a note payable for the rest of due amount, **L.E.300,000.**

-November 17 Purchased tools and equipment on account, **L.E.138,000.**

-November 20 Sold some of the tools at a value equal to their cost, **L.E.18,000,** collectible within 60 days.

-November 25 Received **L.E.6,000** in partial collection of the accounts receivable from the sale of tools.

-November 30 Paid **L.E.68,000** in partial payment of an accounts payable.

The effects of these transactions on the accounting equation are shown in the following table:

	Assets					=	Liabilities		Owner's Equity
	Cash	+ Accounts Receivable	+ Land	+ Building	+ Tools and Equipment	=	Notes payable	+ Accounts payable	+ Adel's capital
1	**800000**					=			**800000**
B.	800000					=			800000
3	**-520000**		**+520000**			=			
B.	280000		520000			=			800000
5	**- 60000**			**+360000**		=	**+300000**		
B.	220000		520000	360000		=			800000
17					**+138000**	=		**+138000**	
B.	220000		520000	360000	138000	=	300000	138000	800000
20		**+18000**			**-18000**	=			
B.	220000	18000	520000	360000	120000	=	300000	138000	800000
25	**+6000**	**-6000**				=			
B.	226000	12000	520000	360000	120000	=	300000	138000	800000
30	**-68000**					=		**-68000**	
B.	158000	12000	520000	360000	120000	=	300000	70000	800000
	=====	====	======	======	======		=====	======	======

Notice: B. (Balances).

1.8 Questions:

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(1) Effects of transactions on elements of the accounting equation:

Some of the transactions carried out by Sohag Enterprise during the first month of the firm's existence are listed below. You are required to determine the pound effect of each transaction on the total assets, the total liabilities, and the owner's equity of the business. Use the symbols (+) for ***increase***, (-) for decrease, and (NC) for ***no change***. An answer is provided for the first transaction to serve as an example (Amounts in L.E.).

Transaction	***Total Assets***	***Total Liabilities***	***Owner's Equity***
a Owner Mohamed Sami invested 1,000,000 cash in the business.	+1,000,000	NC	+1,000,000
b Purchased a computer for the business for 22,500.			
c Borrowed 150,000 from the bank.			
d Purchased office furnishings at a total price of 35,000, terms 5,000 cash and balance payable in two installments.			
e Paid 15,000 of the			

balance due on the office furnishings.			
f Sold an extra typewriter that had cost 1,500 for 1,750 on credit.			
g Collected 1,000 of amount receivable from the purchaser of the typewriter.			
h Bought a small truck to be used in the business for 85,000; paid cash in full.			

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(2) Computation of assets, liabilities, and owner's equity after a series of transactions:

The December 31, 2020, balance sheet of Cairo Realty reported total assets of L.E.9,000,000, total liabilities of L.E.3,500,000, and owner's equity of L.E.5,500,000. The following transactions occurred in January of 2021:

1) The business purchased land for L.E.2,500,000, paying L.E.1,000,000 cash and issuing a note payable for the balance.
2) The business collected accounts receivable totalling L.E.450,000.
3) The business sold one-fifth of the land (which had cost L.E.500,000) for L.E.600,000 cash.

4) The business paid off L.E.500,000 of the note payable.

Compute the following at January 31, 2021:

a Total assets L.E…………..

b Total liabilities L.E…………..

c Owner's equity L.E…………..

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(3) Preparation of balance sheet:

Prepare balance sheet on December 31, 2020, for Magi Productions, from the following list of items which are arranged in random order. You must compute the amount of land to complete the balance sheet (L.E.).

Accounts payable	900,000	Land…?	
Office equipment	204,000	Notes payable…….	3,200,000
Buildings………	3,750,000	Accounts receivable.	1,134,000
Magi, Capital…	3,514,000	Cash…………………	726,000

MAGI PRODUCTIONS

Balance Sheet

December 31, 2020

Assets	**Liabilities & Owner's Equity**

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(4) Completion of balance sheet:

Use the following information to complete the December 31, 2020, balance sheet of Magdy Yaqope Hospital.

1) Owner's equity at January 1, 2020, totalled L.E.2,500,000.
2) Owner made no withdrawals, but invested an additional L.E.250,000 cash in the business during 2020.
3) Net income for 2020 amounted to L.E.2,350,000.
4) Cash and accounts receivable together amount to 2½ times as much as notes payable.

MAGDY YAQOPE HOSPITAL
Balance Sheet
December 31, 2020

Assets (L.E.)		**Liabilities & Owner's Equity(L.E.)**	
Cash…………………	450000	Liabilities:	
Accounts receivable		Accounts payable	
Land…………………	1800000	Notes payable…..	800000
Building……………..		Total liabilities	
Equipment………….	1400000	Owner's equity:	
		M. Y., Capital	
Total………….	*7500000*	*Total*………	

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(5) Effects of transactions on balance sheet items:

Show the effects of each of the seven listed transactions on the balance sheet items of Printing Center Plus. Indicate the new balances after the transaction of ***May 2*** and each subsequent transaction. The effects of the ***May 1*** transaction are already filled in to provide you with an example.

May 1 Mo S began the business by depositing L.E.750,000 cash in a bank account in the name of the business.

2 Purchased a small office building at a price of L.E.580,000 for the land and L.E.650,000 for the building. Paid L.E.430,000 cash and signed a note payable for the balance.

8 Borrowed L.E.150,000 from the bank. Signed a 60-day note payable for this amount.

16 Purchased copying machines, computers, and other office equipment for L.E.190,000. Paid L.E.90,000 cash and signed a note payable for the balance.

28 Sold an item of office equipment (computer) to a friend at its cost of L.E.28,000. The friend paid L.E.8,000 cash and promised to pay the balance within 30 days.

30 Paid L.E.50,000 on the liability for the office equipment.

31 Collected L.E.5,000 from the individual who had bought the typewriter.

L.E.	Assets				=	Liabilities +	Owner's Equity
	Cash +	Accounts + Receivable	Land +	Buildings +	Office Equipment =	Notes Payable +	Mo S, Capital
May 1	750000						750000
2							
Balance							
8							
Balance							
16							
Balance							
28							
Balance							
30							
Balance							
31							
Balance							

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(6) Preparation of balance sheet:

The balance sheet items of the Gold Star Enterprise as of December 31, 2020, are shown below in random order. You are required to prepare a balance sheet for the enterprise, using a similar sequence of assets as you understood from your study of accounting. You should calculate the amount for Maha, Capital.

Land	L.E.450,000	Office equipment	L.E.51,000
Accounts payable	219,000	Building	1050,000
Accounts receivable	283,500	Maha, capital	?
Cash	181,500	Notes payable	1068,000

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(7) Accounting equation:

Compute the missing amount in each of the following three lines:

	Assets	=	Liabilities	+	Owner's Equity
a.	L.E.2,790,000	=	1,710,000	+	?
b.	?	=	2,812,500	+	1,875,000
c.	1,537,500	=	?	+	712,500

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(8) Preparation of balance sheet:

Listed below are some items to be included in the balance sheet of **Travel Golden Arrow Business** owned by Mai as on January 31, 2020:

Accounts payable L.E.130,500 Notes payable L.E.900,000 Accounts receivable L.E.37,250 Notes receivable L.E.47,500 Cars L.E.945,300 Equipment L.E.447,900 Land L.E.123,150 Mai, capital L.E.1,686,150 Cash L.E. ? Salaries payable L.E.48,750 Tents L.E.472,500 Trucks L.E.529,200

Required:

Prepare a balance sheet by using these items and computing the amount of cash at January 31, 2020.

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(9) Preparation of balance sheet:

Listed below in random order are the balance sheet items for **Toshka Farms** at June 30, 2020:

Land L.E.2,750,000 Fences & gates L.E.167,850 Barns & sheds L.E.391,500 Irrigation system L.E.100,625 Notes payable L.E.2,650,000 Cash L.E.83,550 Accounts receivable L.E.111,825 Livestock L.E.603,900 Citrus trees L.E.383,250 Farm machinery L.E.214,850 Accounts payable L.E.385,475 Adam, capital L.E. ? Taxes payable L.E.45,675 Wages payable L.E.9,100.

Required:

Prepare a balance sheet by using these items and computing the amount for Adam, capital.

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(10) Preparation of balance sheet after a series of transactions:

The balance sheet items of The Egyptian Food Shop (arranged in alphabetical order) were as follows at the close of business on December 31, 2020:

Accounts payableL.E.42,500 Land L.E.275,000 Accounts receivable L.E.6,250 Notes payable L.E. ? Building L.E.227,500 Capital L.E.270,450 Cash L.E.37,000 Supplies L.E.17,200 Furniture L.E.100,000.

During the first week of January 2021, the following transactions were occurred:

(1) **Jan. 3** The owner invested an additional L.E.150,000 cash in the business. The accounts payable were paid in full.

(2) **Jan 6** More furniture was purchased on account at a cost of L.E.90,000, to be paid within 30 days. Supplies were purchased for L.E.5,000 cash from a restaurant supply centre which was going out of business. These supplies would have cost L.E.9,375 if purchased under normal circumstances.

Required:

Prepare a balance sheet at December 31, 2020 (You are to compute the missing figure for notes payable) and at January 6, 2021.

1.9 Mid-Term Tests:

<u>QUIZES:</u>

Quiz A

NAME…………………………

NO……………………………..

SECTION………………………

Indicate the best answer for each question in the space provided.

…… ***1*** During the current year, the assets of The Magic Land increased by L.E.1,460,000, and the liabilities increased by L.E.780,000. As a result, owner's equity:

a Decreases by L.E.780,000 during the year.
b Increases by L.E.680,000 during the year.
c Increases by L.E.2,240,000 during the year.
d Is L.E.680,000 at the end of the year.

…… 2 During 2020, the assets of Opera Theatre increased by L.E.900,000, and the liabilities increased by L.E.360,000. If the owner's equity in Opera Theatre is L.E.1,880,000 at the ***end*** of 2020, the owner's equity at the ***beginning*** of 2020 must have been:

a L.E.620,000.
b L.E.1,260,000.
c L.E.3,140,000.
d L.E.1,340,000.

…… ***3*** A business purchases land and building, giving in exchange L.E.2,250,000 cash and a note payable for L.E.950,000. This transaction:

a Increases owner's equity.
b Increases total assets.
c Decreases total liabilities.
d Decreases total assets.

…… ***4*** Clear Photo sells land for cash at a price in excess of its cost. Which of the following is ***not*** true as a result of this transaction?

a Cash is increased.
b Liabilities are not affected.
c Total assets are not affected.
d Owner's equity is increased.

…… ***5*** The owner's equity of Ahmed Zaki Management Corp. is L.E.2,400,000 at December 31, 2020, and is equal to three-fourths of total liabilities. What is the amount of total assets?

a L.E.3,200,000.
b L.E.800,000.
c L.E.4,200,000.
d L.E.5,600,000.

Quiz B

NAME……………………………

NO……………………………..

SECTION………………………

Complete the January 31, 202__ balance sheet of Justice Legal Services using the following information:

(1) Owner's equity at January 1, 202__, was L.E.1,600,000.

(2) The land and building were purchased by the business for a total price of L.E.1,900,000 on January 25, 202__, from a company forced out of business. On January 31, an appraiser valued the property at L.E.2,500,000.

(3) Owner Mustafa Faddy invested another L.E.200,000 cash in the business in January.

(4) Earnings for January amounted to L.E.274,000.

JUSTICE LEGAL SERVICES
Balance Sheet
January 31, 202___

Assets (L.E.)		Liabilities & Owner's Equity (L.E.)	
Cash…………………	100000	Liabilities:	
Accounts receivable…		Notes payable…	
Land…………………	600000	Accounts payable	126,000
Building……………..		Total liabilities	
Equipment…………..	150000	Owner's equity:	
		M. Faddy, Capital	
Total………………		*Total*…………	*2400000*

CHAPTER TWO

CHANGES IN FINANCIAL POSITION

&

ACCOUNTING CYCLE

CHAPTER TWO

CHANGES IN FINANCIAL POSITION
&
ACCOUNTING CYCLE

Chapter Learning Objectives

This chapter aims to:

1) Discuss the role of accounting records in an organization.

2) Describe a ledger account and a ledger.

3) State the rules of debit and credit for balance sheet accounts.

4) Explain the double-entry system of accounting.

5) Explain the purpose of a journal and its relationship to the ledger.

6) Prepare journal entries to record common business transactions.

7) Prepare a trial balance and explain its uses and limitations.

2.1 Introduction:

In Chapter One of this text, it has been discussed that accounting is the process of recording, classifying and summarising the financial transactions. The continuance or sequence of accounting procedures used to record, classify, and summarise accounting information is often called or termed the ***Accounting Cycle***.

Therefore, the accounting procedures must be followed to complete accounting cycle involves the following stages:

1- **Recording of transactions in the book termed as "Journal".** When each business transaction occurs, it is entered in the journal, thus creating a chronological record of event. This stage completes the recording step in the accounting cycle.

2- **Posting to the accounts in the book termed as "Ledger" (Classifying the transactions).** As it will be discussed, the debit and credit changes in account balances are posted from *journal* to *ledger.* This procedure classifies the effects of the financial transactions in terms of specific assets, liability, and owner's equity accounts.

3- **Summarising the transactions.** This stage includes preparation of the trial balance and financial statements. **A trial balance** proves the equality or the balance of the debit and credit entries in the *ledger*. The purpose of this procedure is to verify the accuracy of the posting process and the computation of ledger account balances. **The preparation of financial statements** summarises the effects of business transactions occurring through the date of the statements and completes the accounting cycle.

2.2 The Ledger:

In accounting practice, it should be maintained a separate record for each item that appears in the balance sheet of a business entity. Such records are included in an accounting system designed. For example, a separate record is kept for the asset cash, showing all increases and decreases in cash resulting from the many transactions in which cash received or paid. A similar record is maintained for every other asset, every liability, and for owner's equity.

The record used to keep track of the increases and decreases in a single balance sheet item is termed a **ledger account** or simply an **account**. In manual accounting system, each ledger account is maintained on a separate page of columnar paper. These pages are kept in a loose-leaf binder, which serves as the ledger. This format explains why accounting records conventionally have been described as the company's ***"books"***. Of course, in computer based systems, the ledger accounts are maintained on disc.

2.2.1 The Use of Ledger Accounts:

As we have understood from the above discussion, ledger account is a means of accumulating or collecting in one place all the information about changes in a specific asset, a liability, or owner's equity. For instance, a ledger account for the asset cash provides a record of amount of cash receipts, cash payments, and the current cash balance. By keeping a Cash Account, the business management can keep track of the amount of cash available for meeting payrolls (i.e. salaries or wages) and for making current purchases of assets or services. This record of cash is also useful in planning future operations and in advance planning of applications for bank loans.

An account, in its simplest form, has only three elements:

1- A title, consisting of the name of the particular asset, liability, or owner's equity;

2- A left side, which is called the **debit** side, and

3- A right side, which is called the **credit** side.

This form of account, illustrated below and on the following pages, is called a ***T Account*** because of its resemblance or similarity to the letter ***T***. More complete forms of accounts will be illustrated later on the following pages.

Title of Account	
Left or Debit Side	**Right or Credit Side**

2.2.2 Debit and Credit Entries:

An amount recorded on the left or debit side is called a **debit**, or a **debit entry**; an amount entered on the right or credit side is called a **credit**, or **credit entry**. In practice, accountants use **debit** to mean an entry on the left-hand side of an account and **credit** to mean an entry on the right-hand side. Therefore, debit and credit simply mean left and right.

Illustration 2.1:

In order to illustrate the recording of debits and credits in an account, the ***five cash transactions of Engineer Auto Services explained in Chapter 1 will be used.*** When these cash transactions are recorded in the Cash account, the ***receipts*** are listed in vertical order (according to their occurrence) on the ***debit side*** of the account and the ***payments*** are listed on the ***credit side***. The dates of the transactions may also be listed, as shown in the following illustration:

Cash

1/11	800,000	3/11	520,000
25/11	6,000	5/11	60,000
		30/11	68,000
	806,000		648,000
30/11 Balance	158,000		

You will notice that each debit and credit entry in the ***Cash account*** represents a cash receipt or a cash payment. The amount of cash owned by the business at a given date is equal to the ***balance*** of the account on that date.

2.2.3 Determining the Balance of a T Account:

Practically, the balance of a ledger account is the difference between the debit and credit entries in the account. If the debit total exceeds the credit total, the account has a ***debit balance***; if the credit total exceeds the debit total, the account has a ***credit balance***.

In the foregoing illustration ***Cash account***, a *"dotted rule"* has been drawn across the account following the last cash transaction recorded in November. The total cash receipts (debits) recorded in November amount to L.E.806,000, and the total cash payments (credits) amount to L.E.648,000. These totals, called ***footings*** or ***sums***, are entered in small-size figures just above the rule. (Notice that these footings are written to the left of the regular money columns so that they will not be mistaken for debit or credit entries.) By subtracting the credit total from the debit total (**L.E.806,000 − L.E.648,000**), we determine that the ***Cash account*** has a debit balance of **L.E.158,000** on November 30.

Conventionally, the debit balance is entered in the debit side of the account just below the rule. In fact, the horizontal rule creates a ***"fresh start"*** in the **T** account, with the month-end balance representing the ***net result*** of all the previous debit and credit entries. The ***Cash account*** now shows the amount of cash owned by the business on November 30. In a balance sheet prepared at this date, **Cash** in the amount of L.E.158,000 would be listed as an asset.

2.2.4 Debit Balances in Asset Accounts:

In the preceding illustration, for example ***Cash Account***, *increases* were recorded on the left or debit side of the account and *decreases* were recorded on the right or credit side. The increases were greater than the decreases and the result was a debit balance in the account. **All asset accounts *normally have debit balances***.

The fact that assets are located on the ***left*** side of the balance sheet is an appropriate means of remembering the rule that an increase in an asset is recorded on the **left** (debit) side of the account, and also that an asset account normally has a debit (***left-hand***) balance.

Asset accounts Normally have Debit balances

Any Asset Account	
Debit	**Credit**
(representing an increase)	***(representing a decrease)***

2.2.5 Credit Balances in Liability and Owner's Equity Accounts:

Normally, ***increases*** in liabilities and owner's equity accounts are recorded by credit entries and ***decreases*** in these accounts are recorded by debits. The relationship between entries in these accounts and their position on the balance sheet may be summed up as follows:

(1) Liabilities and owner's equity belong on the ***right*** side of the balance sheet;

(2) An increase in a liability or an owner's equity account is recorded on the ***right*** (credit) side of the account; and

(3) Liability and owner's equity accounts normally have credit ***(right-hand)*** balances.

Any Liability Account or Owner's Equity Account	
Debit (representing a decrease)	**Credit (representing an increase)**

Liability and Owner's equity accounts normally have credit balances

2.2.6 The Double-Entry System for Accounting (The Equality of Debits and Credits):

The system or rules for debits and credits are designed so that *every transaction is recorded by equal pound amounts of debits and credits*. The reason for this equality lies in the relationship of the debit and credit rules to the accounting equation, explained earlier in Chapter One, as follows:

Asset	**= Liabilities + Owner's Equity**
Debit balances	**= Credit balances**

Historically, double-entry accounting is not a new idea. The system has been in use for more than 600 years. It was discussed in accounting literature that the first systematic presentation of the double-entry system appeared in a mathematics textbook written by Luca Pacioli. This text was published in 1494. Although Pacioli wrote the first textbook on this subject, surviving accounting records show that double-entry accounting had already been in use for at least 150 years (Meigs et. al, 1996).

2.2.7 Recording Transactions in Ledger Accounts:

To simplify, the use of debits and credits for recording transactions in ledger accounts now will be illustrated using the November transactions of ***Engineer Auto Services***. Each transaction will first be analyzed in terms of increases and decreases in assets, liabilities, and owner's equity. Then the debit and credit rules in entering these increases and decreases in **T** accounts shall be followed. Asset accounts will be shown on the ***left*** side of the page; liabilities and owner's equity accounts on the ***right*** side.

Illustration 2.2:

Nov. 1 Ahmed Adel, the owner, invested L.E.800,000 cash in the business.

Analysis:

The asset Cash is increased by L.E.800,000, and Owner's Equity is increased by the same amount.

Debit-Credit Rules:

*Increases in assets are recorded by debits; debit cash L.E.800,000.

*Increases in owner's equity are recorded by credits; credit Ahmed Adel, Capital, L.E.800,000.

Entries in Ledger Accounts:

Cash		Ahmed Adel, Capital	
1/11 **800,000**			1/11 **800,000**

Nov. 3 Representing the enterprise, Ahmed Adel negotiated with the City Council of Qena to purchase an abandoned old bus garage that its building is owned by the City Council and its land is owned to some people. On November 3, Engineer purchased the land from its owner for **L.E.520,000 cash.**

Analysis:

The asset Land is increased L.E.520,000, and the asset Cash is decreased L.E.520,000.

Debit-Credit Rules:

*Increases in assets are recorded by debits; debit Land L.E.520,000.

*Decreases in assets are recorded by credits; credit Cash L.E.520,000.

Entries in Ledger Accounts:

Cash

1/11 **800,000**	3/11 **520,000**

Land

3/11 **520,000**	

Nov. 5 Engineer completed the acquisition of its business location by purchasing the old garage building from the City Council for **L.E.360,000.** Engineer made a cash down payment of **L.E.60,000** and issued a 90-day, non-interest-bearing note payable for the remaining **L.E.300,000.**

Analysis:

A new asset Building is acquired at a total cost of L.E.360,000. The asset Cash is decreased L.E.60,000 and a liability Notes Payable of L.E.300,000 is incurred.

Debit-Credit Rules:

*Increases in assets are recorded by debits; debit Building L.E.360,000.

*Decreases in assets are recorded by credits; credit Cash L.E.60,000.

*Increases in liabilities are recorded by credits; credit Notes Payable L.E.300,000.

<u>Entries in Ledger Accounts:</u>

Cash	
1/11 **800,000**	3/11 **520,000**
	5/11 **60,000**

Notes Payable	
	5/11 **300,000**

Building	
5/11 **360,000**	

Nov. 17 Engineer purchased tools and equipment on account from United Tools Group. The purchase price was **L.E.138,000,** due in 60 days.

<u>Analysis:</u>

A new asset Tools and Equipment is acquired at a cost of L.E.138,000, and a liability Accounts Payable of L.E.138,000 is incurred.

<u>Debit-Credit Rules:</u>

*Increases in assets are recorded by debits; debit Tools and Equipment, L.E.138,000.

*Increases in liabilities are recorded by credits; credit Accounts Payable, L.E.138,000.

Entries in Ledger Accounts:

Tools and Equipment		Accounts Payable	
71/11 **138,000**			17/11 **138,000**

Nov. 20 Engineer found that it had purchased more tools than it required. Some neighbouring business offered to buy the excess items. On November 20, it sold the excess tools on account for **L.E.18,000,** which is equal to Engineer's cost. There was no gain or loss on this transaction.

Analysis:

Since the tools are sold at cost, there is no gain or loss on this transaction. An asset Accounts Receivable is acquired in the amount of L.E.18,000, the asset Tools and Equipment is decreased L.E.18,000.

Debit-Credit Rules:

*Increases in assets are recorded by debits; debit Accounts Receivable, L.E.18,000.

*Decreases in assets are recorded by credits; credit Tools and Equipment, L.E.18,000.

Entries in Ledger Accounts:

Accounts Receivable

20/11 **18,000**	

Tools and Equipment

17/11 **138,000**	20/11 **18,000**

Nov. 25 Engineer received L.E.6,000 in partial collection of the accounts receivable.

Analysis:

The asset Cash is increased L.E.6,000 and the asset Accounts Receivable is decreased L.E.6,000.

Debit-Credit Rules:

*Increases in assets are recorded by debits; debit Cash, L.E.6,000.

*Decreases in assets are recorded by credits; credit Accounts Receivable, L.E.6,000.

Entries in Ledger Accounts:

Cash

1/11 **800,000**	3/11 **520,000**
25/11 **6,000**	5/11 **60,000**

Accounts Receivable	
20/11 **18,000**	25/11 **6,000**

Nov. 30 Engineer made a L.E.68,000 partial payment of its accounts payable to United Tools Group.

Analysis:

The liability Accounts Payable is decreased L.E.68,000, and the asset Cash is decreased L.E.68,000.

Debit-Credit Rules:

*Decrease in liabilities are recorded by debits; credit Accounts Payable, L.E.68,000.

*Decreases in assets are recorded by credits; credit Cash, L.E.68,000.

Entries in Ledger Accounts:

Cash	
1/11 **800,000**	3/11 **520,000**
25/11 **6,000**	5/11 **60,000**
	30/11 **68,000**

Accounts Payable	
30/11 **68,000**	17/11 **138,000**

2.2.8 Running (Changing) Form of Accounts:

Conventionally, **T** accounts are widely used in the classroom and in accounting textbooks, because they provide a concise (brief) conceptual picture of the financial effect of a business transaction. In actual practice, nevertheless, most business prefer to use the ***"running or changing"*** form of ledger account.

This form of account has special columns for recording additional information, as illustrated below with the **Cash** account of Engineer Auto Services:

			Cash		Account No. 1	
Date		**Explanation**	**Ref**	**Debit**	**Credit**	**Balance**
202_						
Nov.	1			800000		800000
	3				520000	280000
	5				60000	220000
	25			6000		226000
	30				68000	158000

The ***Date*** column shows the date of the transaction−which is not necessarily the same as the date the entry is recorded in the account. The ***Explanation*** column is needed only for unusual items, and in many companies it is seldom used. The ***Ref*** (Reference) column is used to list the page number of the ***Journal*** in which the transaction is recorded, thus making is possible to trace ledger entries back to their source. (Later in this chapter, the use of a ***journal*** will be explained.) In the ***Balance*** column of the account, the new balance is entered each time the account is debited or credited. So the current balance of the account can always be observed at a glance.

2.2.9 The "Normal" Balance of an Account:

In practice, the running balance form of ledger account does not indicate specifically whether the balance of the account is a debit or credit balance. However, such a case causes no difficulty because we understand that asset accounts normally have debit balances and that liability and owner's equity accounts normally have credit balances.

Sometimes, an asset account may ***temporarily*** acquire a credit balance, either as the result of an accounting error or because of an unusual transaction. For example, an account receivable may acquire a credit balance because of overpayment by a customer. Nevertheless, a credit balance in the Building account could be created only by an accounting ***error.***

2.2.10 Sequence and Numbering of Ledger Accounts:

Accounts are usually arranged in the ledger in ***Financial Statement Order***, that is, assets first, followed by liabilities, owner's equity, revenues, and expenses. The number of accounts needed by a business enterprise will depend upon its size, the nature of its operations, and the extent to which management and regulatory authorities want detailed classification of information. An identification number is assigned to each account. A ***Chart of Accounts*** is a listing of the account titles and account numbers being used by a particular business entity.

In the following list of accounts, many possible account numbers have been skipped; these numbers are held in reserve so that additional accounts can be inserted in any section of the ledger. In this list, the numbers from 1 to 29 are used exclusively for asset accounts; numbers from 30 to 49 are reserved for liabilities; and numbers in the 50s represent owner's equity accounts. The following ***Chart of Accounts*** show an illustration of a balance sheet accounts:

Account Title	Account No.
Assets:	
Cash Account………………………	1
Accounts receivable (debtors)…...	4
Land………………………………..	20
Building……………………………..	22
Tools and Equipment………………	25
Liabilities:	
Note payable (bills payable)………	30
Accounts payable (creditors)………	32
Owner's equity:	
Capital………………………………..	50

Of course, in large organizations with hundreds or thousands of accounts, a more elaborate numbering system is used. Some businesses use an eight- or ten-digit number for each ledger account; each of the digits carries special significance or content as to the classification of the account.

Sequence of Asset Accounts, as shown in all illustrated balance sheets, cash is listed first among the assets. It is followed by such assets as marketable securities, short-term notes receivable, accounts receivable, inventories of merchandise, and supplies. These are the most common examples of current assets. Generally, the term ***current assets*** include cash and those assets which will quickly be converted into cash or used up in operations. Next on the balance sheet come the relatively permanent assets used in the business (often called ***plant assets***). Of this group, land is listed first and is followed by buildings. After these two items, any order is acceptable for other assets used in the business, such as automobiles, furniture and fixtures, computers, lighting equipment, store equipment, etc.

2.3 The Journal:

Throughout the preceding discussion, business transactions were recorded directly in the company's ledger accounts. This intended in order to emphasize or stress the effects of business transactions upon the individual asset, liability, and owner's equity accounts appearing in the company's balance sheet.

In an actual accounting system, nevertheless, the information regarding each business transaction is initially recorded or journalised in an accounting record called the ***journal***. All daily transactions of a business are recorded in the journal in the order in which they occur. After the transaction has been recorded in the journal, the debit and credit changes in the individual accounts are entered in the ***ledger***.

A journal may accordingly be defined as a book including a chronological record of transactions. It is the book in which the transactions are recorded first of all according to the double-entry system. Because the journal is the accounting record in which transactions are ***first recorded***, it is sometimes called the ***book of original entry or record***.

2.3.1 The General Journal:

In practice, many enterprises keep several types of journals. However, the nature of operations and the volume of transactions in the given business enterprise determine the number and type of journals required. The simplest and most famous type of journal is called a ***general journal*** and a pro forma of this journal is given below:

GENERAL JOURNAL				***Page 1***
Date	**Account Titles & Explanation**	**LP**	**Debit**	**Credit**
(1)	(2)	(3)	(4)	(5)
2021 Jan. 1	xxxxxx…………. xxxxxx……….	xx	xxxx	 xxxx

A general journal has only two money columns, one for debits and the other for credits and it may be used for recording any type of transaction. The process of recording a transaction in a journal is called ***journalising*** the transaction. The main sections of a particular page of the general journal include the following information:

1- **Date:** The date on which the transaction was entered is recorded here.

2- **Account Title and Explanation:** the two aspects of the transaction are recorded in this column. In other words, the details regarding accounts which have to be debited and credited are recorded here.

3- **LP:** It means Ledger Page. The transactions entered in the journal are later posted to the Ledger. Procedures about posting the transactions in the Ledger will be explained later.

4- **Debit:** In this column, the amount to be debited is entered.

5- **Credit:** In this column, the amount to be credited is entered.

Illustration 2.3:

To illustrate use of the general journal, now the November transactions of Engineer Auto Services shall be journalized.

Ahmed, a mechanical engineering, starts his new business by opening a service station “Engineer Auto Service”. The following transactions occurred during November 2020:

1- **Nov. 1** Ahmed, the owner, invested L.E.800,000 cash in the business.

2- **Nov. 3** Representing Engineer Auto Service, Ahmed negotiated with both the City Council of Qena and Upper Egypt Bus Company (UEBC) to purchase an old bus garage, as the City Council owned the land while the UEBC owned the building. On November 3, Engineer purchased the land from the city for L.E.520,000 cash.
3- **Nov. 5** Engineer completed the acquisition of its business location by purchasing the old building from UEBC. The purchase price was L.E.360,000, Engineer made a L.E.60,000 cash down payment and issued a three-month note payable for the remaining L.E.300,000.
4- **Nov. 17** Engineer purchased tools and equipment on account (on credit) from The Nile Tools Company. The purchase price was L.E.138,000, due in 2 months.
5- **Nov. 20** Engineer found that it had purchased more tools than it needed. On November 20, it sold the excess tools on account to Nabil Workshop at a price of L.E.18,000. The tools were sold at a price equal to their cost, so there was no gain or loss on this transaction.
6- **Nov. 25** Engineer received L.E.6,000 in partial collection of the account receivable from Nabil Workshop.
7- **Nov. 30** Engineer made a L.E.68,000 partial payment of its account payable to The Nile Tools Co.

Required:

a- Journalise the above transactions in the books of Engineer Auto Services.

b- Prepare the Ledger Accounts and the Trial Balance on the basis of these transactions.

Solution

GENERAL JOURNAL Page 1					
Date		***Accounts Titles and Explanation***	***LP***	***Debit***	***credit***
2020 Nov.	***1***	***Cash Ahmed Adel, Capital Owner invested cash in the business.***	***1 50***	***800000***	*** 800000***
	3	***Land Cash Purchased land for business site.***	***20 1***	***520000***	*** 520000***
	5	***Building Cash Notes Payable Purchased building from CC. Paid part cash; balance payable within 90 days.***	***22 1 30***	***360000***	*** 60000 300000***
	17	***Tools and Equipment Accounts Payable Purchased tools and equipment on credit from UT Corp. Due within 60 days.***	***25 32***	***138000***	*** 138000***
	20	***Accounts Receivable Tools & Equipment Sold unused tools and equipment at cost on***	***4 25***	***18000***	*** 18000***

		account. Sale price due in 60 days.			
	25	***Cash Accounts Receivable Collected part of account receivable.***	***1 4***	***6000***	***6000***
	30	***Accounts Payable Cash Made partial payment of the liability to UT Corp.***	***32 1***	***68000***	***68000***

<u>Notices:</u>

Efficient use of a general journal needs two things:

a. Ability to analyse the effect of a transaction upon assets, liabilities, and owner's equity; and

b. Familiarity with the standard form and arrangement of journal entries.

At this point, the primary interest is in the analytical phase of recording or journalising; the procedural steps can be learned quickly by observing the following points in the illustration of the above entry:

1- <u>The year, month, and day of the first entry on the page are written in the date column. The year and</u>

month need not be repeated for subsequent entries until a new page or a new month is begun.

2- The name of the account to be debited is written for the first line of the entry and is conventionally placed at the extreme left next to the date column. The amount of the debit is entered on the same line in the **left-hand** money column.

3- The name of the account to be credited is entered on the line below the debit entry and is **indented**, that is, placed about 1 inch to the right of the date column. The amount credited is entered on the same line in the **right-hand** money column.

4- A brief explanation of the transaction begins on the line immediately below the last account credited. This explanation includes any data required to identify the transaction, such as the name of the customer or supplier. The explanation is not indented.

5- A blank line should be left after each entry. This spacing causes each journal entry to appear or stand out clearly as a separate unit and makes the journal easier to read.

6- Any entry which includes more than one debit or more than one credit (such as the entry on November 5) is called ***compound journal entry***. Regardless of how many debits or credits are contained in a compound journal entry, ***all the debits*** are entered ***before any credits*** are listed.

7- The LP (Ledger page) column just to the left of the debit money column is left blank at the time of making the journal entry. When the debits and credits are later transferred to ledger accounts, the numbers of the ledger accounts will be listed in this column to provide an appropriate cross-reference with the ledger.

2.3.2 Posting Journal Entries to the Ledger Accounts (and How to "Read" a Journal Entry):

It has been discussed that transactions are recorded ***first*** in the journal. Ledger accounts are updated ***later***, through a process called ***Posting***. Therefore, the term ***Posting*** means transferring the debit and credit items from the ***Journal*** to their respective accounts in the ***Ledger***. In practice, posting may be done at any time, but it should be completed before the preparation of the financial statements. It is advisable to maintain the more active accounts posted to date.

Take in your consideration the first entry appearing in Engineer's general. If you were to read this entry aloud, you would say: ***"Debit Cash, L.E.800,000; credit Ahmed Adel, Capita, L.E.800,000".*** That is exactly or precisely what a person posting this entry should do: *Debit the Cash account for L.E.800,000, and credit Ahmed Adel's Capital account for L.E.800,000.*

Additionally, posting involves recording the date of the transaction in the ledger and creates a ***"cross-reference"*** between the entries in the ledger accounts and the related journal entry.

Of course, in a manual accounting system, the complete posting process includes the following steps for each account title named in the journal entry (Meigs, et. al, 1996, Maheshwari, 1996):

1) Locate the corresponding account in the ledger and enter the date of the transaction.

2) Enter in the appropriate column the pound amount being debited or credited to the ledger account.

3) In the ***Ref*** (posting reference) column of the ledger account, enter the ***page number of the journal*** from which the entry is being posted. (Such action creates a cross-reference between the ledger and the journal, enabling anyone using the ledger to find more information about a particular entry.)

4) Return to the journal; in the ***LP*** (ledger page) column, enter the ***account number*** of the ledger account to which the entry was posted. (The presence or absence of this account number shows, at a glance, which journal entries have been posted, and which has not.)

The posting process of Engineer's first journal entry is illustrated in the following diagram:

GENERAL JOURNAL					Page 1
Date		***Account Titles and Explanation***	***LP***	***Debit***	***credit***
2020 ***Nov.***	***1***	***Cash***	***1***	***800000***	
		Ahmed Adel, Capital	***50***		***800000***
		Owner invested cash in the business.			

GENERAL LEDGER

Cash			Account No. 1			
Date		**Explanation**	**Ref**	**Debit**	**Credit**	**Balance**
2020 Nov.	1		1	800000		800000

Ahmed Adel, Capital			Account No. 50			
Date		**Explanation**	**Ref**	**Debit**	**Credit**	**Balance**
2020 Nov.	1		1		800000	800000

Notice that no new information is recorded during the posting process. In fact, posting involves copying into the ledger accounts information that ***already has been recorded in the journal***. In manual accounting systems, can be a tedious and time-consuming process; but in computer-based systems, it usually is done instantly and automatically. Furthermore, computerized posting greatly reduces the risk of errors.

2.3.3 Ledger Accounts after Posting:

Accordingly, after all the November transactions have been posted, and in case of using running balance form of accounts, Engineer's ledger appears as presented below:

Cash			Account No. 1			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	1		1	800000		800000
	3		1		520000	280000
	5		1		60000	220000
	25		1	6000		226000
	30		1		68000	158000

Accounts Receivable			Account No. 4			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	20		1	18000		18000
	25		1		6000	12000

Land			Account No. 20			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	3		1	520000		520000

Building			Account No. 22			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	5		1	360000		360000

Tools and Equipment			Account No. 25			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	17		1	138000		138000
	20		1		18000	120000

Notes Payable			Account No. 30			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	5		1		300000	300000

Accounts Payable			Account No. 32			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	17		1		138000	138000
	30		1	68000		70000

Ahmed Adel, Capital			Account No. 50			
Date		Explanation	Ref	Debit	Credit	Balance
2020						
Nov.	1		1		800000	800000

Notice that, the accounts are arranged in the ledger in the same order as in the balance sheet- that is to say, assets first, followed by liabilities and owner's equity. On the contrary to the real world, in this illustration several ledger accounts appear on a single page, to conserve space. In actual practice, however, each account occupies a separate page in the ledger.

In case of using **T** form of accounts, Engineer's ledger appears as presented below:

Cash

1/11	800,000	3/11	520,000
25/11	6,000	5/11	60,000
		30/11	68,000
806,000		648,000	
30/11 Balance 158,000			

Accounts Receivable

20/11	18,000	25/11	6,000
18,000		6,000	
30/11 Balance 12,000			

Land

3/11	520,000		
520,000		000,000	
30/11 Balance 520,000			

Building

5/11 360,000	
360,000	000,000
30/11 Balance 360,000	

Tools and Equipment

17/11 138,000	20/11 18,000
138,000	18,000
30/11 Balance 120,000	

Notes Payable

	5/11 300,000
000,000	300,000
	30/11 Balance 300,000

Accounts Payable

30/11 68,000	17/11 138,000
68,000	138,000
	30/11 Balance 70,000

Ahmed Adel, Capital

	1/11 800,000
000,000	800,000
	30/11 Balance 800,000

2.4 The Trial Balance:

As equal pound amounts of debits and credits are entered in the accounts for every transaction recorded, the sum of all the debits in the ledger must be equal to the sum of all the credits. If the computation of account balances has been correct or accurate, it follows that the total of the accounts with debit balances must be equal to the total of the accounts with credit balances.

It is advisable that before using the account balances to prepare a balance sheet, it is desirable to **prove** that the total of accounts with debit balances is actually equal to the total of accounts with credit balances. This proof of the equality of debit and credit balances is called a ***trial balance***. A **trial balance** is a two-column schedule listing the names and balances of all the accounts **in the order in which they appear in the ledger;** the debit balances are listed in the left-hand column and the credit balances in the right-hand column. The totals of the two columns should agree or equal.

From the above discussion, it appears that ***Trial Balance*** is a statement containing the various ledger balances on a particular date. For example, with the balances of the ledger accounts prepared in **Illustration 2.3**, a **Trial Balance** taken from Engineer's ledger can be prepared as follows:

ENGINEER AUTO SERVISE Trial Balance November 30, 2020		
Cash…………………………L.E.	***158,000***	
Accounts receivable…….	***12,000***	
Land………………………..	***520,000***	
Building…………………...	***360,000***	
Tools and equipment…...	***120,000***	
Notes payable……………		***300,000***
Accounts payable……….		***70,000***
Ahmed Adel, capital…….		***800,000***
Total………………L.E.	***1,170,000***	***1,170,000***

2.5 Questions:

(1) Accounting Terminology:

Listed below are eight technical terms introduced in this chapter:

Ledger	**Account**	**Double-entry**	**Posting**
Credit	**Journal**	**Debit**	**Trial balance**

Each of the following statements may (or may not) describe one of these technical terms. For each statement, indicate the accounting term described, or answer **"none"** if the statement does not correctly describe any of the terms.

a. The accounting record in which transactions are initially recorded in a manual accounting system.________________

b. A device that proves the equality of debits and credits posted to the ledger.________________

c. The accounting record from which a trial balance is prepared.________________________

d. The system of accounting in which all transactions are recorded both in the journal and in the ledger.________________________________

e. An entry on the left-hand side of a ledger account.___________________________

f. The process of transferring information from a journal to the ledger._______________________

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(2) Recording transactions directly in* T *accounts; trial balance:

On July 20, P. Q. began a new business called PDQ Printing, which provides typing, duplicating, and printing services. The following six transactions were completed by the business during July.

a. P Q deposited L.E.1,000,000 in a bank account set up for the new business.

b. Purchased land and a small building for L.E.2,500,000, paying L.E.650,000 cash and signing a note payable for the balance. The land was considered to be worth L.E.1,400,000 and the building L.E.1,100,000.

c. Purchased office equipment for L.E.230,000 from Office Interiors, Inc. Paid L.E.80,000 cash and agreed to pay the balance within 60 days.

d. Purchased a motorcycle on credit for L.E.24,000 to be used for making deliveries to customers. Agreed to make payments to Wheels, Inc., within 10 days.

e. Paid in full the account payable to Wheels, Inc.

f. Borrowed L.E.200,000 from a bank and signed a note payable due in six months.

Instructions

1. Record the above transactions directly in the **T** accounts below. Identify each entry in a **T** account with the letter shown for the transaction. This exercise does not call for the use of a journal.

Cash	Office Equipment
Notes Payable	Land
Delivery Equipment	Accounts Payable
Buildings	P. Q. Capital

2. Prepare a trial balance at July 31 by completing the form provided.

PDQ PRINTING
Trial Balance
July 31, 202__

	Debit	Credit

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(3) Recording transactions-journal entry grid:

A list of accounts for Melton Company is given below, followed by a series of transactions. Indicate the accounts that would be debited and credited in recording each transaction by placing the appropriate number (or numbers) in the space provided.

1	Cash	**5**	Office Equipment
2	Accounts Receivable	**6**	Notes Payable
3	Land	**7**	Accounts Payable
4	Building	**8**	Sdek Melton, Capital

Transaction	**Account(s) Debited**	**Account(s) Credited**
Example: Purchased office equipment, paying part cash, with the balance due on account	5	1, 7
a Purchased land and a building, paying part cash and issuing a note payable for the balance of the purchase price		
b Sold a piece of the company's office equipment at cost; received part of the proceeds in cash, with the balance due in 30 days		
c Collected an account receivable		
d Borrowed money from a bank and signing a note payable due in one year		
e Paid an account payable		
f Owner invested additional cash in the business		

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(4) Recording transactions in general journal:

Enter the following transactions in the two-column journal of Continental Dry Cleaners. Include a brief explanation of the transaction as part of each journal entry.

Mar 1 Borrowed L.E.500,000 cash from the bank by signing a 90-day note payable.

3 Owner Tamer Radwan invested an additional L.E.250,000 cash in the business.

4 Purchased an adjacent vacant lot for use as parking space. The price was L.E.750,000, of which L.E.300,000 was paid in cash; a note payable was issued for the balance.

8 Acquired shop equipment from Dar Industrial for L.E.34,000.

8 Collected an account receivable of L.E.17,500 from a customer, Omer Gaber.

9 Issued a check for L.E.6,900 in full payment of an account payable to Chemical Supply Company.

Date	General Journal		
202__ Mar 1			
3			
4			
8			
8			
9			

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(5) Journalize and post basic transactions:

Gemmy Gem Co. was organized to grade construction sites. On June 1, owner Adel Gemmy deposited L.E.800,000 in a new bank account opened in the name of the business.

On June 3, the company acquired grading equipment costing L.E.980,000, paying L.E.450,000 cash and signing a note payable for the balance.

On June 10, the company paid L.E.70,000 of the amount owed for equipment acquired on June 3.

Instructions: Journalize these three transactions and post them to the ledger accounts.

GENERAL JOURNAL **Page 1**

Date	Account Titles & Explanations	LP	Debit	credit

LEDGER

Cash

Date	Explanation	Ref	Debit	Credit	Balance

Grading Equipment

Date	Explanation	Ref	Debit	Credit	Balance

Note Payable

Date	Explanation	Ref	Debit	Credit	Balance

A. Gemmy, Capital

Date	Explanation	Ref	Debit	Credit	Balance

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(6) Recording transactions in general journal: Enter the following selected transactions in General Journal for Electric Appliance Centre. Include a brief explanation of the transaction as part of each journal entry.

Jan. 1 The owner, invested an additional L.E.80,000 cash in the business.

Jan. 5 Purchased cars, the price was L.E.102,000 of which L.E.32,000 was paid in cash; a note payable was issued for the balance.

Jan. 15 Paid L.E.5,000 to an account payable, Cairo Supply Co.

Jan. 18 Borrowed L.E.30,000 cash from the bank by signing a 90-day note payable.

Jan. 23 Collected an account receivable of L.E.3,000.

Jan. 30 Acquired office equipment from Ideal Co. for L.E.8,000. Made a cash down payment of L.E.1,500; balance to be paid within 30 days.

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(7) Journalize and post basic transactions:

Magic Land Entertainment is a sole proprietorship that owns and operates a chain of children theatres. Selected business transactions of the enterprise during April 2020 are listed below.

April 1 Purchased cleaning supplies on account from Persil Supply Co., L.E.5,000. payment due within 2 months, to be paid in two equal instalments of L.E.2,500.

April 3 Purchased projection equipment for cash from Cairo Sound Co., L.E.6,000.

April 5 Returned to Cairo Sound Co. a projector purchased on April 3, because the lens was defective. The projector had cost Magic Land L.E.2,000; Cairo Sound Co. agreed to refund Magic Land's purchase price within 5 days.

April 10 Received the L.E.2,000 from Cairo Sound Co.

April 12 The owner invested an additional L.E.200,000 cash in the business.

April 15 Purchased the Village Theatre for L.E.630,000, paying L.E.150,000 in cash and issuing a note payable for the balance of the purchase price. The assets included in the purchase price, and their values at April 15, were as follows:

Land L.E.170,000, Building L.E.365,000 and Equipment L.E.95,000.

April 26 Paid the first instalment owed to Persil Supply Co. from April 1 purchase.

Instructions

Prepare journal entries to record the above transactions. Select the appropriate account title from the following chart of accounts:

Cash, Land, Notes payable, Accounts receivable, Buildings, Accounts payable, Cleaning supplies, Equipment, and Capital.

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(8) Journalize and post basic transactions, and prepare trial balance:

An owner formed a business entity to provide bus service for a fee to public and private school in the New City area. The business is organised as sole proprietorship called New City Transportation Services. The transactions during July 2020, while the new business was being organised, are listed below:

July 1 The owner deposited L.E.1,125,000 cash in the business.

July 3 The business purchased land and a building at a cost of L.E.600,000, of which L.E.360,000 was regarded as applicable to the land and L.E.240,000 to the building. The transaction involved a cash payment of L.E.150,000 and the issuance of a note payable for the balance of the purchase price.

July 5 Purchased 9 new buses at L.E.135,000 each from General Motors Sales Company. Paid L.E.382,500 cash, and agreed to pay L.E.400,000 by July **31** and the remaining balance by August **15**. The liability was viewed as an account payable.

July 7 Sold one of the buses at cost to Car Camping Services. The buyer paid L.E.75,000 in cash and agreed to pay the balance within one month.

July 8 Upon inspection, one of the buses was found to be defective and was returned to Motors Sales Company. The amount payable to this creditor was thereby reduced by L.E.135,000.

July 20 Purchased office equipment at a cost of L.E.12,000 cash.

July 31 Paid amount of L.E.400,000 in partial payment of the liability to Motors Sales Company.

The account titles and the account numbers used by the business are as follows:

Cash 10, Accounts receivable 11, Land 16, Buildings 17, Office equipment 20, Buses 22, Notes payable 31, Accounts payable 32, and Capital 50.

Instructions

a. Journalise the July transactions.
b. Post to ledger accounts.
c. Prepare a trial balance at July 31, 2020.

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

(9) Journalize and post basic transactions, prepare a trial balance, and prepare a balance sheet:

After playing several seasons of professional football, Mahmoud El-Khatib had saved enough money to start a business, to be called Number 10 Auto Rental. The transactions during March 2021, while the new business was being organised are listed below:

Mar. 1 Mahmoud El-Khatib invested L.E.700,000 cash in the business.

Mar. 2 The new business enterprise purchased land and a building at a cost of L.E.600,000, of which L.E.360,000 was regarded as applicable to the land and L.E.240,000 to the building. The transaction involved a cash payment of L.E.207,500 and the issuance of a note payable for the balance. The note is due in 5 years.

Mar 4 Purchased 20 new automobiles at L.E.43,000 each from Motors Sales Company. Paid L.E.200,000 cash; the balance, in the form of note payable, is to be paid in 4 monthly instalments of L.E.165,000 each, beginning March 15.

Mar. 7 Sold an automobile at cost to Mostafa Abdo, who paid L.E.12,000 in cash and agreed to pay the balance within 60 days.

Mar. 8 One of the automobiles was found to be defective and was returned to Motors Sales Company. The amount payable to this creditor was thereby reduced by l.E.43,000.

Mar. 15 Paid L.E.165,000 to Motors Sales Company as the first monthly payment on note payable created on March 4.

Mar. 20 purchased office equipment on credit; total cost, L.E.20,000, due in 30 days.

The account titles and account numbers used by the business are as follows:

Cash 10, Accounts receivable 11, Land 16, Buildings 17, Office equipment 20, Automobiles 22, Notes payable 31, Accounts payable 32, and Capital 50.

Instructions

a. Journalise the March transactions.
b. Post to ledger accounts.
c. Prepare a trial balance at March 31, 2021.
d. Prepare a balance sheet at March 31, 2021.

2.6 Mid-Term Tests:

QUIZES:

Quiz

NAME…………………………

NO……………………………..

SECTION………………………

Indicate the best answer for each question in the space provided.

The account balances for A-Tech as of May 31, 2020, are listed below in alphabetical order (L.E.):

Accounts Payable	100,000	Equipment .	160,000
Accounts Receivable	120,000	Land ….	500,000
Building ………	400,000	Notes Payable.	280,000
Cash ….........	60,000	Taha S , Capital	860,000

…… ***1 Refer to the above data.*** In a trial balance prepared on May 31, 2020, the sum of the ***debit column*** is:

a L.E.1,240,000. **c** L.E.1,440,000.
b L.E.860,000. **d** Some other amount.

On June 3, A-Tech collected L.E.70,000 of its accounts receivable and paid L.E.40,000 of its accounts payable. In addition, owner Taha Saad invested an additional L.E.24,000 in the business.

…… 2 ***Refer to the above data.*** On June 4, the balance in the ***Cash*** account is:

a L.E.90,000. **c** L.E.114,000.
b L.E.54,000. **d** Some other amount.

…… ***3 Refer to the above data.*** On June 4, the balance in ***Taha Saad, Capital*** account is:

a L.E.884,000. **c** L.E.760,000.

b L.E.784,000. **d** Some other amount.

…… ***4 Refer to the above data.*** In a trial balance prepared On June 4, the sum of the ***credit column*** is:

a L.E.1,130,000. **c** L.E.1,154,000.
b L.E.1,224,000. **d** Some other amount.

…… ***5 Refer to the above data.*** On June 6, the bookkeeper for A-Tech makes this entry:

Equipment ………..	63,000	
Cash …………..		15,000
Accounts Payable		48,000

This transaction:

a Decreases total Assets.
b Involves the sale of equipment for L.E.63,000.
c Increases total assets L.E.63,000.
d Increases liabilities.

CHAPTER THREE
ACCOUNTING FOR MERCHANDISING OPERATIONS

CHAPTER THREE

ACCOUNTING FOR MERCHANDISING OPERATIONS

3.1 Merchandising Enterprises:

In the previous chapters, the main stress was upon illustrating the accounting cycle for organisations that render ***services*** to their customers. On the contrary, merchandising organisations earn their revenue by selling ***Goods.*** Goods that merchandising enterprise sells to its customers; are called ***inventory or merchandise***. Accordingly, the inventory of an automobile dealership consists of automobiles and trucks offered for sale, whereas the inventory of a grocery store consists of a wide variety of food items and others. In most cases, inventory is a relatively ***liquid*** asset which it usually will be sold within a few weeks or months. As a result, the asset inventory appears near the top of the balance sheet, immediately below accounts receivable (debtors). In other words, the asset inventory is included into what it is called **"Current Assets"** group.

3.2 The Operating Cycle of a Merchandising Enterprise:

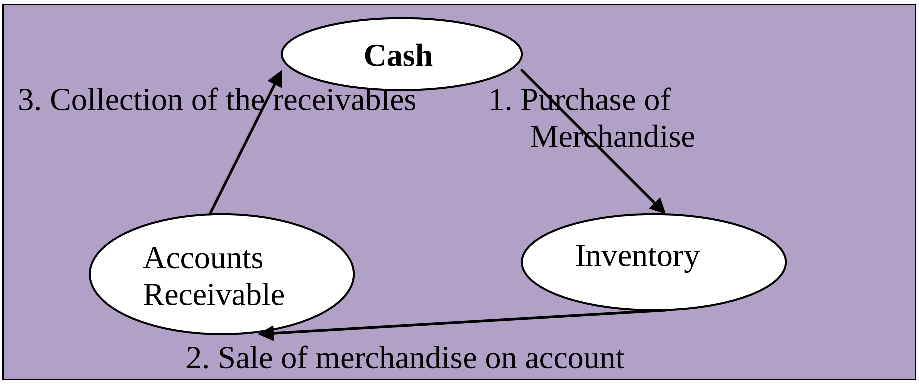
There is a series of transactions through which an enterprise generates its revenue and its cash receipts from customers. This series of transactions is called **"Operating Cycle".** The operating cycle of a merchandising enterprise includes the following major transactions:

(1) Purchases of merchandise;

(2) Sales of the merchandise, often on account (credit); and

(3) Collection of the accounts receivable from customers.

The word **cycle** means that this sequence of transactions repeats continuously. In other words, some of the cash collected from the customers is used to purchase more merchandise, and the **cycle** begins anew. Such continuous sequence of merchandising transactions can be illustrated in the following diagram (Meigs & Meigs et. al, 1996):



In comparison with **manufacturing** enterprises, most **merchandising** enterprises purchase their inventories from other business organisations in a ***<u>ready-to-sell</u>*** condition. Enterprises that **manu-facture** their inventories are called **manufactures** rather than **merchandisers.** Of course, the operating **cycle** of a **manufacturing** enterprise is longer and more complex than that of a **merchandising** enterprise, because the first transaction, purchasing merchandise, is replaced by the many transactions involved in manufacturing the merchandise. However, the concentration in this chapter will be confined to enterprises that purchase their inventory in a ready-to-sell condition.

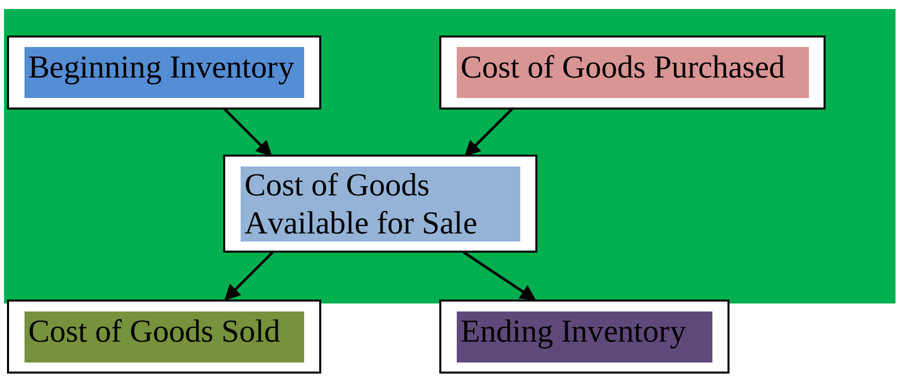
3.3 Retailers and Wholesalers:

In effect, merchandising firms include two types of traders: retailers and wholesalers. A ***retailer*** is a business enterprise that sells merchandise directly to the public or consumers. Retailers may be large or small; they vary in size from giant department store chains, such as Omer Efendy Stores, to small business, such as grocery shops. Actually, more businesses engage in retail sales than in any other types of business activity.

In contrast, the other main type of merchandising enterprise is the ***wholesaler.*** **Wholesaler** buy large quantities of merchandise from several different manufacturers and after that resell this merchandise to many different retailers. As wholesalers do not sell directly to the public, even the largest wholesalers are not well known to most consumers. Nevertheless, wholesaling is a chief type of merchandising activity.

3.4 Systems used in Accounting for Merchandising Transactions:

The flow of costs for a merchandising enterprise is as follows: Beginning inventory plus the cost of goods purchased is the cost of goods available for sale. Those goods that are not sold by the end of the accounting period represent ending inventory. The following illustration describes these relationships (Kimmel, Weygandt, and Kieso, 2011):



In practice, enterprises use one of two systems to account for inventory. They are:

1. A **Perpetual Inventory System,** or

2. A **Periodic Inventory System.**

3.4.1 Perpetual Inventory System:

In this system, *perpetual inventory system,* merchandising transactions are recorded **as they occur.** This system draws its name from the fact that the accounting records are maintained perpetually up-to-date. Accordingly, **purchases** of merchandise are recorded by debiting an asset account entitled **"Inventory Account."** When merchandise is sold, **two** entries are needed: **one** to recognise the **revenue earned** and the **second** to recognise the related **cost of goods sold.** As such, this second entry also reduces the balance of the **Inventory Account** to reflect the sale of some of the firm's inventory.

In a ***perpetual inventory system,*** enterprises maintain detailed records of the cost of each inventory purchase and sale. These records continuously-perpetually- show the inventory that should be on hand for every time. For example, a car dealership has separate inventory records for each automobile, truck, and van on its lot and showroom floor. Similarly, a grocery store uses bar codes and optical scanners to keep daily running records of every box of cereal and every jar of jelly that it buys and sells. Under this system, a firm determines the cost of goods sold ***each time a sale occurs.***

This system includes an ***Inventory Subsidiary Ledger***. Such ledger provides enterprise's employees with updated information about each type of product that the enterprise sells, including the per-unit cost and the number of units purchased, sold, and currently on hand.

An Illustration:

The following are some transactions regarding specific items of merchandise through the operating cycle of **Computer World,** a retail store.

Sept. 1 Purchased 10 CX-21 computer monitors (screens) on account from National Wholesale Co. The monitors cost **L.E.3,000** each, for a total of **L.E.30,000**; payment is due in 30 days.

Sept. 7 Sold 2 monitors on account to Luxor Travel Agency at a retail sales price of **L.E.5,000** each, for a total of **L.E.10,000.** Payment is due in 30 days.

Oct. 1 Paid the **L.E.30,000** account payable to National Wholesale Co.

Oct. 7 Collected the **L.E.10,000** account receivable from Luxor Travel Agency.

In addition to a general ledger, **Computer World** maintains separate subsidiary ledger for inventory.

Required:

Record the above transactions according to perpetual inventory system.

Solution:

Purchases of Merchandise on Sept. 1:

Of course, purchases of inventory are recorded at cost. Hence, Computer World records its purchase of the 10 computer monitors on September 1 as follows:

Inventory Account …………	30,000	
Accounts Payable Account		
(National Wholesale C0.) ……..		30,000

Purchased 10 computer monitors for L.E.3,000 each; Payment due in 30 days.

Note that, the data contained in this entry are posted to the general ledger **in addition to the subsidiary ledgers.** First of all, the entry is posted to the **Inventory and Accounts Payable** in the General Ledger. The debit to **Inventory** also is posted to the CX-21 Monitors Account in the inventory subsidiary ledger. The quantity of monitors purchased (**10**) and the per-unit cost (**L.E.3,000**) also are recorded in this subsidiary ledger account (as it will be illustrated below).

Sales of Merchandise on Sept. 7:

The revenue earned in a sales transaction is equal to the **Sales Price** of the merchandise and is credited to a revenue account entitled **Sales.** Except in scarce circumstances, sales revenue is considered ***recognised*** when the merchandise is *delivered to the customer,* even if the sale is made on account. As a result, Computer World will recognise the revenue from the sale to Luxor Travel Agency on September 7, as presented below:

Accounts Receivable (Luxor Travel Agency) …………………	10,000	
Sales Account………………		10,000
Sold 2 CX-21 monitors for L.E.5,000 each; payment due in 30 days.		

Furthermore, a *second journal entry* is needed at the date of sale to record the cost of goods sold, as shown below:

Cost of Goods Sold a/c ……….	6,000	
Inventory a/c ……………..		6,000

To transfer the cost of 2 CX-21 monitors (L.E.3,000 a piece) from Inventory to the Cost of Goods Sold Account.

You will notice that this second entry is based on the **cost** of the merchandise to Computer world, not on its retail sales price. The per-unit cost of the CX-21 monitors (L.E.3,000) was determined from the inventory subsidiary ledger. Both of the journal entries relating to this sales transaction are posted to Computer World's General Ledger. Moreover, the **L.E.10,000** debit to Accounts Receivable (first entry) is posted to the account for Luxor Travel Agency in the accounts receivable ledger. The credit to Inventory (second entry) also is posted to the CX-21 Monitors Account in the inventory subsidiary ledger.

Payment of Accounts Payable to Suppliers on Oct. 1:

The payment to National Wholesale Co. on October 1 can be recorded as follows:

By Accounts Payable a/c
(N. Wholesale Co.)………… 30,000
To Cash a/c………………… 30,000
Paid account payable.

Collection of Accounts Receivable from Customers on Oct. 7:

On October 7, the process of collection of the account receivable from Luxor Travel Agency will be recorded as shown below:

Cash a/c ……………………….. 10,000
Accounts Receivable a/c
(Luxor Travel agency) ………. 10,000
Collected an account receivable from a credit customer.

Also, both portions of this entry are posted to the general ledger; the **credit** to **Accounts Receivable** also is posted to **Luxor Travel Agency Account** in the accounts receivable ledger. In addition, it can be said that the collection of the cash from Luxor Travel

Agency completes Computer World's operating cycle with regard to these 2 units of merchandise.

The Inventory Subsidiary Ledger:

In fact, an inventory subsidiary ledger contains a separate account (or **inventory card**) for each type of product in the enterprise's inventory. Computer World's subsidiary inventory record for CX-21 monitors can be shown as follows:

Item CX-21 **Primary supplier** N. Wholesale Co.
Description 21" Grey scale Mon. **Sec. Supplier** United Importers Co.
Location Storeroom 2 **Inventory Level: Min** 2 **Max:** 10

	Purchased			Sold			Balance		
Date	**Units**	**Unit Cost**	**Total**	**Units**	**Unit Cost**	**Cost of Goods Sold**	**Units**	**Unit Cost**	**Total**
Sep. 1	**10**	**L.E. 3000**	**L.E. 30000**				**10**	**L.E. 3000**	**L.E. 30000**
7				**2**	**L.E. 3000**	**L.E. 6000**	**8**	**3000**	**24000**

As you notice above, when CX-21 monitors are purchased, the quantity, unit cost, and total cost are entered in this subsidiary ledger account. On the other hand, when any of these monitors are sold, the number of units, unit cost, and total cost of the units sold are recorded in this subsidiary ledger account. After each purchase or sales transaction, the

Balance columns are updated to show the quantity, unit cost, and total cost of the monitors still on hand.

3.4.2 Periodic Inventory System:

In the merchandising enterprise, a **Periodic Inventory System** is an *alternative* system to a **perpetual inventory system**. In this system, a **periodic inventory system**, no effort is made to maintain **up-to-date** records of either the inventory or the cost of goods sold. Alternatively, these amounts are determined only **"Periodically"**, usually at the end of each year. Thus, in this system, enterprises do not keep detailed inventory records of the goods on hand throughout the period. They determine the cost of goods sold ***only at the end of the accounting period***. At that point, the enterprise takes a physical inventory count to determine the cost of goods on hand.

To determine the cost of goods sold under a periodic inventory system, the following steps are necessary:

1. Determine the cost of goods on hand at the beginning of the accounting period.

2. Add to it the cost of goods purchased.

3. Subtract the cost of goods on hand at the end of the accounting period.

Operation of a Periodic Inventory System:

In practice, a periodic inventory system operates as follows: When merchandise is purchased, its cost is debited to an account entitled **Purchases Account**, rather than to the **Inventory Account.** When merchandise is sold, an entry is made to recognise the sales revenue, but **No entry** is made to record the **cost of goods sold** or to **reduce** the **balance** of the **Inventory Account.** As the inventory records are not updated as transactions occur, there is **No** inventory subsidiary ledger. The basic procedure of the **periodic inventory system** is the taking of a **complete physical inventory** at year-end. Such physical count determines the amount of inventory appearing in the balance sheet. The cost of goods sold for the entire year then is determined by a **short computation.**

An Illustration:

For example, assume that Happy Occasions, a special occasion supply store, has a periodic inventory system. At December 31, 2020, the following information is obtained from the enterprise's records:

1- The inventory on hand at the end of 2019 costs **L.E.70,000.**

2- During 2020, purchases of merchandise for resale to customers totalled **L.E.650,000.**

3- Inventory on hand at the end of 2020 cost **L.E.60,000.**

The inventories at the ends of 2019 and 2020 were specified by taking a **complete physical inventory** at (or very near) each year-end. As the **Inventory Account** was **not updated** as transactions occurred during 2020**,** it still shows a **balance** of **L.E.70,000** (the inventory on hand at the **beginning** of the year). Moreover, the **L.E.650,000** cost of merchandise purchased during 2020 was recorded in the **Purchase Account.**

Recording Purchases of Merchandise:

Happy Occasions made several purchases of merchandise during 2020**.** The required to record the first of these purchases can be illustrated as follows:

Jan. 6		
Purchases a/c ……………….	650,000	
Accounts Payable		
(Food Products Co.) ……..		650,000
Purchased inventory on account; payment due in 30 days.		

Of course, the above entry was posted to the **Purchases** and **Accounts Payable Accounts** in the general ledger. The **debit** to Purchases was **<u>Not</u>** *double-posted*, as there is **no inventory subsidiary ledger** in a periodic system.

Computing the Cost of Goods Sold:

The inventory at the year-end is determined by taking a complete physical count of the merchandise on hand. Once the ending inventory is known, the **cost of goods sold** for the entire year can be specified by a short computation, as shown below, using the 2020 data for Happy Occasions:

Beginning inventory (1) L.E.	70,000
Add: Purchases (2)……………	650,000
Cost of goods available for sale	720,000
Less: Ending inventory (3)…….	60,000
Cost of goods sold……………	660,000

Recording Inventory and the Cost of Goods Sold:

Happy Occasions has at the moment determined its inventory at the end of 2020 and its **cost of goods sold** for the year. Nevertheless, neither of these amounts has yet been recorded in the firm's accounting records. In adopting a periodic system, the ending inventory and the cost of goods sold are **recorded** during the firm's year-end **closing procedures.** The term *closing procedures* can be referred to the making of **end-of-period adjusting and closing entries.**

In summary, an operation of a periodic inventory system can follow the following procedures:

(1) Purchase of Merchandise:

As it has been explained above, under a periodic inventory system, the cost of merchandise purchased for resale is recorded by an account called **Purchase Account**, as shown in the following entry:

Purchases a/c …………………… 140,000
Accounts Payable a/c (Yahya Wholesale Co.) …………… 140,000
Purchased merchandise on account.

(2) Other Accounts Included in the Cost of Goods Sold:

The *cost of goods sold* for the entire year is determined at year-end by a simple computation as shown below:

Inventory: beginning of the year (per last year physical count)… L.E.	10,000
Add: Purchases …………….	140,000
Cost of goods available for sale during the year………………………	150,000
Less: Ending inventory (per this year's Physical count)…………………	12,000
Cost of goods sold………………	138,000

In the above illustration, only three items were used in computing the *cost of goods sold*: beginning inventory, purchases, and ending inventory. Nevertheless, in most cases two further accounts may be involved in this computation; that is, **Purchase Returns and Allowances,** and

Transportation-in. these items will be highlighted as follows:

Purchase Returns and Allowances:

When merchandise purchased from wholesalers or suppliers is found to be unsatisfactory, the goods may be returned or a request may be made for an allowance on the price. When goods are returned to the suppliers, the journal entry to record this process can be as follows:

Accounts Payable a/c (Yahya Wholesale Co.) ……………..	3,000	
Purchase Returns and Allowances a/c ………...		3,000

To reduce liability to Yahya Wholesale Co. by the cost of goods returned for credit.

Purchase Returns and Allowances Account may be considered a reduction in the cost of purchases made during the period. So, it is preferable to credit this **contra- purchase account** when merchandise is returned to supplier rather than crediting the **Purchase Account** directly.

Transportation-in:

Practically, **transportation** charges concerning merchandise are treated in the same manner in both **periodic** and **perpetual systems.** As such, the freight charges which are paid on coming shipments are debited to an account called **Transportation-in Account** that is added to the **cost of goods sold.** On the other hand, delivery costs on sold shipments are debited to **Delivery Expense Account,** which is classified as a selling expense.

Accounting for Sales Transactions:

Also, accounting for sales transactions does not change under both periodic and perpetual inventory system. But, there is one notable exception. In a periodic inventory system, no entries are made to transfer costs from the **Inventory Account** to the **Cost of Goods Sold Account.** For example, assume that Mohamed Stores sells merchandise on account to Yousif Shop for **L.E.6,000.** Yousif Shop finds **L.E.1,000** worth of this merchandise defective and returns it to Mohamed Stores immediately. Yousif Shop then pays for the remainder of these goods. The entry required for recording the original sales transaction by Mohamed Stores will be as follows:

Accounts Receivable (or Debtors) a/c (Yousif Shop)	6,000	
Sales a/c		6,000
To record credit sale, terms.		

You will notice that **only one journal entry** is needed to record a sale. Hence, the basic advantage of a periodic inventory system is that it is not necessary to record the **cost of goods sold** concerning individual sales transactions.

Sales Returns and Allowances a/c	1,000	
Accounts Receivable a/c (Yousif Shop)		1,000
Credit customer returned defective merchandise.		

Again, only one journal entry is required. Under a periodic inventory system, no entry is made to update the **Inventory Account** or to adjust the **cost of goods sold.** As a result of this sales return, Yousif Shop owes Mohamed Stores only of **L.E.5,000.** Hence, the journal entry necessary to record the collection of this account receivable will be as follows:

Cash a/c …………………………..	5,000	
Accounts Receivable a/c (Yousif Shop) ……………………………		5,000
To record collection of account receivable.		

3.5 Additional Transactions Related to Purchases and Sales of Merchandise:

In practice, merchandising transactions are not limited to the basic transactions discussed in the preceding sections of this chapter. In addition to those transactions, merchandising enterprises must pay much attention to and account for a variety of additional transactions, such as discount offered to credit customers for prompt payment, merchandise returns and refunds, transportation costs, and so on.

3.5.1 Additional Transactions Related to Purchases:

Conventionally, purchases of merchandise are usually recorded at cost. Nevertheless, this cost can be affected by some factors such as **Cash Discount** and **Transportation Charge.**

3.5.1.1 Credit Terms and Related Cash Discounts:

Normally, wholesalers and manufacturers sell their merchandise ***on account*** (also called on credit). As such, the **credit** terms are often stated in the seller's bill (also called **invoice**). In the usual conditions, wholesalers and manufacturers allow their customers **one or two months** in which to pay for credit purchases. This period may be varied from firm to firm depending upon its circumstances. Nevertheless, sellers frequently offer their customers (purchasers or buyers) a small discount to encourage them for earlier payment.

In practice, perhaps the most common credit terms provided by manufacturers or wholesalers are ***2/10, n/30.*** This expression is read ***2, 10, net 30,*** and **means** that full payment is due in **30 days**, but that the purchaser may take ***2% discount*** if payment is made within ***10 days***. Accordingly, the period during which the discount is available is **called** the ***discount period***. As the discount offers an incentive for the customer to make any early **cash** payment, it is termed a ***cash discount***. In the buyers or purchasers point of view, these discounts are referred to as ***purchase discounts***, while sellers frequently refer to them as ***sales discounts*****.**

Enterprises, which benefit from advantage of all cash discounts, offered on purchases of merchandise, firstly record purchases of merchandise at the **net cost.** In other words, these enterprises initially record these purchases using **invoice price** *minus* any available discount.

For instance, suppose that on November 3 **Computer World** purchases **100** power-point programmes from **PC Products.** The cost of these programmes is **L.E.500** each, for a total of **L.E.50,000.** Nevertheless, **PC Products** provides credit terms of **2/10, n/30.** If **Computer World** pays for this purchase within the discount period, it will have to pay only **L.E.49,000, or 98%** of the full invoice price. Hence, Computer World will record this purchase as follows:

Inventory a/c (or Purchases) …..	49,000	
Accounts Payable a/c (PC Products)		49,000

To record purchase of 100 power-point programmes at net cost (L.E.500 x 98% x 100).

Therefore, if the invoice is paid within the discount period, **Computer World** will record payment of a

L.E.49,000 account payable. On the other hand, **Computer World** could fail, depending upon its financial conditions, to make payment within the discount period. In this case, **Computer World** shall pay **PC Products** the entire invoice price of **L.E.50,000,** rather than the recorded liability of **L.E.49,000.** As such, the journal entry which is required to record payment ***after the end of discount period***, for example, on December 3, will be as follows:

Accounts Payable a/c (PC Products)	49,000	
Purchase Discounts Lost ………	1,000	
Cash a/c ……………………		50,000
To record payment of invoice after expiration of discount period.		

From the above entry, you will notice that the additional amount of **L.E.1,000** paid since the discount period has expired is debited to an account entitled **Purchase Discounts Lost. Purchase Discounts Lost** is an ***expense discount.*** Therefore, the only benefit to Computer World from this **L.E.1,000** expenditure was a **20-days delay** in paying for its obligation (an accounts payable). Accordingly, the lost purchase discount is basically considered a **finance charge,** the same as interest expense. Moreover, in an **Income Statement**, **finance charges** usually are classified as **non-operating** expenses.

Additionally, the fact that purchase discounts ***not taken*** (lost) are recorded in a separate expense account is the major reason why an enterprise has to record purchases of merchandise at **net cost.** The idea beyond the use of a **Purchase Discounts Lost Account** is that this treatment immediately brings to enterprise management's attention any failure to take advantage of the cash discounts offered by suppliers.

Recording Purchases at Gross Invoice Price:

As an alternative to recording purchases at **net cost**, and following more conservative policy, some business enterprises may select to record merchandise purchases at the **gross (total)** invoice price. Accordingly, if payments is made within the **discount period**, the enterprises must record the amount of the **purchase discount** ***taken*** (also called **Discounts Received**).

For example, assume that **Computer World** adopted a policy of recording purchases at **gross** invoice price. The required entry on November 3 to record the purchase from **PC Products** would have been shown as below:

Inventory (or Purchases) a/c …..	50,000	
Accounts Payable (PC Products)		50,000
To record purchase of 100 power-point programmes at gross invoice price (L.E.500 x 100 units).		

As such, if agreed payment is made within the discount period, **Computer World** discharge this **L.E.50,000** account payable by paying only **L.E.49,000**, as shown below:

Accounts Payable a/c (PC Product)	50,000	
Cash a/c………………		49,000
Purchase Discounts Taken a/c		1,000
Paid a L.E.50,000 invoice within the discount period; taking a 2% purchase discount.		

Notice that **Purchase Discounts Taken Account (or Discounts Received Account)** is considered as a reduction in the cost of goods sold.

Anyway, the above two methods, the **net cost and gross price,** are widely used and tend actually to the same results in financial statements. Perhaps the basic shortcoming in the **gross price** method is that it does **not** direct or pay management's attention to discounts lost.

3.5.1.2 Returns of Unsatisfactory Purchased Merchandise:

Sometimes, a buyer may discover that the purchased merchandise is unsatisfactory and want to return it to the supplier for a refund. The majority of sellers permit such refunds. For example, suppose that on November 9 **Computer World** returns to **PC Products** 5 of the power-point programmes purchased on November 3, because these programmes were not appropriately labelled. Since **Computer World** has not yet paid for this merchandise, the return will reduce the amount that **Computer World** owes **PC Products.** The gross invoice price of the returned merchandise was **L.E.2,500 (L.E.500 per programme).** You must keep in mind, however, that **Computer World** records purchases at **net cost.** Built on this fact, these power-point programmes are posted into **Computer World's** inventory subsidiary ledger at a per-unit cost of **L.E.490, or L.E.2,450** for the 5 programmes being returned. Therefore, the proper entry to record this purchase return will be as follows:

Accounts Payable a/c (PC Products).	2,450	
Inventory a/c …………………...		2,450
Returned 5 defective power-point programmes to supplier.		

The reduction in inventory must also be recorded in the subsidiary ledger accounts.

3.5.1.3 Transportation Costs on Purchases

The sales agreement should indicate who-the seller or the buyer-is to pay for transporting the goods to the buyer's place of business. When a common carrier such as a railroad, trucking company, or airline transports the goods, the carrier prepares a freight bill in accord with the sales agreement.

Freight terms are expressed as either FOB shipping point or FOB destination. The letters FOB mean ***free on board***. Thus, **FOB shipping point** means that the seller places the goods free on board the carrier, and the buyer pays the freight costs. Conversely, **FOB destination** means that the seller places the goods free on board to the buyer's place of business, and the seller pays the freight. So, the purchaser sometimes may pay the costs of delivering the purchased merchandise to its address. In fact, transportation costs relating to the **acquisition** of inventory or any other **asset** are <u>**not expenses**</u> of the current accounting period; rather, these charges are considered <u>**part of the cost of the asset**</u> being obtained.

It is recognised that the ***cost*** of an asset includes all reasonable and necessary costs of getting the asset to an appropriate location and putting it into usable condition. Hence, if the purchaser is able to attach transportation costs to particular products, these costs should be **debited directly** to the inventory account as part of the **cost** of the merchandise. For example, if Computer World (the buyer) pays L.E.1,500 for freight charges, it will record the following entry in its books:

Inventory (or Purchases) a/c …….	1,500	
Cash a/c ……………………..		1,500
To record payment of freight on goods purchased.		

Thus, any freight costs incurred by the buyer are part of the cost of merchandise purchased. The reason: Inventory cost should include any freight charges necessary to deliver the goods to the buyer.

Mostly, a variety of different products arrive in a single shipment. As such, it may be impractical for the purchaser to specify the amount of the total **transportation cost** applicable to each product. As a result, many enterprises follow the proper policy of debiting all transportation costs to an account entitled ***Transportation-in Account***. The pound amount of transportation-in usually is too small to present separately in the financial statements. Accordingly, this amount is merely included in the amount reported in the income statement as cost of goods sold.

3.5.2 Additional Transactions Related to Sales

As it was discussed and illustrated transactions related to purchases, credit terms and merchandise returns also influence the amount of sales revenue achieved by the seller. As long as the credit customers (buyers or debtors) take advantage of cash discounts or return merchandise for a refund, the seller's revenue is reduced. Hence, revenue presented in the **Income Statement** of a merchandising enterprise is usually called **net sales**. Thus, the term ***net sales,*** means that this figure represents total sales revenue **minus** sales **returns** and **allowances** and **minus sales discounts.**

3.5.2.1 Sales Returns and Allowances:

Normally, the majority of merchandising enterprises permit customers (buyers) to get a refund by returning any merchandise regarded to be unsatisfactory. Thus, if the merchandise has only slight defects, customers sometimes agree to keep the merchandise when an **allowance** (or reduction) in the sales price is given.

As such, under the **perpetual inventory approach,** two journal entries are required in order to record the sale of merchandise: the first of them is to recognise the revenue earned and the other is to transfer the cost of the merchandise from the **Inventory Account** to **Cost of Goods Sold.** So, if some of the merchandise is returned, both of these journal entries are **partially reversed.** Firstly, the journal entry to reduce sales revenue as the result of a sales **return** (**allowance**) may be shown as follows (for example):

Sales Returns and Allowance a/c ….	2,000	
Accounts Receivable (or Cash) a/c		2,000

Customer returned merchandise purchased on account for L.E.2,000. Allowed customer full credit for returned merchandise.

In effect, **Sales Returns and Allowances** are considered a **contra-revenue account.** This is because it is deducted from gross sales revenue as a procedure to determine net sales. Moreover, the question that imposes itself is: why use a separate **Sales Returns and Allowances Account** rather than only debiting the **Sales Account**? The answer is that using a separate **contra-revenue account** may enable management to see both the total amount of sales in addition to the amount of sales returns. Also, the relationship between these amounts provides management with an indication of customer satisfaction with the merchandise.

Furthermore, if merchandise is returned by the customer, a **second** entry must be made to remove or deduct the cost of this merchandise from the **Cost of Goods Sold Account** and restore it to the **inventory records**, as shown below:

Inventory a/c…………………	1,600	
Cost of Goods Sold a/c……		1,600
To restore in the Inventory Account the cost of merchandise returned by a customer.		

Form the above entry you will notice that it is based on the **cost** of the returned merchandise to the seller, ***Not on its sales price*****.** Also, this entry is not necessary when a sales **allowance** is given to a customer who keeps the merchandise instead of returning it.

3.5.2.2 Sales Discounts (Discounts Allowed):

Previously, it has been discussed that sellers frequently offer **cash discounts**, for example, **2/10, n/30,** to encourage their customers (buyers) to make **early** payments for purchases on account (on credit). But sellers and buyers account for or treat **cash discounts** differently**.** For the seller, the **cost related to cash discounts** is not the discounts **lost** when payments are delayed, but rather the discounts **taken** by customers that pay within the discount period. Thus, sellers often design their accounting systems to measure the **sales discounts** *taken* by their customers. For accomplishing this objective, the seller records the sale and the related account receivable at the **gross** or full invoice price.

For example, suppose that **Computer World** sells merchandise to **Adam Nouh** for **L.E.5,000**, offering terms of **2/10, n/30.** The sales revenue is recorded at the full invoice price, as presented below:

Accounts Receivable a/c (Adam Nouh) 5,000
    Sales a/c……………… 5,000
Sold merchandise on account. Invoice price, L.E.5,000; terms, 2/10, n/30.

Accordingly, if **Adam** pays after the discount period has expired, **Computer World** merely records the receipt of **L.E.5,000** cash in full payment of this account receivable. On the contrary, if **Adam** pays **within** the discount period, he will pay only **L.E.4,900** to settle his account. As such, **Computer World** will record the receipt of **Adam's** payment as shown below:

Cash a/c…………………… 4,900
Sales Discounts (or Disc. Allowed) a/c 100
  To Accounts Receivable a/c (Adam Nouh) 5,000
Collected a L.E.5,000 account receivable from a customer who took a 2% discount for early payment.

Notice that **Sales Discounts (also called Discounts Allowed)** is also considered another **contra-revenue account.** Therefore, in computing **net sales**, **Sales Discounts** are deducted from

gross sales along with any sales returns and allowances.

On the other hand **contra-revenue accounts** have much in common with **expense accounts;** both are deducted from gross revenue in determining **net income**, and both have **debit balances**.

3.5.2.3 Sales Delivery Expenses:

Sometimes the seller may pay for delivering merchandise to customers. If the seller incurs any costs in delivering merchandise to the customer, these costs are debited to an expense account which is entitled **Delivery Expense Account** (or Transportation-out Account / Freight-out Account). As such, in an income statement, delivery expense is classified as a **regular operating expense, <u>not</u>** as part of the cost of goods sold. For example, if the seller pays L.E.2,500 for freight charges, it will record the following entry in its books:

Freight-out a/c …………………. Cash a/c …………………… To record payment of freight on goods sold.	2,500	 2,500

3.5.3 Cash Discounts and the Three-column Cash Book:

3.5.3.1 Cash Discounts:

As it has been explained, it will be better if the enterprise's customers pay their accounts as quickly as possible. A business enterprise may accept a smaller sum in full settlement if payment is made within a certain period of time (discount period). As explained earlier, the amount of the reduction of the sum to be paid is termed ***Cash Discount.*** Thus, the term *cash discount* refers to the allowance given for prompt payment. The rate of cash discount is usually stated as a percentage, according to transaction terms, which are quoted on all sales documents by the selling firm.

3.5.3.2 Discounts Allowed and Discounts Received:

In effect, an enterprise may have two types of **cash discounts** in its books. These types are as follows:

1- **Discounts Allowed (or Sales Discounts).** Cash discounts allowed by a business enterprise to its customers (buyers or debtors) when they pay their accounts due promptly.

2- **Discounts Received (or purchase discounts).** This type of discounts is received by a business enterprise from its suppliers when it pays their accounts promptly.

3.5.3.3 Discount Columns in Cash Book:

Usually, the discounts allowed account and the discounts received account are in the **General Ledger** along with all the other revenue and expense accounts. In practice, every effort should be made to avoid too much reference to the **General Ledger.** Therefore, in the case of discounts this can be done by adding an additional column on each side of the cash book in which the amounts of discounts are entered. As such, **discounts received** are entered in the discounts column on the **credit side** of the cash book, while **discounts allowed** are entered in the discounts column on the **debit side** of the cash book. Accordingly, the cash book, taking the discounts into account, can be shown as explained in the following comprehensive illustration.

Comprehensive Illustration:

The following information appears in the books of **Happiness Firm** during May 2020 and you are required to prepare the Cash Book to record this information:

May 1 Balances brought down from April:

Cash Balance **L.E.2,900**, Bank Balance **L.E.65,400**. Debtors Accounts: Kamil **L.E.12,000**, Karima **L.E.28,000**, Shahinda **L.E.4,000**. Creditors Accounts: Basim **L.E.6,000,** Ahmed **L.E.44,000,** Lokman **L.E.10,000.**

May 2 Kamil pays by check, having deducted 2.5% cash discount **L.E.300, L.E.11,700.**

May 8 Paid Lokman his account by check, deducting 5% cash discount **L.E.500, L.E.9,500.**

May 11 Withdrawn **L.E.10,000** cash from the bank for business use.

May 16 Karima pays her account by cheque, deducting **2.5%** discount **L.E.700, L.E.27,300.**

May 25 Paid wages in cash, **L.E.9,200.**

May 28 Shahinda pays her account in cash after having deducted **5%** cash discount of **L.E.200**, **L.E.3,800.**

May 29 Paid Basim by check less **5%** cash discount of **L.E.300, L.E.5,700.**

May 30 Paid Ahmed by check less **2.5%** cash discount of **L.E.1,100, L.E42,900.**

Solution:

Receipts Cash Book Payments

Particulars	Discount	Cash	Bank	Particulars	Discount	Cash	Bank
	L.E.	L.E.	L.E.		L.E.	L.E.	L.E.
May 1 Balance b/d		2900	65400	May 8 Lokman	500		9500
May 2 Kamil	300		11700	May 11 Cash			10000
May 11 Bank		10000		May 25 Wages		9200	
May 16 Karima	700		27300	May 29 Basim	300		5700
May 28 Shahinda	200	3800		May 30 Ahmed	1100		42900
				May 31 Balance c/d		7500	36300
	<u>1200</u>	<u>16700</u>	<u>104400</u>		<u>1900</u>	<u>16700</u>	<u>104400</u>
Jun 1 Balance b/d		7500	36300				

3.6 Questions and Problems:

3.6.1 Questions:

1. Mohamed Ali Enterprise uses a **perpetual** inventory system. The firm sells merchandise (goods) costing **L.E.15,000** at a sales price of **L.E.21,500.** In recording this transaction, the accountant will make all of the following entries ***<u>except:</u>***

a. Credit Sales, **L.E.21,500.**

b. Credit Inventory, **L.E.21,500.**

c. Debit Cost of Goods Sold, **L.E.15,000.**

d. Credit Inventory, **L.E.15,000.**

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

2. A credit balance of **L.E.20,000** on the cash columns of the cash book mean

a. We have spent **L.E.20,000** more than we have received.

b. We have **L.E.20,000** cash in hand

c. The bookkeeper has made a mistake

d. Someone has stolen **L.E.20,000.**

3.6.2 Problems:

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

1. Upper Egypt enterprise uses a perpetual inventory system. On January 1 the Inventory Account had a balance of **L.E.93,500.** During the first few days of January, the following transactions happened:

Jan. 2 Purchased merchandise on credit from Victory Co. for **L.E.6,300.**

Jan. 3 Sold merchandise for cash, **L.E.19,000.** The cost of these goods was **L.E.12,500.**

Required:

a. Prepare entries in general journal form to record the above transactions.

b. What was the balance of the Inventory Account?

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

2. Commercial Bookshop returned certain merchandise which it had purchased from Dar-Elmaarif. Dar-Elmaarif allowed the bookshop full credit for this return against the account receivable (debtors) from the bookshop. The returned goods had been purchased by Commercial Bookshop for **L.E.70,000,** terms **2/30, n/90.** Commercial Bookshop records purchases of merchandise **net** of any available cash discounts.

Required

Prepare journal entries to record the return of this merchandise in the accounting records of (a) Commercial Bookshop and (b) Dar-Elmaarif. (Assume that the cost of the goods to Dar-Elmaarif had been **L.E.56,000**.)

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

3. Modern Office sells facsimile machines, copiers, and other types of office equipment. On May 10, the firm purchased for the first time a new **plain-paper** fax manufactured by Xerox Company. Transactions relating to this product during May and June were as follows:

May 10 Purchased five P-500 facsimile machines on account from Xerox Co., at a cost of **L.E.5,600** each. Payment is due in 30 days.

May 23 Sold four P-500 facsimile machines on account to Elhoda Stockbrokers; sales price, **L.E.9,000** per machine. Payment is due in 30 days.

May 24 Purchased an additional seven P-500 facsimile machines on account from Xerox. Cost, **L.E.5,600** per machine; payment due in 30 days.

June 9 Paid **L.E.28,000** cash to Xerox Co. for the facsimile machines purchased on May 10.

June 19 Sold two P-500 facsimile machines to MOHM for cash. Sales price, **L.E.9,500** per machine.

June 22 Collected **L.E.36,000** from Elhoda Stockbrokers in full settlement of the credit sale on May 23.

Required:

a. Prepare journal entries to record these transactions in the accounting records of Modern Office. (The firm uses a perpetual inventory system.)

b. Post the appropriate information from these journal entries to an inventory subsidiary ledger account.

c. How many Xerox P-500 facsimile machines were in inventory on May 31?

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

4. Appeared below is a series of related transactions between Egypt Wholesale Corp. and Star Fish, a chain of retail stores:

Feb. 9 Egypt Wholesale sold Star Fish 100 pairs of boots on account, terms 1/10, n/30. The cost of these boots to Egypt Wholesale was **L.E.160** per pair, and the sales price was **L.E.250** per pair.

Feb. 12 United Express charged **L.E.810** for delivering this merchandise to Star Fish. These charges were split evenly between the buyer and seller, and were paid immediately in cash.

Feb. 13 Star Fish returned ten pairs of boots to Egypt Wholesale because they were the wrong style. Egypt Wholesale allowed Star Fish full credit for this return.

Feb. 19 Star Fish paid the remaining balance due to Egypt Wholesale within the discount period.

Both companies use a perpetual inventory system.

***Required*:**

a. Record this series of transactions in the general journal of Egypt Wholesale Corp. (The company records sales at gross sales price.)

b. Record this series of transactions in the general journal of Star Fish. (The firm records purchases of goods at **net cost** and uses a Transportation-in account in recording transportation charges on inwards shipments.)

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

5. From the following details, prepare a two-column cash book and balance off as at the end of the month:

Mar 1 Balances brought down from last month: Cash in hand **L.E.560:** Cash in Bank **L.E.23,560.**

Mar 2 Paid rates (taxes) by check **L.E.1,560.**

Mar 3 Paid for postage stamps in cash **L.E.50.**

Mar 5 Cash sales of **L.E.740.**

Mar 7 Cash paid into bank **L.E.600.**

Mar 8 Paid to Amir by check **L.E.750:** paid to Esmail in cash **L.E.20.**

Mar 12 Collected from Mohamed **L.E.1,500, L.E.500** being in cash and **L.E.1,000** by check.

Mar 17 Cash drawings by proprietor **L.E.200.**

Mar 20 Collected from John by check **L.E.790.**

Mar 22 Withdrew **L.E.200** from the bank for business use.

Mar 24 Bought a new equipment for **L.E.1,950** cash.

Mar 28 Paid rent by check **L.E.400.**

Mar 31 Cash sales paid direct into the bank **L.E.1,050.**

☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

6. From the following details, enter up a three-column cash book. Balance off at the end of the month, and show the relevant discount accounts as they would appear in the general ledger.

May 1 Started business with L.E.60,000 in the bank.

May 1 Purchased fixtures paying by check L.E.9,500.

May 2 Purchased goods paying by check L.E.12,400.

May 3 Cash sales L.E.4,070.

May 4 Paid rent in cash L.E.2,000.

May 5 Collected from Mai her account of L.E.2,200 by a check for L.E.2,100, allowing her L.E.100 discount.

May 7 Paid Manar & Co L.E.800 owing to them by means of a check L.E.760, they allowed us L.E.40 discount.

May 9 We received a check for L.E.3,800 from Yaser, discount having been allowed L.E.200.

May 12 Paid rates by check L.E.4,100.

May 14 Walid pays us a check for L.E.1,150.

May 16 Paid Mahmoud his account of L.E.1,200 by cash L.E.1,140, having deducted L.E.60 cash discount.

May 20 Islam pays us a check for L.E.780, having deducted L.E.20 cash discount.

May 31 Cash sales paid direct into the bank L.E.880.
☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺☺

REFERANCES AND TABLE OF CONTENTS:

REFERENCES:

Accounting Standards Steering Committee-ASSC (1975), *The Corporate Report*, London: The Institute Chartered Accountants in England and Wales.

American Accounting Association-AAA (1966), *A Statement of Basic Accounting Theory*, Evanston, Illinois: AAA.

American Institute of Certified Public Accountants-AICPA (1982), Accounting Terminology Bulletin No.1, 1968, in FASB, *Accounting Standards, Original Pronouncements as of June1,* volume 1, Stamford: FASB, pp.5005-5019.

American Institute of Certified Public Accountants-AICPA, (1999), *Comprehensive Report of the Special Committee on Financial Reporting: Improving Business Reporting- A Customer Focus*, [On Line]. Available: http://www.aicpa.org/index.htm [Accessed on 27/4/2000].

Berry, A. and Jarvis, R. (1997), *Accounting in a business Context*, London: International Thomson Business Press.

Enthoven, A.J.H. (1973*), Accounting and Economic Development Policy*, Amsterdam: North-Holland Publishing Company.

Ezzamel, M. (1994), "The Emergence of the 'Accountant' in the Institutions of Ancient Egypt", *Management Accounting Research,* Vol.5, No.3-4, pp.221-246.

Financial Accounting Standards Board-FASB (1999), *Statement of Financial Accounting Concepts*, No.1, 1978, "Objectives of Financial Reporting by Business Enterprises", 1998/99 Edition, New York: John Wiley & Sons, Inc.

Glautier, M.W.E. and Underdown, B. (1987), *Accounting Theory and Practice*, London: Pitman Publishing.

Hartley, W.C.F. (1987), *An Introduction to Business Accounting for Managers*, Oxford, England: Pergamon Press.

Kimmel, P.D., Weygandt, J.J. and Kieso, D.E. (2011), *Financial Accounting-Tools for Business Decision Making,* John Wiley &Sons (Asia) Pte Ltd.

Maheshwari, S.N. (1996), *Advanced Accountancy,* India: VIKAS PUBLISHING HOUSE PVT LTD.

Meigs, R.E., et. Al. (1996), *Accounting: the Basis for Business Decisions*, New York: The McGraw-Hill Companies, Inc.

Moonitz, M. (1961), *The Basic Postulate of Accounting*, Accounting Research Study No. 1, New York: AICPA.

Radebaugh, L.H. and Gray, S.J. (1997), *International Accounting and Multinational Enterprises*, New York: John Wiley & Sons, Inc.

Rawy, A.A. (2004), *Financial Reporting and Contemporary Changes in the Egyptian Environment*, Ph.D. Thesis, the University of Hull, U.K.

Van Greuning, H. and Koen, M. (2001), *International Accounting Standards: A Practical Guide*, Washington, D.C.: The World Bank.

Wood, F. (1993), *Business Accounting 1*, London: PITMAN PUBLISHING.

TABLE OF CONTENTS: