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Accounting Studies in English

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Preface

This textbook has been written to provide students with a very detailed and comprehensive introduction to accounting studies in English. In this book, students will be able to get all the information they need to have a good understanding of the nature of accounting, bookkeeping, forms of businesses in Egypt, the accounting framework and its components, the accounting cycle.

In addition, the book provide an up-to-date information regarding the presentation of the financial statements, which give students a good foundation for knowing the content and formats of different financial statements.

To fulfil the purpose of this book, it has been divided into chapters intended to put students, who study business, on the right way towards getting full understanding of business accounting.

Chapter One
An Introduction To Accounting

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An Introduction To Accounting

1-1 <u>What is accounting?</u>

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 filed 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 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 in its simple nature is the means or the tool by which we measure or evaluate and describe the results of economic activities or events.

Whether we are managing a business, making investment, preparing our income tax return (declaration), or only paying our phone or electricity bill, we are practicing and working with accounting concepts and accounting information.

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 or 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 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 or her family affairs have to keep a record of the money received and spent by him or her during a given period.

He or she can record his or 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 dairy in a chronological order. Such a record will help in knowing regarding. (Maheshwari, 1996)

The sources from which he or she received cash and the purposes for which it was used. Whether his or her receipts are more than his or her payments or vice–versa?

The balance (the remaining) of cash in hand or deficit, if any at the end of a particular period.

1–2 <u>DO we need accounting?</u>

As mentioned above, in case the person who is responsible for housekeeping and family affairs, he or she can collect valuable data and information regarding the nature of his or her receipts and payments.

For example, this person can find out the total amount spent by him or her during a given period, say a year on different items he or she purchased.

Similarly, he or she can find out the sources of his or 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 or 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).

Accordingly, the answer on a question such as do we need accounting? Or for what purpose is accounting used? , can be presented on two levels at least: That of the individual and that of the enterprise.

If we are considered the individual, accounting information could be used to help plan future level of expenditure, to help raise or increase additional finance and to decide or determine the best way to spend their money.

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 , part 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 or she has to know the following:

- What he or she owns?
- What he or she owes?
- Whether he or she earned a profit or suffered a loss as a result of running a business?
- What is his or her financial position (whether he / she will be in a position to meet all his 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 one 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.

1-3 Definition Of Accounting:

Actually, the role of accounting has been changing greatly with the change in the economic and social developments over the last few centuries.

In its stage, accounting was regarded only as a technique for historic description of financial activities. Over a span of time, new dimensions have been added to the accounting discipline. Until recently, accounting was regarded to be an art.

This could be noted from the following definition of accounting cited by the American Institute of Certified public Accountants (AICPA, 1982, p.5007):

Accounting is an art of recoding, classifying and summarizing in significant manner and in terms of money, transactions and events, which are in part at least of a financial characters and interpreting the results thereof .

According to the American Accounting Association's(AAA) definition of accounting, accounting can be considered an information system, which aims at exchanging data and information among a variety of parties , whether inside or outside the organization. The AAA (AAA, 1966, p.1) defined accounting broadly as:

> The process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information.

Accordingly, accounting is being considered as a service activity that is not only concerned with recording, classifying or summarizing the economic transactions, but also an important tool for providing appropriate information To Whom It May Concern.

Therefore, the following functions could be closely related to accounting activity:

A–Recording:

When people normally talk regarding accounting it means the type used by business and other organizations.

They cannot retain all the details in their mind therefor they have to keep records of it.

They will not only record cash received and paid out, they will also record goods bought and sold.

Recording is considered the basic function of accounting and it is essentially not only concerned with ensuring that all business transactions of financial character are actually recorded, but also that they are recorded in an orderly and systematically manner.

As we will see in the next chapters, recording is done in the book which is called "Journal" this book may further sub–divided into subsidiary books such as cash journal which is used to record cash transactions, purchases journal which is used for recording credit purchase goods, sales journal which used for recording credit sales of goods, and so on.

We must keep in mind the fact that the number of subsidiary books to be kept by the business will vary from business to business depending the nature and the size of the business.

B– Classifying:

When the data is being recorded it should be sorted out so as to be most useful to the interested parties. Classification process is mainly concerned with the systematic analysis of recorded data, with a view to group transaction or entries of the same nature at one place. The classification process is done in the book termed as "ledger". The ledger book consists of different pages individual account heads under which all financial transactions of one nature are collected.

For example, all expenses under the head of wage expense after being recorded in the journal will be classified under separate head in the ledger called "Wages Expenses" .

The same treatment should be followed regarding all chasses of expenses and revenues, which will assist in finding out the total expenditures incurred or revenues realized under appropriate heads.

C- Summarizing:

Summarizing process involves presenting the data in an understandable and useful manner to both internal and external users of accounting statements.

Summarizing process will leads to the preparation of some statements, as we will see later, such as Trial Balance, Income Statement, Balance Sheet, etc.

D–Deals with Financial Transactions:

Accounting deals and records only those transactions and events in terms of money which are of a financial character.

Accordingly, transactions which are not of a financial character are not recorded in the books of accounts.

For instance , if a business has got a team of dedicated and trusted employees , it is of important use the business , but because it is not of a financial character and capable of being expressed in terms of money , it will note be considered and recorded in the books of business .

Nevertheless, a new branch of accounting called Human Resource Accounting is introduced and developed to value the human resources of the business and present them in an appropriate manner in the financial statements.

E- Interpretation:

Interpretation is considered the final function and the end work of accounting. The recorded financial data is interpreted in a manner that allows the end-user to make a meaningful judgment regarding the financial condition and profitability of the business operations in question.

The data is also used for the preparation of the future plans and building policies for implementing such plans. To sum up, accounting is concerned with the quantification of economic events in money terms in order to collect, record, evaluate and communicate the results of past events and to aid in decision-making.

1-4 Who uses accounting information?

Accounting is of all importance to the owners and managers. However, other parties such as creditors. Investors, employees, etc.

Are also concerned with the accounting information. Whether accounting information relates to the activities of an individual or to a business enterprise, its various users can be places in two categories: those inside the enterprise, the managers or in the case of small business the owner or the proprietor and those outside the enterprise, banks, the government, tax authorities etc.

1-4-1- Internal Users:

Accounting information is sued internally by some users, but the major internal user is the management of a business. For a small business this is likely to be the owner (the proprietor). A business is done with the objective of making profit. Business' profitability and financial rightness are matters of chief importance to the owners who have invested their money in the business.

On the other hand , many business are much larger and these may owned by numerous individuals or groups of individuals and in such situation it is unlikely that the actual owners would or could take an active part in the day-to-day running of the business .

As a result, these owners delegate the authority of running the enterprise to a group of directors and managers.

These directors and managers are involved in the routine decision making and are equivalent of the owners in a small business regarding their information are often met through unpublished reports of various kinds.

These needs could be summarized in some meaningful broad as follows (Berry and Jarvis, 1997):

- **Stewardship:** the need to protect the business' possessions or properties – normally referred to as assets-from theft, abuse etc.

- **Planning:** management needs information to plan activities so that the finance can be raised, marketing and promotional campaigns can be set up and production plans can be made (planning function of management).
- **Control:** management needs information to control the activities of the enterprise that may include setting sales targets, ensuring that there are enough goods in stores etc. This will also include identifying where targets have and have not been met (control function of management).
- **Decision making:** management needs information to make specific decisions such as; should the enterprise produce an item or buy it? How much will it cost to produce a particular item? How much money will the business need in order to run it activities? (Decision support function).

1-4-2 External Users:

This category may include a variety of external users groups. Therefore, it is not strange if we say that financial accounting can broadly be thought as of that part of the accounting system which endeavors to meet the needs of the various external user groups.

The corporate Report, Published by the Institute Chartered Accountants in England and Wales (ASS, 1975) includes most of the accepted external users of accounting as follows:

A- Owners:

In the case of small business, the owners are likely involved in the day-to-day operations of the business. However, as the business grows, it is likely that the owners will become divorced or separated from the immediate routine operation and the management will undertake this role.

As much , the owners needs to know : whether the enterprise has done as well as it should have done ; whether the managers have looked after , and made good use of the resources of the enterprise , and how the enterprise is going to fare in the future .

B– Lenders:

Lenders are the persons who have extended credit to the enterprise. People and organizations only lend money in order to earn a return on that money.

They are therefore interested in seeing that as enterprise is achieving sufficient profit to provide them with their return (usually in the form of interest).

They are also concerned to ensure that the enterprise will be able to repay the money it has borrowed , so they need to ascertain what the enterprise owns and what it owner .

C– Suppliers of goods and services:

In practice , goods and services can be supplied on the oasis either that they are paid for when they are supplied (in cash) or that they are paid for at some agreed date in the future (on account) .

In both situations the supplier will be interested to know whether the firm is likely to stay in business and whether it is probably to expand or contract.

Suppliers of goods who have not been paid immediately will also be concerned with assessing the likelihood of getting paid.

D– **Customers:**

Customers are the target to whom the enterprise is planning to market its goods or services.

Like suppliers, customers would like to assess an enterprise's ability to survive and in turn to carry on supplying them with goods or services.

The customers will need to see that the enterprise is profited, that it owns enough to pay what it owes and that it is likely to remain in business and supply goods efficiently and on time.

E-The Employees:

In any business, employees depend greatly on the survival of the enterprise for their wages or salaries and therefore are interested in whether the enterprise is likely to survive. In the long term, an enterprise needs to make a profit in order to survive.

The employees may also be interested in comparing how well the enterprise is doing, compared with other similar enterprise, for the wages negotiation.

F– The Government:

Accounting information is required by government and its related authorities. The government uses accounting information for a number of purposes, perhaps the most clear of which is the levying (imposing) of taxes.

To attain this purpose, the government needs to know how much profit has been made. The government also uses accounting information to produce industry statistics for the purpose of regulation and so on.

G–The General Public:

This group of users. Anyway, the general public may require many different types of information regarding enterprises in both the public and private sectors.

For instance, the public could be interested in the level of pollution resulting from a particular industry. Researchers and academics also have their special interest in accounting information.

An ordinary citizen may be interested in the accounting information of the institutions with which he comes in contact in his / her daily life, such as banks and public utilities including gas, transport and electricity enterprises. Accounting information users and their purposes in using information are summarized in the following table:

Users and their purposes in using information:

Type of users	Reason for using business reporting
Investors	Help with investment decisions.
Creditors	Help with credit decisions.
Management and board members	Help with decision about managing the business.
Employee groups	Help understand compensation policies and a company's ability to meet compensation and benefit

	commitments.
Competitors	Help evaluate competitive strengths and weaknesses and business strategy
Regulators	Help assess compliance with regulations
Academics	Provide data for research.
The press	Provide data for articles.
Users concerned with various social causes	Help assess a company's involvement in areas of concern.

1-5 Types of accounting 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 develop .

As there are many types of economic decision, 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:

A- Financial Accounting:

Financial accounting in 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 organization or an individual entity.

Conventionally, accountants use the term financial position to describe an entity's financial resources and obligations at one point in time or given data, and the term results of operations to describe or portray the entity's financial activities during the year a part of year.

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 enterprise 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.

Financial accounting information also is important for preparing income tax return or declaration. In short, financial accounting information is used to serve too much different purpose that it often is called general purpose accounting information.

B– 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 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 organized and developed in a manner connected directly to the decision under condition .

Notwithstanding, management accounting information often involves evaluations of nonfinancial factors, such as political and environmental considerations, product quality, customer satisfaction, and employee productivity.

C– Tax Accounting:

The preparation of income tax declarations or returns is considered a specialized filed within accounting discipline. Tax declarations, to a great extent, are built on financial accounting information.

Nevertheless, such information often is adjusted or reorganized to comply with income tax reporting requirements. However, the most challenging aspect of tax accounting is not the preparation of an income tax declaration, but tax planning.

Tax planning means forecasting or anticipating the tax effects of business transactions and structuring these transactions in a manner that will minimise the income tax burden.

D– The Main Objective Of Accounting:

Accounting did not emerge from a vacuum and thus it is developing to achieve many objectives.

The following are the basic objectives of accounting:

(1) – Accounting is intended to keep systematic:

Records: Accounting activity is done to provide regular and systematic records of economic transaction.

Imagine the state in the absence of accounting. For example, how the trader keeps a track of numerous transactions occurred during a given period of time.

In the absence of accounting there would have been heavy overload or burden on human memory which in most cases would have been impossible to bear or tolerate.

(2) –Accounting is intended to protect entity's:

Properties: it is conceived that accounting provides protection to enterprise from misuse or abuse.

This could be possible on the base of accounting supplying the following information to the enterprise's manager or the owner (Maheshwari, 1996):

- The amount of the owner's funds invested in the business.
- How much the business has to pay to other interested parties?
- How much the business has to collect from others?
- How much the business has in the form of (a) fixed assets, (b) cash in hand, (c) cash at bank account etc.?

(3) –Accounting is intended to ascertain the operational profit or loss:

Accounting assists in determining the net profit earned or loss suffered as a result of carrying the business.

This process is being done by keeping an appropriate record of revenues and expenses of a given period.

(4) –Accounting is intended to determine the financial position of the Entity :

It is not enough to know the net profit or loss resulting from carrying the business during a period of time. It is an important for the businessman to have a good idea about his financial position at specific date.

For example, where he stand: what he owes and what he owns? This goal is implemented by a statement which shows the enterprise's financial position.

(5) –Accounting is intended to facilitate decision making process:

The task of collection, analysis and reporting of information at the required point of time to the required levels of authority in order to facilitate economic decision making is the responsibility of accounting.

Questions

Questions (1): Indicate whether each of the following is true (T) or false (F):

No.	The question
(1)-	Accounting is the language of business.
(2)-	Accounting can be useful only for recording business transactions.
(3)-	The only business events that are entered in accounting records are those that can be expressed in monetary terms.
(4)-	Like suppliers, customers, would like to asses on enterprise's ability to Survive.
(5)-	Management accounting information is used to serve so many different purposes that it often called general purpose accounting information.
(6)-	Interpretation is considered the final function and the end work of accounting.
(7)-	Accounting information is used only by external users with a financial interest in a business enterprise.

(8)–	Managerial accounting is the area of accounting that provides internal reports to assist the decision making needs of internal users.
(9)–	The primary objective of financial accounting is to provide general purpose financial statements to help external users analyze and interpret an organization's activities.
(10)–	Internal users include lenders, shareholders, brokers and managers.
(11)–	The major external users of accounting is the management of the business.
(12)–	Financial accounting covers a variety of areas such as cost accounting, budgetary control.
(13)–	Suppliers interested in comparing how well the enterprise is doing compared with other similar enterprises for the purpose of wage negotiations.
(14)–	Accounting information is used by management in making different decisions.
(15)–	Accounting is concerned with the qualification of economic events in money terms.

(16)–	Control function of management includes identifying where targets have and have not been met.
(17)–	Planning function of management include identifying where targets have and have not been met.
(18)–	All user groups are similar in their needs of financial information.
(19)–	Several user groups need information that is non–financial.
(20)–	General purpose reports are those prepared by enterprise itself for internal and external user groups.
(21)–	In accounting literature there is only one definition of accounting.
(22)–	Interests of employees are direct conflict with those of the firm and in particular with those of management.
(23)–	When the data is being recorded it should be sorted out so as to be most useful to the interested parties.

(24)-	Summarizing process is done in the book which is called Journal.
(25)-	Stewardship needs information to control the activities of the enterprise that may include setting sales targets.
(26)-	Owners are the persons who have extended credit to the enterprise.
(27)-	Lenders do not need to ascertain what the enterprise owns and what it owes.
(28)-	Investors use information to provide data for articles.
(29)-	Accounting is intended to ascertain the operational profit and loss.
(30)-	No branch of accounting called Human Resources accounting.
(31)-	A business is done with two chief matters profitability and rightness.

Questions (2): Choose the best answer for each of the following questions:

1- The main function of accounting is to:

A. Record economic data.
B. Provide the informational basis for action.
C. Classifying and recording business transactions.
D. Attain non-economic goals.

2- The basic function of financial accounting is to :

A. Record all business transactions.
B. Interpret the financial data.
C. Assist the management in performing functions effectively.

3- Management accounting provides invaluable services to management in performing :

A. All management in performing.
B. Coordinating management functions.

C. Controlling functions.

4- The inputs to accounting process are:

A. Useful information.

B. Useful data.

C. Economic activities.

D. None of the above.

5- The classification process is done in the book termed as:

A. Statement.

B. Journal.

C. Ledger.

D. None of the above.

6- External users of accounting information include all of the following except:

A. Shareholders.

B. Customers.

C. Purchasing managers.

D. Government regulators.

7- Cost accounting is one of areas to:

A. Financial accounting.

B. Management accounting.

C. Tax accounting.

D. None of the above.

8- Accounting are intended to:

A. Protect entity's proprieties.

B. Determine the financial position.

C. Facilitate decision making process.

D. All of the above.

9- Which one of the following is not an external user of accounting information?

A. Regulatory agencies.

B. Customers.

C. Investors.

D. All of these are external users.

10- Which of the following is an external user of accounting information?

A. Labor unions.

B. Finance directors.

C. Company officers.

D. Managers.

11- Which of the following would not be considered internal users of accounting data for a company?

A. The president of a company.

B. The controller of a company.

C. Creditors of a company.

D. Salesmen of the company.

12- The need to protect the business possession:

A. Management accounting.

B. Decision making management.

C. Planning management.

D. Stewardship.

13- .... Are the persons who have extended credit to the enterprise:

A. Owners.

B. Lenders.

C. Management.

D. Suppliers.

14-.............. Is the best process mainly concerned with the systematic analysis of recorded data:

A. Recording.

B. Classifying.

C. Summarizing.

D. None of the above.

15-.............. Process involves presenting data in an understandable and useful manner to both internal and external users of accounting statements:

A. Recording.

B. Classifying.

C. Summarizing.

D. None of the above.

16-The need to protect the business possessions or prosperities normally referred to as assets from theft, fraud, abuse:

A. Control.

B. Stewardship.

C. Agency.

D. None of the above.

17- ……… will need to see that the enterprise is likely to remain in business and supply goods efficiently and on time:

A. Lenders.

B. Customers.

C. Employees.

D. Suppliers.

18- ………… information often involves evaluations of non-financial factors, such as a political and environmental considerations, product quality, customer satisfaction, and employee productivity:

A. Cost Accounting.

B. Financial Accounting.

C. Tax accounting.

D. Management Accounting.

19- ....in long run interested in comparing how well the enterprise is doing compared with other similar enterprises for the purpose of wage negotiations:

A. Employees.
B. Customers.
C. Suppliers.
D. Government.

20- .... Uses accounting information for a number of purposes, perhaps the most clear of which is the levying taxes:

A. Management.
B. Customers.
C. Suppliers.
D. Government.

21- Recording concerned with ensuring that all business transactions of financial characters are:

A. Actually recorded.
B. Recording in an orderly.
C. Recorded in a systematically manner.

D. All of the above.

22-…………… is the process mainly concerned with the systematic analysis of recorded data:

A. Recording.

B. Classifying.

C. Summarizing .

D. None of the above.

23- The final function and end work of accounting, is:

A. Recording.

B. Classifying.

C. Summarizing.

D. None of the above.

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24 …………. Is the original form of accounting which is basically confined to the preparation of financial statements for the external users:

A. Tax accounting.

B. Financial Accounting.

C. Management Accounting.

D. Cost Accounting.

Chapter Two
Forms of Business Organization

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2-1 Introduction:

Business organizations very greatly in the nature of their operations, their needs for capital, the number of owners, and the legal form of the business organization.

In Egypt, like most of countries, there are three main forms of business organizations. They are sole proprietorships (traders), partnerships, and corporations.

Accordingly, the risks incurred or borne both by equity investors and by creditors vary greatly depending upon the form of an organization.

On the other hand, although these organizations use the same accounting principles, the information contained in their financial statements should be interpreted differently.

2-2 Sole Proprietorships:

A sole proprietorship is an unincorporated business owned by one person. In practice, sole proprietorships are considered the most common form of business organization because they are so easy to form and start.

Forming or creating a sole proprietorship requires no complicated authorization from any governmental authority or agency. In most cases, the business needs little or no investment of capital. For instance, youngest with certificate in law and consultant services has a sole proprietorship.

On a larger scale, sole proprietorship are widely used for farms, service businesses, small retail stores , restaurants , and professional practices, such as medicine, law, and public accounting .

A sole proprietorship or an individual firm provides a good model for demonstrating accounting principles because it is the simplest form of business organization.

However, in reality and in the business world, it will be hardly to see financial statements for these organizations. Most, if not all, sole proprietorships are relatively small business with few financial reporting obligations.

Their needs for accounting information consist basically of data used in daily business operations the balance in the firm's bank account and the amounts receivable and payable. In essence, most sole proprietorships do not prepare formal financial statements unless some special need emerges.

2-2-1 The Concept of the "Separate" Business Entity:

Generally Accepted Accounting Principles (GAAP) Require that a set of financial statements describe the affairs of a specific business entity. The concept is termed the **Entity Principle**. A **business**

entity is an economic unit that engages in determined business activities.

For accounting purposes every business organization–including sole proprietorship is treated as an entity separate from the other activities of its owner.

Such treatment enables everyone to measure the performance of the business separately from the other financial affairs of its owners.

On the other hand, and in the eyes of the law, a sole proprietorship is **not** an entity **separate** from its owner. According to the law, the proprietor is the "entity", and a sole proprietorship merely represents some of this individual's financial activities.

The fact that a sole proprietorship and its owner legally are **one and the same** explains many of the distinctive characteristics of this form of organization.

2-2-2 Characteristics of a Sole Proprietorship:

The basic characteristics of a sole proprietorship can be summarized as follows:

1- Ease of formation:

As a result of the ease of formation, these forms of organizations are very common.

2- Business assets actually belong to the proprietor:

Because the business is not a legal entity, it can not own property.

The business assets actually belong to the proprietor, not to the business. Therefore, the proprietor may transfer assets in or out of the business.

3- The business pays no income taxes:

In Egypt, the tax laws see net income of the sole proprietorship as an income of natural person. In other words, tax laws do not view a sole proprietorship as separate from the other financial activities of its owner.

Accordingly, the proprietorship does not file an income tax return or pay income taxes.

Instead. The proprietor or the owner must include the net income of the business in his or her personal income tax return (tax declaration).

4- The business pays no salary to the proprietor:

The owner of a sole proprietorship is not "Working for salary". Instead, the owner's compensation consists of the entire net income (or net loss) of the business.

Therefore, any money withdrawn from the business by its owner should be recorded by debiting the owner's Drawing Accounting, not recognized as salaries expense.

5- The owner is personally liable for the debts of the business:

This concept is termed "Unlimited Personal Liability" and is very important to be treated as just one item in the characteristics. The owner of a sole proprietorship is personally responsible for all of the business debts.

Unlimited personal liability is considered the greatest disadvantage to this form of organization. Other forms of business organization all provide owners with some means of limiting their personal liability for business debts.

2-2-3 Accounting Practice in Sole Proprietorships:

In the balance sheet of a sole proprietorship, total owner's equity is represented by the balance in the owner **Capital** account. Investments of assets by the owner are recorded by crediting this account.

Withdrawals of assets by the owner are recorded by debiting the owner's **Drawing** Account. At the end of the accounting period, the drawing account, and also the income summary account, is closed into the owner's capital account.

A sole proprietorship is owned by only one person, therefore when reporting ownership equity in the balance sheet, the owner's equity section includes only one item that is the equity of the owner. This can be illustrated as follows:

ABC

Balance Sheet as on Des.31, 2017

Asset liabilities& Owner's Equity

		Owner's Equity **WXY ,Capital**	 **90,000**

The only financial reporting obligation of much sole proprietorship is the information that must be included in the owner's personal income tax return.

For this reason, much sole proprietorship bases their accounting procedures on **Income Tax Rules**, rather than generally accepted accounting principles. Also, the financial information that they develop usually is **not** audited.

2-2-4 Evaluating the Financial Statements of Sole Proprietorships:

(1) -The Adequacy of Net Income:

Logically, sole proprietorships do not recognize any salary expense in relation to the owner, not any interest expense on the capital that the owner has invested in his / her business.

Therefore, if the business is to be considered successful, its net income should at least provide to owner with reasonable compensation for any personal service and equity capital which the owner has provided to the business.

Furthermore, the net income of a sole proprietorship should be adequate to compensate the owner for taking or bearing reasonable risks. In practice, many small businesses do not succeed. The owner of a sole proprietorship has unlimited personal liability for the debts of the business.

Thus, if a sole proprietorship bears or sustains large losses, the owner can lose **much more** than the amount of his or her equity investment. Accordingly, the net income of sole proprietorship should be sufficient or adequate to compensate the owner for these factors:

A- Personal services rendered or provided to the business.

B-Capital invested.

C-The degree of financial risk which the owner is taking.

(2) –Evaluating Solvency:

As it will be discussed later , for a business organized as a corporation, creditors often base their lending decisions upon the relationships between assets and liabilities in the corporation's balance sheet.

However, if the business is organized as a sole proprietorship, the balance sheet will be less useful to creditors. As it was explained, the assets listed in the balance sheet are owned by the **owner or proprietor**, not by the business.

The owner can transfer assets in and out of the business **at will**. In addition, it is the **proprietor** who is financially responsible for the firm's debts depends on **solvency of the owner**, not on the relationships among the assets and liabilities appearing in the firm's balance sheet.

Actually, the **solvency** of a sole proprietorship may be affected by many things which **do not appear** in the financial statements of the business.

The owner may have great personal wealth or overwhelming personal debts. To sum up, creditors of a sole proprietorship should look past the balance sheet of the business.

The real issue is the debt-paying ability of the owner. Therefore, creditors of the business may ask the **owner** to supply **personal** financial information. They also may investigate the owner's credit history.

2-3 Partnerships:

A partnership can be defined as an unincorporated business owned by two or more **partners**. A partner may be either an individual or a corporation.

A partnership often is referred to as a **firm** (company). Partnerships are the least common form of business organization, probably because they often result in **to many bosses**. Nevertheless, they are widely used for professional practices, such as medicine, law, and public accounting.

They also are used for many small businesses, especially those which are family–owned.

For accounting purposes, like sole proprietorship a partnership is viewed as an entity separate from the other activities of its owners.

But under the point of view of the law, the partnership is **not separate** from its owners. In addition, the law regards the partners as **personally and jointly** responsible for the activities of the business.

As such, the assets of partnership **do not** belong to the business; they belong **jointly** to the entire partner. Unless special provisions or agreements are made, each partner has **unlimited personal liability** for the debts of the business.

Accordingly, the partnership itself pays no income taxes, but the partners include their respective shares of the firm's net income in their personal income tax returns.

Legally, partnerships have **limited lives.** From a legal standpoint, a partnership ends upon the withdrawal or death of an existing partner. Admission of a new partner terminates or ends the "old" partnership and creates a new legal entity.

However, this is only a legal distinction. Most, if not all, partnerships have **continuity of existence** extending beyond the participation of individual partners. Partnership agreements often have provisions that make the retirements of partners and the admission of new partner's routine events that do not affect the operations of the business.

In the real world, the term "**partnership**" actually includes three distinct types of organizations. They are: general partnerships, limited partnerships, and limited liability partnerships. Those three types of organizations are briefly introduced in the following points:

(1) –General Partnerships :

In this type of partnerships, each partner has rights and responsibilities similar to those of a sole proprietor. For instance, each general partner can withdraw cash and many other assets from the business at will (accept title to real estate which is held in the name of the partnership and, hence, cannot be sold nor withdrawn by any partner at will).

Furthermore, each partner has the full "authority **of an owner**" to negotiate contracts binding or obligating upon the business.

This concept is called **mutual agency**. Also, every partner has **unlimited personal liability** for the debts of the firm.

Combining the characteristics of unlimited personal liability and mutual agency makes a general partnership a potentially dangerous from of business organization.

Shortly, general partnerships involve the same unlimited personal liability as sole proprietorships. This risk is increased or intensified, however, because you may be held financially responsible for your partner's actions, as well as for your own.

(2) -Partnerships That Limit Personal Liability:

This type of partnerships includes limited partnerships and limited liability partnerships. The purpose of these forms of partnerships to place limits upon the potential liability of individual partners.

a) Limited Partnerships:

A limited partnership has one or more **general partners** and also one or more **limited partners**. The general partners are partners in the traditional way, with unlimited personal liability for the debts of the business. And also the right to make managerial decisions. On the other hand, the **limited partners** are basically passive investors.

In other words, they share in the profits of the business, but they do not participate actively in management and don't personally liable for debts of the business. Therefore. If the goes under, the losses incurred by the limited partners are limited to the amounts they have invested in the business.

Historically, limited partnerships were widely used for various investment ventures, such as drilling for oil and developing real estate. This business often lost money, at least in the early years. For such ventures, the limited partnership concept had great appeal (attraction) to investors.

Limited partners could include their share of any partnership net loss in their personal income tax declarations, therefore offsetting taxable income from other sources. Moreover, as **limited** partners, their financial risk was limited to the amount their equity investment.

b) Limited Liability Partnerships:

A limited liability partnership is a relatively new form of business organizations, organized in the U.S.A. Professional, such as doctors, lawyers, and accountants traditionally have required organizing their practices either as sole proprietorships or as partnerships.

The purpose beyond this requirement was to insure that these professionals had unlimited liability for their professional activities. Over the years, many professional partnerships have grown in size. For example, several public accounting firms have thousands of partners and operate in countries all over the world.

On the other hand, lawsuits against professional firms have increased greatly in number and in money amount. To protect and prevent these lawsuits from bankrupting **innocent** partners, the concept of the limited liability partnership has emerged.

In this type of partnership, each partner has unlimited personal liability for his or her **own** professional activities, but not for the actions of other partners, Unlike a limited partnership, all of the partners in a limited liability partnership may participate in management of the firm.

2-3-1 Accounting Practices in Partnerships:

In the majority of respects, partnership accounting is similar to that in a sole proprietorship except there are more owners. As a result, a separate capital account and drawing account is maintained for each partner.

Like sole proprietorships, partnerships recognize no salaries expense for service provided to the organization by the partners. Amounts paid to partners are recorded by debiting the partner's drawing account. The partners' equity section of the balance sheet might appear as follows:

ABC FIRM

Balance Sheet as on Des.31, 2019

Asset   Liabilities & Partners' Equity

		Partners' Equity	
		L, capital	**90,000**
		M, capital	**180,000**
		N, capital	**270,000**
		Total partners' equity	540,000

On the other hand, the statement of owner's equity, which is prepared by a statement of partners' equity. It shows separately the changes in each partner's capital account, as appearing below:

M & **A**

Statement of Partners' Equity

For the year ended December 31, 2019

	M	A	Total
Balance, jan.1,2008	**80,000**	**80,000**	**160,000**
Add : investments	**5,000**	**5,000**	**10,000**
Net income for the year	**15,000**	**15,000**	**30,000**
Subtotal	100,000	100,000	200,000
Less : Drawing	12,000	8,000	20,000
Balance , Dec. 31, 2017	88,000	92,000	180,000

2-3-1-1 Allocating Net Income among the Partners:

A distinct feature of a partnership is the need to divide or allocate the firm's net income among its partners. Allocating partnership net income mean computing each partner's share of total net income (or loss) and crediting (or debiting) this amount to the partner's capital account.

This dividing of partnership income is simply a journal entry made in the books and it does not involve any distributions of cash or other assets to the partners.

The amount that an individual partner withdraws during the year may differ greatly from the amount of partnership net income allocated to that partner. All partners pay personal income taxes on the amount of partnership income allocated to them; not on the amounts of assets withdrawn.

Partners have great freedom in deciding how to allocate the partnership's net income among them. In the absence of prior agreement, prevailing laws and conventions generally provide for an equal split (allocation) among the partners, but this rarely happens. Partners usually agree well in advance how the firm's net income will be allocated.

2-3-1-2 The Importance of a Partnership Contract:

Actually, every partnership requires a carefully written partnership contract, prepared before the firm starts operation. This contract is an agreement among the partners as to their rights and responsibilities.

It determines the responsibilities of individual partners, how net income (or loss) will be allocated, and the amounts of assets that partners are allowed to withdraw.

On the other hand, a partnership contract or agreement does not prevent disputes from arising among the partners, but it does, however, provide a contractual base for their resolution.

2-3-2 Evaluating the Financial Statement of a Partnership:

(1) -The adequacy of Net Income:

In essence, the net income of a partnership is similar to that of a sole proprietorship. The net income represents the partners' compensation for such things, including:

a) Personal services.
b) Invested capital , and
c) The risks of ownership.

Additionally, the reported net income is an income before income tax. The services and capital provided by individual partners may vary, as may the degree of financial risk assumed.

Thus, it will be difficult to evaluate the income of a partnership regarded as a whole. Instead, the individual partners must separately evaluate their respective shares of the partnership net income in light of their personal contributions to the firm.

As a result, some partners may find the partnership quite rewarding, while others may consider their share of the partnership net income inadequate.

(2) -Evaluating solvency:

The balance sheet of a partnership is, relatively, more meaningful than that of a sole proprietorship. Perhaps, this is because there are legal distinctions or differences between partnership assets, which are jointly owned, and the personal assets of individual partners.

Moreover, personal responsibility for business debts may not extend to all of the partners. As such, creditors should understand the difference among the types of partnerships. For example, in general partnership, all partners have unlimited personal liability for the debts of the business.

This situation affords or gives creditors the maximum degree of protection. In a limited partnership, however, only the general partners have personal liability for these obligations. In a limited liability partnership, liability for negligence or malpractice extends only to those partners directly involved.

2-4 Corporations:

In any economy, nearly all large businesses and many small ones are organized as corporations.

In the real world, there is much more sole proprietorship than corporations; however in money volume of business activity, corporations hold an impressive lead.

As a result of the dominant role of the corporation in any economy, it is important for everyone interested in business, economics, or politics to have an understanding of corporations and their accounting policies.

2-4-1 A Corporation:

A corporation is a legal entity, having an existence separate and distinct from that of its owners. The owners of corporation are called **stockholders** (or shareholders), and their ownership is evidenced by transferable shares of **capital stock**. Accordingly:

- a corporation is more difficult and costly to form than other types of organizations. And it must obtain a **character** (or personality) from the authority and it also must receive authorization from that authority to issue shares of capital stock. The formation of a corporation usually needs the services of attorney (lawyer) and accountant.
- A corporation, as a separate legal entity, may own property in its own name. The assets of a corporation belong in the corporation itself, not to the stockholders.
- A corporation has legal status in court, so it may sue and be used as if it were a person. As a legal entity, a corporation may enter into contracts, is responsible for its own debts, and pays income taxes on its earnings.
- On a daily basis, corporations are run by salaried professional managers, not by their stockholders. In many cases, the managers and stockholders are one and the same. In other words, managers

may own stock, and stockholders may be hired into management roles. Nevertheless, ownership of stock does not automatically give the shareholder managerial authority. Therefore, the stockholders are primarily investors, rather than active participants in the business.

- The top level of a corporation's professional management is the board of directors. These directors are elected by the stockholders, and are responsible for hiring the other professional managers. Furthermore, the directors make basic policy decisions, including the extent to which profits of the corporation are distributed to stockholders.
- The fact that directors are elected by the stockholders means that a stockholders or a group of stockholders owning more than 50% of the company's stock effectively controls the corporation. These controlling stockholders have the voting power to elect the directors; who in turn

set company policies and appoint managers and corporate officers.

- The transferability of corporate ownership together with professional management, gives corporations a greater continuity of existence than other forms of organizations.
- Individual stockholders may sell, give, or bequeath (devise) their shares to someone else without disrupting (precluding) business operations. Thus, a corporation may continue its business operations indefinitely, regardless of changes in ownership.

2-4-2 Stockholders' Liability for Debts of a Corporation:

The following points should be taken into consideration:

- Stockholders in a corporation have no personal liability for debts of the business. In case of corporation failure, stockholders potential losses are limited to the amount of their equity in the business.

- Limited personal liability is considered the greatest advantage of the corporate from of business organization, regarding investors in large companies and the owners of many small businesses.
- Creditors should carefully understand the fact that shareholders are not personally liable for the debts of a corporation. Creditors have claims against only the assets of the corporation, not the personal assets of the corporation's owners.
- Limited shareholders liability, transferability of ownership, professional management, and continuity of existence make. The corporation the best form of organization for pooling the resources of a great many equity investors.

2-4-3 Accounting Practices of Corporations:

Of course, generally accepted accounting principles are basically the same for all types of business organizations. However, as a result of the legal characteristics of corporations, there are meaningful differences in the ways these organizations account for some things, such as income taxes, salaries paid to owners, owners' equity, and distributions of profits to their owners.

Regarding salaries paid owners, for instance, unincorporated businesses record such payments to their owners of a corporation cannot make withdrawals of corporate assets. Also, many of a corporation's employees may also be stockholders.

Thus, corporations make no distinction between employees who are stockholders and those who are not. All salaries paid to employees (including employee / stockholders) are recognized by the corporation as salaries expense.

- **Owners' Equity in a Corporate Balance Sheet:**

  In every from of business organization, there are two basic sources of owners' equity, they are:

1) Investment by the owners, and

2) Earnings from profitable operations.

Shown below is the stockholders' equity section of a company's balance sheet:

Gold Stars Co.

Balance sheet as on Dec.31, 2019

		Stockholders' equity:	
		Capital stock……	**200,000**
		Retained earnings…	**300,000**
		Total stockholders' equity	500,000

As shown above, in a business organized as a corporation, the term stockholders' equity is used rather than the term owner's/partners' equity.

It is not customary to show separately the equity of each stockholder. In the case of large corporations, this clearly would be impossible, since this business often have several million individual stockholders (or owners).

Stockholders' equity is subdivided into two general categories:

A. Capital stock and

B. Retained earnings.

- **Capital stock:** represents the amount which the stockholders originally invested in the business in exchange for shares of the company's stock.
- **Retained earnings:** in the contrary, represents the increase in stockholders' equity that has accumulated over the years as a result of profitable operations.

2-4-4 evaluating the Financial Statements of a corporation:

(1) -The Adequacy of net Income:

Actually, the financial statements of a corporation are much easier to evaluate than those of an unincorporated business. For instance, the income of an incorporated business represents compensation to the owners for three distinct factors:

a. Service rendered to the business.
b. Capital invested in the business.
c. The risks of ownerships, which often encompass unlimited personal liability.

However, this is not the case with a corporation. If stockholders render service to the business, they are compensated with a salary. The corporation recognizes this salary as an expense in the computation of its net income. Does not serve as compensation to the owners for personal service rendered to the business.

Furthermore, stockholders' financial risk of ownership is limited to the amount of their investment. Thus, the net income of a corporation represents simply the return on the stockholders' financial investment the stockholder need only ask, "Is this net income sufficient to compensate me for risking the amount of my investment?"

This makes it relatively easy for stockholders to compare the profitability of various corporations in making investment decisions.

(2) −**Evaluating Solvency:**

Creditors often look to the solvency of the individual owners, rather than that of the business entity, when extending credit to an unincorporated business. This is because the owners often are personally liable for the business debts.

However, in lending funds to a corporation, creditors generally may loo; only to the business entity for repayment. Thus, the financial strength of the business organization becomes much more critical when the business is formed as a corporation.

Finally, the most common differences among the three forms of business organization are shown in the following table:

Characteristics of forms of business organization

	Sole Proprietorship	General Partnership	Corporation
1-Legal status	Not a separate legal entity	Not a separate legal entity	Separate legal entity
2-Liability of owners for business debts	Personal liability for business debts	Personal liability for business debts	No personal liability for corporate debts
3-Accounting status	Separate entity	Separate entity	Separate entity
4-Tax status	Income taxable for owner	Income taxable for partners	Files a corporate tax return and pays income taxes on its earnings
5-Persons with managerial authority	Owner	Every partner	Hired professional managers
6-Continuity of the business	Entity ceases with retirement or death of owner	New partnership is formed with a change in partners	Indefinite existence

Questions

Questions (1): Determine whether each of the following statements is true (√) or false (×):

No.	Question
(1)–	In Egypt, like most of countries, there are three main forms of business organizations. They are sole proprietorships, partnerships, and corporations.
(2)–	The risks incurred or borne both by equity investors and by creditors vary greatly depending upon the form of an organization.
(3)–	Unlimited personal liability is considered the greatest disadvantage to individual form of business organizations.
(4)–	Withdraw of assets by the owner of a sole proprietorship are recorded by crediting the owner's drawing account.
(5)–	The only financial reporting obligation of much sole proprietorship is the information that must be included in the owner's personal income tax return.

(6)-	In sole proprietorship form of business organization, if the business is to be considered successful, its net income should at least provide the owner with reasonable compensation for any personal services and equity capital which the owner has provided to the business.
(7)-	If the business is organized as a sole proprietorship, the balance sheet will be more useful to creditors.
(8)-	Actually, the solvency of a sole proprietorship may be affected by many things which do not appear in the financial statements of the business.
(9)-	Each general partner can withdraw cash and many other assets from the business at will.
(10)-	In a general partnership, each partner has the full "authority of an owner" to negotiate contracts bonding or obligating upon the business.
(11)-	A limited partnership has one or more general partners and also one or more limited partners.
(12)-	In the limited liability partnership, each partner has unlimited personal liability for his or her own professional activities, but not for the actions of other partners.

(13)-	Partnerships recognize salaries expense services provided to the organization by the partners.
(14)-	A distinct feature of a partnership is the need divide or allocate the firm's net income among partners.
(15)-	All partners pay personal income taxes on the amount of partnership income allocated to them and on the amounts of assets withdrawn.
(16)-	Actually, every partnership requires a carefully written partnership contract, prepared before the firm starts operation.
(17)-	A partnership contract or agreement prevents disputes from arising among the partners and provides a contractual base for their resolution.
(18)-	In a limited partnership, all partners have personal liability for the partnership's obligations.
(19)-	Nearly all large businesses and many small ones are organized as corporations.
(20)-	In general partnership, the partners often hire professional managers.
(21)-	A corporation is a legal entity, having an existence

	separate and distinct from that of its owners.
(22)-	A sole proprietorship is an unincorporated business owned by two or more partners.
(23)-	The owners of a corporation are called partners, and their ownership is evidenced by transferable shares of capital stock.
(24)-	The existence of corporation form of ownership is described as a divorce between ownership and management.
(25)-	A corporation is easy and cheap to form than other types of organizations.
(26)-	The accounting and legal relationship between the business and its owner is shown in the income statement.
(27)-	A corporation, as a separate legal entity, may own property in its own name.
(28)-	On a daily basis, corporations are run by their stockholders.
(29)-	In corporations, partners generally manage the business as well as own it.
(30)-	The transferability of corporate ownership, together with professional management, gives corporations a greater continuity of existence than other forms of organizations.

(31)–	Stockholders in a corporation have personal liability for the debts of the business.
(32)–	Limited personal liability is considered the greatest advantage of the corporate form of business organization.
(33)–	Capital stock represents the amount which the partners originally invested in the business in exchange for shares of the company's stock.
(34)–	Retained earnings represent the increase in stockholders' equity that has accumulated over the years as a result of unprofitable operations.
(35)–	When the owner of a sole proprietorship draw assets or cash we are recorded it by crediting the asset or cash account.
(36)–	The net income of a sole proprietorship should be sufficient to compensate the owner for services to the business, capital provided to the business, and the risks of ownership.
(37)–	Owners of sole proprietorships and general partnerships are personally liable for the debts of the business.

(38)–	The main disadvantage of Partnerships form of business organization probably having too many bosses.
(39)–	Withdrawals from a sole proprietorship result in a reduction in the retained earnings of the business.
(40)–	
(41)–	The personal assets of the owner of a sole proprietorship should be included on the balance sheet of the business.
(42)–	A partnership may be created merely by two or more persons agreeing to act as partners.
(43)–	A partner must pay personal income taxes on his or her share of partnership net income, regardless of whether the partner has withdrawn this amount of money from the business during the year.
(44)–	Partner can enter into a contract on behalf of a partnership without a majority vote of all of the partners.
(45)–	The year–end balance sheet of a profitable partnership will ordinarily include in the current liability section the item income taxes payable.
(46)–	The balance sheet of a profitable corporation may include in the current liability section the item income taxes payable.

(47)-	A partnership ceases its existence upon the death or withdrawal of one the partners.
(48)-	In evaluating whether to extend credit to a sole proprietorship, the most important factor is the financial position of the business.
(49)-	If a limited partnership defaults on a debt, the creditor may not look to any of the individual partners for payment.
(50)-	A corporation may sue and be sued, and it may own property in its own name.
(51)-	The board of directors of a corporation are appointed by corporate management and confirmed by the stockholders.
(52)-	Forming or creating corporation requires no complicated authorization from any governmental authority or agency.
(53)-	Forming or creating a sole proprietorship requires complicated authorization from governmental.
(54)-	Limited personal liability of the stockholders for the debts of the business is a major advantage of the corporate form of organization.
(55)-	A corporation is dissolved whenever a stockholder dies or withdraws from the organization.

(56)–	The accounting and legal relationship between the business and its owner is shown in the income statement.
(57)–	A corporation must have at least five stockholders.
(58)–	The three common forms of business ownership include sole proprietorship, partnership, and non–profit.
(59)–	The net income of a corporation compensates stockholders for personal service to the business and capital provided to the business.
(60)–	A corporation is a legal entity separate from its owners; it may use and be used, and it may own property in its own name.
(61)–	The management, as employees of the corporation, may or may not be Shareholders.
(62)–	The net income of a corporation represents simply the return on the stockholders' financial investment.
(63)–	A partnership is a business owned by two or more people.
(64)–	No partner can enter into a contract on behalf of a partnership without a majority vote of all of the partners.
(65)–	All partners are legally entitled to participate equally in the earnings of a partnership.

(66)-	In equity section in the balance sheet the term stockholders In a corporation, is used rather than the term owners /partners equity.
(67)-	The stockholders are primarily investors, rather than active participants in the business.
(68)-	Owners of a partnership are called shareholders.
(69)-	Corporations make distinction between employees who are stockholders and those who are not.
(70)-	In a business organized as a corporation, the term stockholders' equity is used rather than the term owner's / partners' equity.
(71)-	The partnership form of organization enables businesses to raise large amounts of capital through the sale of stock to a large number of shareholders.
(72)-	Creditors generally may look only to the business entity for repayment, when lending money to the partnership.
(73)-	The risks incurred or bone both by investors and by creditors are the same whatever the form of an organization.

(74)–	The three major types of business organizations are sole proprietorships, partnerships, and corporations.
(75)–	Usually, business enterprises do not differ from one to another.
(76)–	Most, if not all, partnerships have continuity of existence extending beyond the participation of individual partners.
(77)–	From legal standpoint, a partnership ends upon the withdrawal or death of an existing partner.
(78)–	The law regards the partners as personally and jointly responsible for the activities of the business.
(79)–	A business entity is an economic unit that engages in determined business activities.
(80)–	Under the point of view of the law, the partnership is not separate from its owners.
(81)–	Partnership is the least common form of business organization, probably because they often result in too many bosses.
(82)–	A partnership can be defined as an unincorporated business owned by one or more partners.

(83)–	The owner of a sole proprietorship does not personally responsible for all of the business' debts.
(84)–	The owner of a sole proprietorship is "working for salary".
(85)–	In Egypt, the tax laws see net income of the sole proprietorship as an income of business entity.
(86)–	The business assets in a corporation actually belong to the proprietor, not to the business.
(87)–	For accounting purposes, every business organization including sole proprietorship is treated as an entity separate from the other activities of its owner.
(88)–	Sole proprietorships are relatively large businesses with many financial reporting obligations.
(89)–	Sole proprietorships are considered the most common form of business organization because they are so easy to form and start.
(90)–	A sole proprietorship is an unincorporated business owned by one or more persons.
(91)–	A limited partner generally participates in management of the partnership.

(92)-	Even though a partnership is not a separate legal entity, for accounting purposes the partnership affairs should be kept separate from the personal activities of the owners.
(93)-	The activities and records of the partnership are not kept separate from the activities and records of the owners.
(94)-	A limited liability company offers the limited liability of a partnership or proprietorship and the tax treatment of a corporation.
(95)-	The greatest disadvantage to individual form of business organizations is the unlimited personal liability.
(96)-	In the partnership form of business, the owners are called stockholders.
(97)-	General partnership, have to file a partnership tax return and pays income taxes on its earnings.
(98)-	Owners of a corporation are called shareholders or stockholders.
(99)-	In sole proprietorship the solvency may be affected by many things which do not appear in the financial statements of the business.
(100)	Sole proprietorship has indefinite existence.

(101)	Every stockholder in corporation personally liable for corporate debts.

Questions (2): Choose the best answer for each of the following statements:

(1)- Which of the following types of business owners do not make an active role in the daily management of the business?

A. General partners.
B. Sole proprietors.
C. Sole trader.
D. Limited partner.

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(2)- Net income of a corporation should be adequate to compensate the stockholders for:

A. Service provided to the corporation and invested capital.
B. Service provided to the corporation, invested capital, and the risks of ownership.
C. Invested capital and the risk of losing their investment.
D. Risks of personal liability for business debts.

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(3)- The amount of cash which the owner of a sole proprietorship can withdraw from the business in a given year is limited to :

A. The amount of dividends declared by the directors of the business.

B. The balance of the Cash Account at the beginning of the year.
C. The net income for the year.
D. None of the above.

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(4)- Which of the following is not a characteristic of a sole proprietorship?

A. The owner is personally liable for the debts of the business.
B. Form an accounting standpoint, a sole proprietorship is regarded as an entity separate from the personal affairs of the owner.
C. The business is subject to double taxation as income taxes must be paid both by the business entity and then by its owner.
D. The owner is free to withdraw assets from the business at any time and in any amount.

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(5)- Which the following is true about a sole proprietorship?

A. The business assets are held in the name of the business.
B. The business pays income taxes.
C. The business a separate legal entity.
D. The owner is personally liable for all debts of the business.

---

(6)- Which the following is not a characteristic of sole proprietorship?

A. Ease of formation.
B. Business pays income taxes.
C. Business pays no salary to its owner.
D. Business assets belong to the owner.

(7)- Which the following is not a characteristic of a sole proprietorship?

A. Unlimited personal liability for business debts by owner.
B. Assets of the business belong to the business.
C. The business pays no salary to its owner.
D. Ease of formation.

(8)- The net income of a sole proprietorship compensates the owner for all of the following , except:

A. Personal service provided by the owner to the business.
B. Capital invested by the owner.
C. Money borrowed by the owner from a bank for the business.
D. The risks of ownership of the business.

(9)- Which of the following investors do not have unlimited liability for the debts of the business?

A. An owner of a sole proprietorship.
B. A partner of a general partnership.
C. A general partner of a limited partnership.
D. A stockholder of a corporation.

(10)-Which of the following types of business pays income taxes on its net income?

A. A sole proprietorship.
B. A general partnership.
C. A limited partnership.
D. A corporation.

(11)-Which of the following is not a characteristic of a general partnership?

A. Mutual agency.
B. Unlimited liability for business debts.
C. Double taxation
D. Limited life.

(12)-Which of the following is the most important disadvantage of the general partnership form of business organization?

A. Limited life.
B. Multiple owners.
C. Unlimited personal liability for business debts.
D. Taxation of business profits.

(13)-The characteristics of a general partnership known as mutual agency means that :

A. All partners may bind the partnership to contract.
B. All partners participate in the profits of the partnership.
C. All partners have unlimited personal liability for the debts of the partnership.
D. All partners are responsible for payment of income taxes on partnership profits.

(14)-Which of the following types of business organizations is most appropriate for a group of attorneys?

A. A sole proprietorship.
B. A limited partnership
C. A limited liability partnership.

D. A general partnership.

---

(15)-Title to the assets of a partnership is held by:

A. The partnership.
B. The managing partner.
C. The individual partners that contributed the assets.
D. The board of directors of the partnership.

---

(16)-Which of the following is not a characteristic of a general partnership?

A. Each partner has the authority to bind the partnership to contracts.
B. Each partner's liability is limited to the amount he or she invested.
C. Ease of formation.
D. Each partner must pay personal income taxes on his or her share of partnership net income.

---

(17)-Each partner of a general partnership may be held personally liable for:

A. Business debts equal to the balance of that partner's capital.
B. Only the amount that the partner originally invested in the business.
C. All debts of the business.
D. All debts of the business and all persona debts of the other partners.

---

(18)-Which of the following is not true regarding general partnerships?

A. The individual partners are personally liable for the debts of the partnership.

B. The individual partners pay income taxes on their share of partnership profits.
C. The individual partners participate in management only if they are hired by the partnership.
D. Cash withdrawn by a partner is recorded in the partner's drawing account.

---

(19)-Which of the following is true regarding a general partnership?

A. A general partnership pays income taxes on its net income.
B. Any individual partner may be held liable for all of the debts of the general partnership.
C. A general partnership distributes dividends from profits to the individual partners.
D. A general partnership is a legal entity.

---

(20)-The unique characteristic of a limited partnership is that:

A. None of the partners can be held personally responsible for the debts of the business.
B. The number of partners is limited to that specified in the partnership contract.
C. Only a limited portion of the partnership income subject to income taxes.
D. The liability of some of the partners for losses incurred by the business is limited to the amount of their investments.

---

(21)-Which of the following statements does not describe a characteristic of a limited partnership?

A. This form of organization is often used for ventures providing investors with tax-protected income.
B. Limited partners usually do not participate actively in the management of the business.
C. Limited partners have the right to participate in partnership profits, but their liability for losses is limited to the amount of their investment.
D. All of the partners are limited partners.

---

(22)-For which of following types of organizations is the financial position of the business most important to a bank considering making a loan to the business?

A. A corporation.
B. A sole proprietorship.
C. A general partnership.
D. A limited partnership.

---

(23)-Which of the following types of business organizations has a legal existence separate and apart from its owner (s)?

A. A sole proprietorship.
B. A general partnership.
C. A corporation.
D. A limited partnership.

---

(24)-Which of the following is not a characteristic of the corporate form of organization?

A. The owners of corporation cannot lose more than the amount of their investment.

B. Shares of stock in a corporation are more transferable that is an interest in a partnership.
C. Stockholders have authority to decide by majority vote the amount of dividends to be paid.
D. The corporation is a very efficient vehicle obtaining large amounts of capital required for large scale production.

---

(25)-Title to the assets of a corporation is legally held by:

A. The stockholders, jointly and severally.
B. The corporation, as a legal entity.
C. The president of the corporation in trust for the stockholders.
D. The board of directors, as trustees.

---

(26)-Which of the following is not a characteristic of the corporate form of organization?

A. Ease of transferring ownership.
B. Limited liability of owners.
C. Ease of gathering large amounts of capital.
D. Owners' payment of the corporate income taxes based on the owner's proportionate share of corporate net income.

---

(27)-A business needs large amounts of equity capital, the appropriate form of organization most likely is:

A. A corporation.
B. A general partnership.
C. A limited partnership.
D. A limited liability partnership.

(28)-Which of the following is the least important factor in deciding the appropriate form of business organization for a particular business?

A. Personal liability for debts.

B. Income tax considerations.

C. The need for equity capital.

D. The number of employees.

(29)-Retained earnings represents :

A. Cash that has been retained in the business.

B. The total investments by the owners of the business.

C. Income of the business that has been reinvested rather than distributed to the owners.

D. Cash available for dividends.

(30)-Which of the following forms of business organizations are normally treated as a going concern from an accounting viewpoint?

A. A sole proprietorship.

B. A partnership.

C. A corporation.

D. All of the above re treated as going concerns.

(31)-The proprietorship form of business organization :

A. Must have at least three owners in most states.

B. Represents the largest number of businesses.

C. Combines the records of the business with the personal records of the owner.

D. Is characterized by a legal distinction between the business as an economic unit and the owner.

---

(32)-Which of the following types of business organizations that is requires the least complicated authorization from any governmental authority or agency:

A. A sole proprietorship .

B. A limited partnership.

C. A limited liability partnership.

D. A general partnership.

---

(33)-Which of the following types of business organizations have separate legal entity:

A. A sole proprietorship.

B. A general partnership.

C. Corporation .

D. None of the above.

---

(34)- ....Account used to record the withdrawals of cash or other assets by an owner of an unincorporated business.

A. Drawing .

B. Liabilities.

C. Owner's Equity .

D. None of the above.

---

(35)-A business organized as a corporation :

A. Is not a separate legal entity in most states .

B. Requires that stockholders be personally liable for the debts of the business .

C. Is owned by its stockholders.

D. Terminates when one of its original stockholders dies

(36)-The main characteristics of corporation are :

A. Separate legal entity.
B. Personal liability for business debts .
C. Indefinite existence .
D. A & C.

(37)-Which of the following is not an advantage of the corporate form of business organization?

A. Limited liability of stockholders.
B. Transferability of ownership.
C. Unlimited personal liability for stockholders.
D. Unlimited life.

(38)- A business that enjoys limited liability is a:

A. Proprietorship .
B. Partnership .
C. Corporation .
D. None of the above.

(39)-A corporation:

A. Is a business legally separate from its owners .
B. Is controlled by the FASB .
C. Has shareholders who have unlimited liability for the acts of the corporation .
D. Is the same as a limited liability partnership .

(40)-A limited partnership:

A. Includes a general partner with unlimited liability .
B. Is subject to double taxation.
C. Has owners called stockholders .

D. Is the same as a corporation .

---

(41)-The economic entity assumption requires that the activities :

A. Of different entities can be combined if all the entities are corporations.

B. Must be reported to the Securities and Exchange Commission.

C. Of a sole proprietorship cannot be distinguished from the personal economic events of its owners.

D. Of an entity be kept separate from the activities of its owner.

---

(42)-The partnership form of business organization:

A. Is a separate legal entity

B. Is a common form of organization for service-type businesses.

C. Enjoys an unlimited life .

D. Has limited liability .

---

(43)-The accounting and legal relationship between the business and its owner is shown in the:

A. Balance sheet.

B. Trail balance.

C. Income statement.

D. None of the above.

---

(44)-The greatest disadvantage to individual form of business organizations is the:

A. Limited personal liability.

B. Unlimited personal liability.

C. Enjoys an unlimited life.

D. None of the above.

---

(45)-A__________________Ceases its existence upon the death or withdrawal of one of the partners:

A. Partnership .

B. Corporation .

C. Sole proprietorship.

D. None of the above.

---

(46)-In sole proprietorship, when reporting ownership equity in the balance sheet owner's equity section includes:……

A. Equity of the owner.

B. Equity and drawing of the owner.

C. Liabilities & Equity of the owner.

D. None of the above.

---

(47)-……………is The right of each partner to act as an agent for a partnership and to bind (obligate) the business to contracts:

A. Limited personal liability .

B. Mutual agency

C. Solvency

D. Unlimited personal liability

---

(48)-The accounting and legal relationship between the business and its owner is shown in the:

A. Statement of cash flows.

B. Trail balance.

C. Income statement.

D. None of the above.

---

(49)-The concept that a business owners has unlimited personal liability for the debits of

the business, applies to sole proprietorships and general partners in partnerships:

A. Limited personal liability .
B. Mutual agency.
C. Solvency.
D. Unlimited personal liability .

---

(50)-Written agreement among partners as to the operation of a Partnership. Usually includes the plan for sharing profits and losses:

A. Mutual agency .
B. Solvency.
C. Partnership contract .
D. None of the above.

---

(51)-the risks incurred or borne both by equity investors and by creditors vary greatly depending upon:

A. The financial situation of an organization.
B. The form of an organization.
C. The legal status of an organization.
D. None of the above.

---

(52)-In the balance sheet of a sole proprietorship, total owner's equity is represented by the balance in the:

A. Owner's Capital account.
B. Owner's drawing account
C. Owner's cash account
D. All of the above.

---

(53)-A limited partnership has one or more general partners and also one or more:

A. Limited partners.

B. Unlimited partners.
C. Institutional partners.
D. None of the above.

---

(54)-The top level of a corporation's professional management is the:

A. Financial management.
B. Board of directors.
C. Executive management.
D. None of the above.

Chapter Three
The Accounting Cycle

Chapter Three
The Accounting Cycle

3.1. Introduction:

By adding up what the accounting records say belongs to a business and deducting what they say the business owes, you can identify what a business is worth according to those accounting records. The whole of financial accounting is based upon this very simple idea. It is known as the accounting equation.

3.2. Basic Accounting Equation:

Other essential building blocks of accounting are the categories into which economic events are classified. The two basic elements of a business are what it owns and what it owes.

In accounting, special terms are used to describe many things. The amount of the resources supplied by the owner is called capital. The actual resources that are then in the business are called assets. This means that when the owner has supplied all of the resources, the accounting equation can be shown as:

Accounting Equation:

Assets = Liabilities + Owner's Equity

This equation is referred to as the basic accounting equation. Assets must equal the sum of liabilities and owner's equity.

Because creditors' claims are paid before ownership claims if a business is liquidated, liabilities are shown before owner's equity in the basic accounting equation.

The accounting equation applies to all economic entities regardless of size, nature of business, or form of business organization.

The equation provides the underlying framework for recording and summarizing the economic events of a business enterprise.

This can then be replaced with words describing the resources of the business:

Resources: what they are = Resources: who supplied them

Assets = Capital + Liabilities

Capital = Assets − Liabilities

It is a fact that no matter how you present the accounting equation, the totals of both sides will always equal each other, and that this will always be true no matter how many transactions there may be.

The actual assets, capital and liabilities may change, but the total of the assets will always equal the total of capital + liabilities. Or, reverting to the more common form of the accounting equation, the capital will always equal the assets of the business minus the liabilities.

Let's look in more detail at the categories in the basic accounting equation.

3.2.1 Assets:

As indicated above, assets are resources owned by a business. Thus they are the things of value used in carrying out such activities as production, consumption, and exchange. The common characteristic possessed by all assets is the capacity to provide future services of benefits to the entities that use them. In a business enterprise, that service potential of future economic benefit eventually results in cash inflows (receipts) to the enterprise.

Assets may be tangible such as land, buildings, machinery, and inventory. Assets may also take an intangible form in terms of legal claims or rights such as amounts due from customers (accounts receivable) and patents (protected rights).

In short, assets are things physical or not, owned by the business entity and have a value. Assets are valued according to their historical costs. Changes in prices, of assets after their acquisition are neglected because assets are acquired for use and not for resale.

3.2.2. Liabilities:

Liabilities are claims against assets. include amounts owed by the business for goods and services supplied to the business and for expenses incurred by the business that have not yet been paid for. They also include funds borrowed by the business.

Put more simply, liabilities are existing debts and obligations. - For example, businesses of all sizes and degrees of success usually find it necessary to borrow money and to purchase merchandise on credit. These obligations are called accounts payable. Persons or entities to whom owes money are called creditors.

Most claims of creditors attach to total enterprise assets rather than to the specific assets provided by the credits.

In the event of nonpayment, creditors may legally force the liquidation of a business. In that case, the law requires that creditor claims be paid before – ownership claims.

3.2.3. Owner's Equity:

is often called the owner’s equity or net worth. It comprises the funds invested in the business by the owner plus any profits retained for use in the business less any share of profits paid out of the business to the owner.

The ownership claim on total assets is known as owner's equity. It is equal to total assets minus total liabilities. Here is why: the assets of a business are supplied or claimed by either creditors or owners.

To determine what belongs to owners, we therefore subtract creditors' claims-the liabilities- from assets. The remainder- owners' equity- is the owner's claim on the assets of the business. Since m6 claims of creditors take precedence over ownership claims, the latter are often referred to as residual equity.

In a proprietorship, owner's equity is increased by owner's investments and revenues. It is decreased by owner's drawings and expenses.

3.2.3.1. Investments by Owner:

Investments by owner are the assets put into the business by the owner. These investments in the: business increase owner's equity.

3.2.3.2. Drawing:

An owner may withdraw cash or other assets during the accounting period for personal use. These withdrawals could be recorded as a direct decrease of owner's equity. However, it is generally considered preferable to use a separate classification referred to as drawings to determine the total withdrawals for the accounting period. Drawings decrease total owner's equity.

3.2.3.3. Revenues:

Revenues are the gross increase in owner's equity resulting from business activities entered into for the purpose of earning income. Generally, revenues result from the sale of merchandise, the performance of services, the rental of property, and the lending of money.

Revenues usually result in an increase in an asset. They may arise from different sources and are identified by various names depending on the nature of the business. The titles for and sources of revenue common to many businesses are: sales, fees, services, Commissions, interest dividends, royalties, and rent.

3.2.3.4. Expenses:

Expenses are the decreases in owner's equity that result from operating the business. They are the cost of assets consumed or services used in the process of earning revenue. Expenses represent actual or expected cash outflows (payments). Like revenues, expenses take many forms and are identified by various names depending on the type of asset consumed or service used.

For example, a business recognizes the following types of expenses: wages expenses; utility expense (electric, gas, and water expense); telephone expense; delivery expense; supplies expense; rent expense; interest expense; and property tax expense.

In summary, the principal sources (increases) of owner's equity are:

(1) Investments by owners. And,

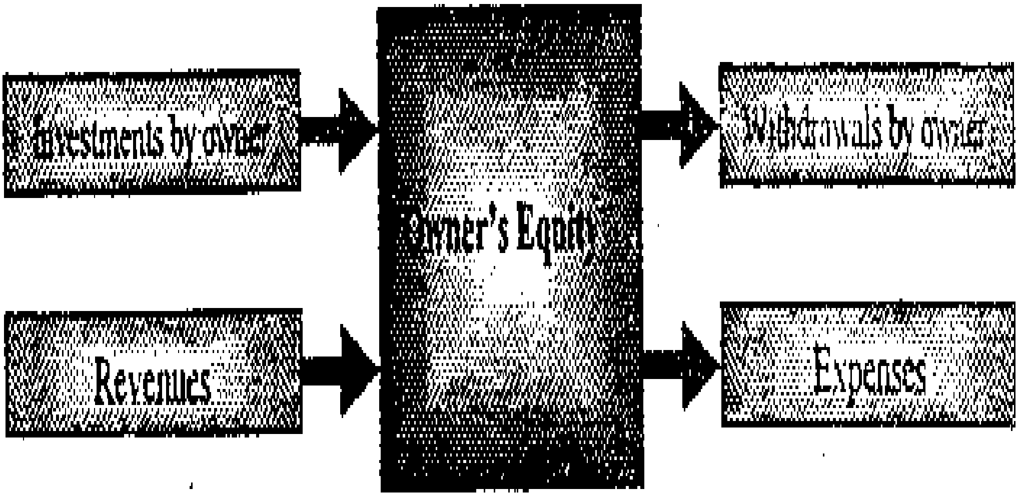
(2) Revenues from business operations.

In contrast, reductions in owner's equity are a result of:

(1) Withdrawals of assets by owners. And,

(2) Expenses

Net income results when revenues exceed expenses conversely, a net loss occurs when expenses exceed revenues. These relationships are shown in chart (2.A.)



3.3 Effects of Business Transactions on Accounting Equation:

Transactions (often referred to as business transactions) are the economic events of the enterprise that are recorded. Transactions may be identified as external or internal. External transactions involve economic events between the company and some outside enterprise or party. Internal transactions are economic events that occur entirely within one company.

A company may carry on many activities that do not in themselves represent business transaction. Hiring employees, answering the telephone, talking with customers, and placing an order for merchandise with a supplier are examples. Some of these activities, however, may lead to a business transaction: employees will earn wages, and merchandise will be delivered by the supplier.

Each transaction must be analyzed in terms of its effect on the components of the basic accounting equation. This analysis must identify the specific items affected and the amount of the change in each item.

The equality of the basic equation must be preserved.

Therefore, each transaction must have a dual effect on the equation. For example, if an individual wet is increased, there must be a corresponding:

1- Decrease in another asset, or.

2- Increase in a specific liability, or.

3- Increase in owner's equity.

It follows that two or more items could be affected when an asset is increased. For example, as one asset is increased LE. 10,000 another asset could decrease L.E.6, 000, and a specific liability could increase L.E. 4,000 Note also that any change in an individual liability or ownership claim is subject to similar analysis.

3.3.1. Transaction Analysis:

The following examples are business transactions for a new business during its first month of operation.

You will want to study these transactions until you are sure you understand them. They are not difficult but they are important to your success in this course. The ability to analyze transactions in terms of the basic accounting equation is essential for an understanding of accounting.

Transaction (1): The Introduction of Capital.

On 1 January 2020, M. Ali started his business and deposited E£60,000 into a bank account opened specially for the business. The statement of financial position can be shown as follows:

M. Ali
Statement of Financial Position as at 1 January 2020

	E£
Assets: Cash at bank	60,000
Capital	60,000

Note how the top part of the statement of financial position contains the assets and the bottom part contains the capital. This is always the way the information is presented in a statement of financial position.

Ahmed decides to open a computer programming. Service. On September l, 2015, he invests L.E.15, 000 cash in the business, which he names. SOFTBYTE This transaction results in an equal increase in assets and owner's equity. In this case, there is an increase in the asset Cash, L.E.15, 000, and an equal increase in the owner's equity, Ahmed capital, L.E.15, 000.

The effect of this transaction on the basic equation is:

<u>Assets</u> = <u>Liabilities</u> + <u>Owner's Equity</u>

Cash = Ahmed Capital

15,000 = 15,000

Observe that the equality of the basic equation has been maintained. Note also that the source of the increase in owner's equity is indicated, to make clear that the increase is an investments rather than revenue from operations. Why does this matter?

Because investment by the owner do not represent revenues, and they are excluded in determining net income.

Transaction (2): Purchase of an asset by Cheque or cash:

On 5 January 2020, Ali buys a small shop for £32,000, paying by cheque. The effect of this transaction on the statement of financial position is that the cash at the bank is decreased and the new asset, shop, is added:

M. Ali
Statement of financial position as at 5 January 2020

	E£
Assets: Shop	32,000
Cash at bank	28,000
Capital	60,000

Note how the two parts of the statement of financial position 'balance'. That is, their totals are the same. This is always the case with statements of financial position, and is why they used to be called, 'balance sheets'.

Transaction (3): Purchase of an asset on Credit:

On 7 January 2020, Ali buys some goods for £7,000 from H. Mohamed, and agrees to pay for them sometime within the next two weeks. The effect of this is that a new asset, inventory, is acquired, and a liability for the goods is created. A person to whom money is owed for goods is known in accounting language as a creditor, and is described in the statement of financial position as an account payable. The statement of financial position becomes:

M. Ali
Statement of financial position as at 7 January 2020

	E£
Assets: Shop	32,000
Inventory	7,000
Cash at bank	28,000

Less: Account Payable	(7,000)
Capital	60,000

Note how the liability (the account payable) is shown as a deduction from the assets. This is exactly the same calculation as is presented in the most common form of the accounting equation.

Transaction(4): Sale of an asset for immediate payment:

On 15 January 2020, goods which cost £400 were sold to I. Hassan for the same amount. Hassan paid for them immediately by cheque. Here one asset, inventory, is reduced, while another asset, cash at bank, is increased. The statement of financial position becomes:

M. Ali
Statement of financial position as at 15 January 2020

	E£
Assets: Shop	32,000
Inventory	6,000
Accounts Receivable	600
Cash at bank	28,400
Less: Account Payable	(7,000)
Capital	60,000

Transaction (5): Sale of an asset on credit

On 11 January 2020, goods which cost E£600 were sold to M. Tag for the same amount, the money to be paid later. The effect is a reduction in the amount of goods held, i.e. inventory, and the creation of a new asset. A person who owes the business money is known in accounting language as a debtor, and is described in the statement of financial position as an account receivable. The statement of financial position is now:

M. Ali

Statement of financial position as at 11 January 2020

Assets: Shop	32,000
Inventory	6,400
Accounts Receivable	600
Cash at bank	28,000
Less: Account Payable	(7,000)
Capital	60,000

Transaction (6): The payment of a liability:

On 20 January 2020, Ali pays a cheque for £3,000 to H. Mohamed in a partial payment of the amount owing. The asset of cash at bank is therefore reduced, and the liability to the creditor is also reduced. The statement of financial position is now:

M. Ali

Statement of financial position as at 20 January 2020

	E£
Assets: Shop	32,000
Inventory	6,000
Accounts Receivable	600

Cash at bank	25,400
Less: Account Payable	(4,000)
Capital	60,000

Note how the total of each part of the statement of financial position has not changed. The business is still worth £60,000 to the owner.

Transaction (7): Collection of an asset :

M. Tag, who owed Ali E£600, makes a partial payment of £300 by cheque on 31 January 2015. The effect is to reduce one asset, account receivable, and to increase another asset, cash at bank. The statement of financial position becomes:

M. Ali
Statement of financial position as at 31 January 2020

	E£
Assets: Shop	32,000
Inventory	6,000
Accounts Receivable	300
Cash at bank	25,700
Less: Account Payable	(4,000)
Capital	60,000

Transaction (8): Services Rendered for Cash:

Example: SOFTBYTE receives L.E. 1,200 cash from customers for programming services it has provided.

This transaction represents the principal revenue-producing activity of SOFTBYTE.

Recall that revenue increases owner's equity. Both assets and owner's equity are, then, increased by this transaction: in this case, Cash is increased L.E. 1,200, and Capital is increased L.E. 1,200 the new balances in the Equation are:

Assets	=	**Liabilities**	+	**Owner's Equity**
Cash **+1200**	=	Accounts Payable		Capital +1200
1200	=	**0**	+	**1200**
1200	=	**1200**		

Remember that owner's equity is increased when revenue is earned, and in SOFTBYTE's case that is when the service is provided. When collections on account are received at a later date, Cash will be increased and Accounts Receivable will be decreased

Transaction (9): Purchase of Advertising on Credit.

SOFTBYTE receives bill for L.E.250 from the daily news for advertising the opening of its business but postpones payment of the bill until a later date. This transaction results in an increase in liabilities and a decrease in owner's equity. The specific terms Involved are Accounts Payable and capital. The effect on the equation is:

Assets	=	Liabilities	+	Owner's Equity
0	=	Accounts Payable +250		Capital -250

The cost of advertising is considered an expense, as opposed to an asset, because the benefits have been used.

This expense is included in determining net income.

Transaction (10) Services Rendered for Cash and Credit :

Example: SOFTBYTE provides programming services of L.E.3,500 for customers. Cash amounting to L.E.1,500 is received from customers, and the balance of L.E.2,000 is billed to customers on account. This transaction results in an equal increase in assets and owner's equity.

Three specific items are affected: Cash is increased L.E.I500; Accounts Receivable is increased L.E. 2000; and Capital is increased LJE. 3,500. The new balances are as follows:

Assets		=	Liabilities	+	Owner's Equity
Cash **+1500**	Acc. Receivable +2000	=	0		Capital -3500
+1500	+2000	=	0	+	3500
3500		=	3500		

Transaction (11) Payment of Expenses:

Example: Expenses paid in cash for September are store rent. L.E.600, salaries of employees, L.E.900, and utilities, L.E.200, these payments result in an equal decrease in assets and owner's, equity. Cash is decreased L.E.I, 700 and Ahmed Capital is decreased by the same the effect of these payments on the equation is

Assets	=	**Liabilities**	+	**Owner's Equity**
Cash **-1700**	=	Accounts Payable 0		Capital -1700
1700	=	0	+	1700
1700	=	**1700**		

Transaction (12) 'Withdrawal of Cash by Owner:

Ahmed withdraws L.E.I, 300 in cash from the business for his personal use. This transaction results in an equal decrease in assets and owner's equity. Thus, both Cash

Assets	=	**Liabilities**	+	**Owner's Equity**
Cash **-1300**	= =	**0**		Ahmed Capital **-1300**
1300	=	**0**	+	**1300**
1300	=	**1300**		

and Ahmed Capital are decreased L.E.I, 300, as shown below:

Observe that the effect of a cash withdrawal by the owner is the opposite of the effect of an investment by the owner. Owner's drawings do not represent expends. Like owner's investment, they are not included in determining net income.

3.4. Summary of the Effects of Transactions On The Accounting Equation:

It can be seen that every transaction has affected two items. Sometimes it has changed two assets by reducing one and increasing the other. In other cases, the effect has been different. However, in each case other than the very first (when the business was started by the owner injecting some cash into it), no change was made to the total of either section of the statement of financial position and the equality between their two totals has been maintained. The accounting equation has held true throughout the example, and it always will.

A summary of the effect upon assets, liabilities and capital of each type of transaction you’ve been introduced to so far is shown below:

Example	Effect	
1 Owner pay capital to the bank	Increase asset (Bank)	Increase Capital
2 Buy inventory by cheque	Decrease asset (bank)	Increase asset (inventory)
3 Buy inventory on credit	Increase asset (inventory)	Increase liability (accounts payable)
4 Sale of inventory on credit	Decrease asset (inventory)	Increase asset (accounts receivable)
5 Sale of Inventory by cheque	Decrease asset (inventory)	Increase asset (bank)
6 Pay creditor	Decrease liability (accounts payable)	Decrease asset (bank)
7 Debtor pays money owing by cheque	Increase asset (bank)	Decrease asset (accounts receivables)
8 Owner takes money out of the business bank account for own	Decrease asset (bank)	Decrease capital

use		
9 Owner pays creditor from private outside the firm	Decrease liability (accounts liability)	Increase Capital

Transactions (8) and (9) cause the totals of each part of the statement of financial position to change (as did the very first, when capital was introduced to the business by the owner). When the capital changes, the totals of the two parts of the statement of financial position both change.

3.5 Double Entry System:

Double-entry accounting means every transaction affects and is recorded in at least two accounts. *The total amount debited must equal the total amount credited* for each transaction. Therefore, the sum of the debits for all entries must equal the sum of the credits for all entries. As well, the sum of debit account balances in the ledger must equal the sum of credit account balances. The only reason that the sum of debit balances would not equal the sum of credit balances is if an error had occurred. Double-entry accounting helps to prevent errors by assuring that debits and credits for each transaction are equal.

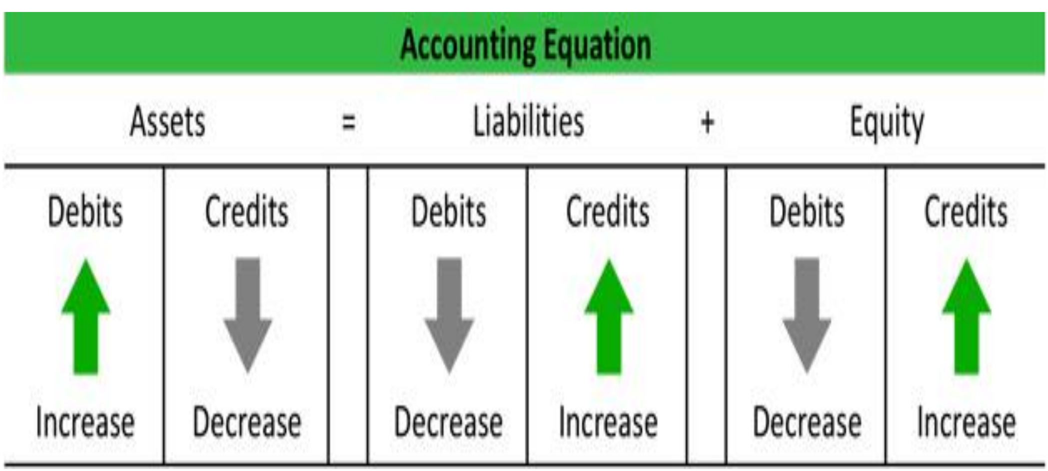
The system for recording debits and credits follows from the accounting equation which is:

Accounting Equation:

Assets = Liabilities + Owner's Equity

Assets are on the left side of this equation. Liabilities and equity are on the right side. Like any mathematical equation, increases or decreases on one side have equal effects on the other side. For example, the net increase in assets must be accompanied by an identical net increase in the liabilities and equity side. Some transactions only affect one side of the equation. This means that two or more accounts on one side are affected, but their net effect on this one side is zero.

The debit and credit effects for asset, liability, and owner's equity accounts are captured in the following figure:



The three important rules for recording transactions in a double-entry accounting system are:

1. Increases in assets are debited to asset accounts. Decreases in assets are credited to asset accounts.

2. Increases in liabilities are credited to liability accounts. Decreases in liabilities are debited to liability accounts.

3. Increases in owner's equity are credited to owner's equity accounts. Decreases in owner's equity are debited to owner's equity accounts.

Furthermore, increases in owner's capital or revenues *increase* owner's equity. Increases in owner's withdrawals or expenses *decrease* owner's equity. These important relations are reflected in the following four additional rules:

4. Investments by the owner are credited to owner's capital because they increase equity.
5. Revenues are credited to revenue accounts because they increase equity.
6. Expenses are debited to expense accounts because they decrease equity.
7. Withdrawals made by the owner are debited to owner's equity

3.6 Rules of Debit and Credit:

The transactions in the Journal are recorded on the basis of the rules of debit and credit. For this purpose business transactions have been classified into three categories:

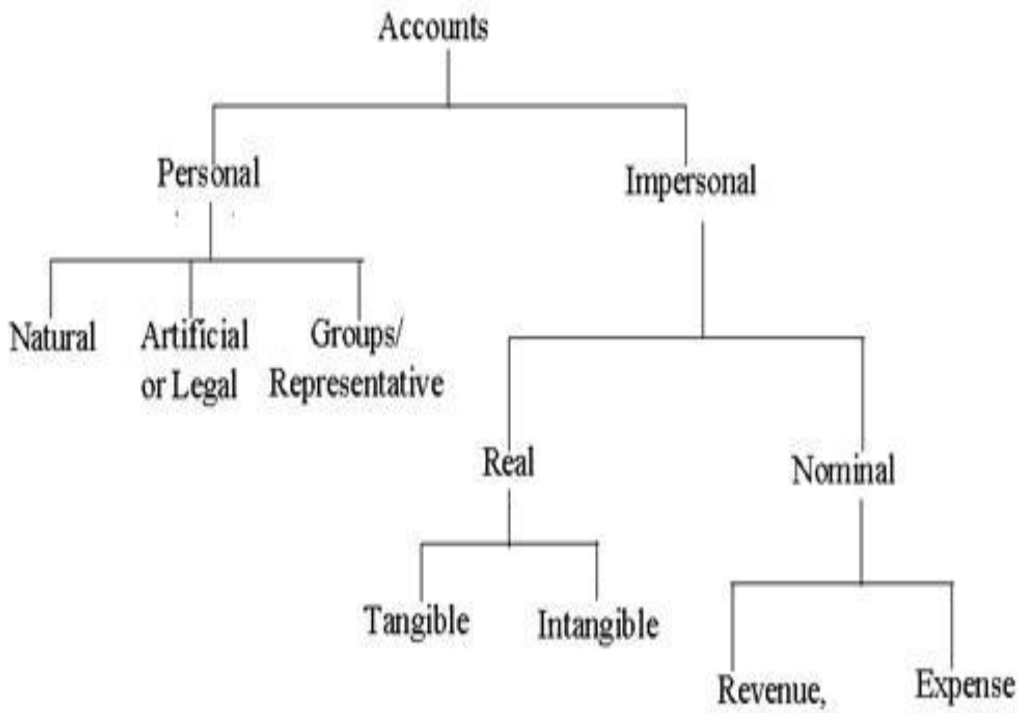
- ➢ Transactions relating to persons
- ➢ Transactions relating to properties and assets
- ➢ Transactions relating to incomes and expenses

On this basis, it becomes necessary for the business to keep an account of:

- ✓ Each person with whom it deals
- ✓ Each property or asset which the business owns
- ✓ Each item of income or expense

The accounts falling under the first heading are called as 'Personal Accounts'. The accounts falling under the second and third headings are termed as 'Impersonal Accounts'.

The classification of the accounts, as explained above, can be put in the form of the following chart:



Each of the above categories of accounts and the relevant rule for 'debit and credit' have been explained in detail in the following pages:

Personal accounts.

Personal accounts include the accounts of persons with whom the business deals. These accounts can be classified into the three categories:

1. Natural Personal Accounts.

The term 'Natural Persons' means persons who are the creation of God, e.g., Mohamed's Account, Nabil's Account, Shahd's Account, Misk's Account…etc.

2. Artificial Personal Accounts.

These accounts include accounts of corporate bodies or institutions which are recognised as persons in business dealings, for example, the account of a Limited Company, the account of a Co-operative Society, the account of a Club, the account of Government, the account of an Insurance Company etc.

3. Representative Personal Accounts.

These are accounts which represent a certain person or group of persons. For example, if the rent is due to the landlord, an outstanding rent account will be opened in the books. Similarly, for salaries due to the employees

(not paid), an outstanding salaries account will be opened. The outstanding rent account represents the account of the landlord to whom the rent is to be paid while the outstanding salaries account represents the accounts of the persons to whom the salaries have to be paid. All such accounts are therefore termed as 'Representative Personal Accounts'.

The Rule is:

Debit the Receiver

Credit the Giver

For example, if cash has been paid to Ali, the account of Ali will have to be debited. Similarly, if cash has been received from Hamza, the account of Hamza will have to be credited.

Real accounts:

Real accounts may be of the following types:

1. Tangible Real Accounts**.**

Tangible Real Accounts are those which relate to such things which can be touched, felt, measured etc. Examples of such accounts are cash account, building account, furniture account, stock account, etc. It should be noted that bank account is a personal account; since it represents the account of the banking company—an artificial person.

2. Intangible Real Accounts.

These accounts represent such things which cannot be touched. Of course, they can be measured in terms of money, for example, patents account, goodwill account, etc.

The Rule is:

Debit What Comes in and
Credit What Goes out

For example, if a building has been purchased for cash, the building account should be debited (since it is coming in the business) while the cash account should be credited (since cash is going out the business). Similarly when furniture is purchased for cash, furniture account should be debited while the cash account should be credited.

Nominal accounts:

These accounts are opened in the books to simply explain the nature of the transactions. They do not really exist. For example, in a business, salary is paid to the manager, rent is paid to the landlord, commission is paid to the salesman, cash goes out of the business and it is something real; while salary, rent or commission as such do not exist. The accounts of these items are opened simply to explain how the cash has been spent. In the absence of such information, it may difficult for the person concerned to explain how the cash at his disposal was utilised.

Nominal Accounts include accounts of all expenses, losses, incomes and gains.

The examples of such accounts are rent, rates lighting, insurance, dividends, loss by fire, etc.

The Rule is:

Debit All Expenses and Losses

Credit All Gains and Incomes

You should note that when some prefix or suffix is added to a Nominal Account, it becomes a Personal Account. For example, the rent account is A Nominal Account but Outstanding Rent is Personal Account.

The Following Figure Summarise the Debit and Credit Rules

Rules of Double Entry System

Accounts	Rules
Personal	• Debit the receiver • Credit the giver
Real	• Debit what comes in • Credit what goes out
Nominal	• Debit all expenses and losses • Credit all incomes and gains

Classification of Goods Account:

The term goods include articles purchased by the business for resale. Goods purchased by the business may be returned to the supplier. Similarly, goods sold by the business to its customers can also be returned by the customers to the business due to certain reasons. In business, it is desired that a separate record be kept of all sale, purchase and return of goods. Hence,

Goods Accounts can be classified into the following categories:

- **Purchases Account.** The account is meant for recording all purchases of goods. Goods 'come in' on purchasing of goods and, therefore, the Purchases Account is debited on purchase of goods.
- **Sales Account.** The account is meant for recording of selling of goods. The goods 'go out' on selling of goods, and therefore, on sale of goods, the Sales Account is credited.
- **Purchases Returns Account.** The account is meant for recording return of goods purchased. The goods 'go out' on returning of goods to the suppliers and, therefore, the account should be credited on returning goods purchased.
- **Sales Returns Account.** The account is meant for recording return of goods sold, by the customers. The goods 'come in' and, therefore, the Sales Returns Account should be debited on return of goods.

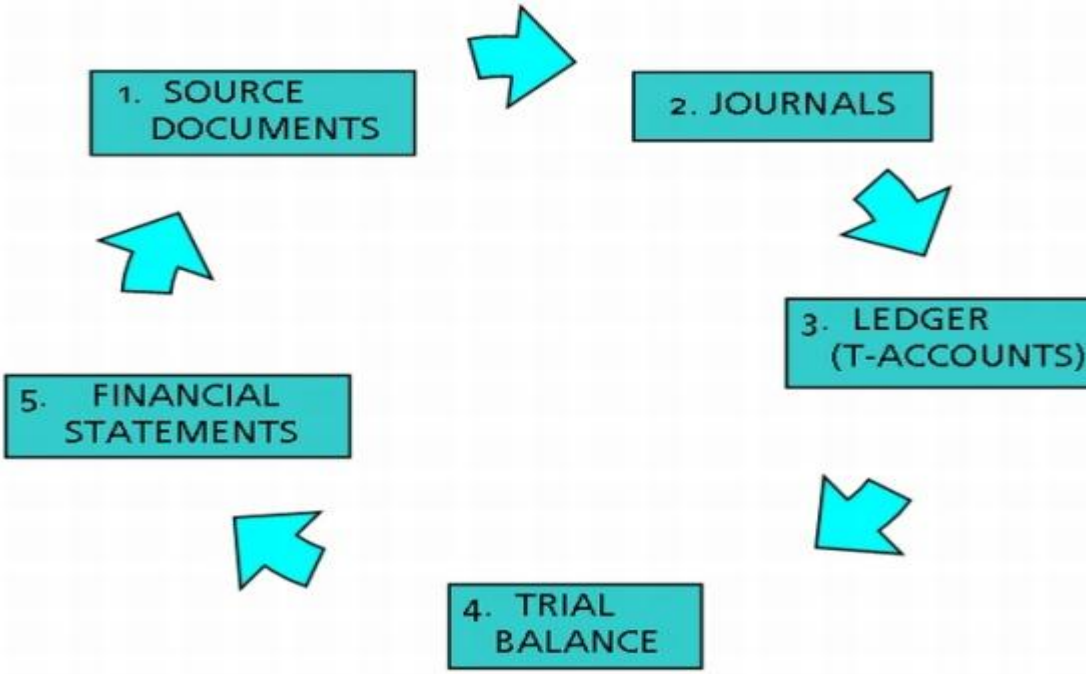
3.7 Recording and Posting Transactions:

In the previous section, we analysed transactions, Step One of the accounting cycle, and recorded their effects directly in T-accounts to help you understand the double-entry accounting system. Yet accounting systems rarely record transactions directly in accounts. Instead, Step Two of the accounting cycle requires that we record transactions in a record called a journal before recording them in accounts. This is to avoid the potential for error and the difficulty in tracking mistakes.

A journal gives us a complete record of each transaction in one place. It also directly links the debits and credits for each transaction. The process of recording transactions in a journal is called journalizing. Step Three of the accounting cycle is to post, or transfer, entries from the journal to the ledger. Posting occurs after debits and credits for each transaction are entered into a journal.

This process leaves a helpful trail that can be followed in checking for accuracy. It also helps us avoid errors. This section describes both journalizing and posting of transactions. Step Four of the accounting cycle, preparing a trial balance, is explained in the next section. Each of these steps in processing transactions is shown in the following figure:

Accounting Cycle:



Before explaining how to record business transactions in the journal, we need to remind you of the Double-Entry Accounting system and how to determine the debit and credit sides of the business transaction.

3.8 The Journal Entry:

The **General Journal** is flexible in that it can be used to record any economic transaction. A General Journal entry includes the following information about each transaction:

1. Date of transaction
2. Titles of affected accounts
3. Dollar amount of each debit and credit
4. Explanation of transaction

The following figure shows how a simple journal would look like:

Journal Entry Format			
Date	**Account Name**	**Debit**	**Credit**
January 1			
	Debited Account	xxxx	
	-Credited Account		xxxx
	Description of the Journal Entry		

Journalising Transactions

We can identify seven steps in journalizing entries in a General Journal: These steps are:

1. Enter the date on the first line of the journal entry.

2. Enter the titles of accounts debited. Account titles are taken from the chart of accounts and are aligned with the left margin of the Account Titles and Explanation column.

3. Enter the debit amounts in the Debit column on the same line as the accounts to be debited.

4. Enter the titles of accounts credited. Account titles are taken from the chart of accounts and are indented from the left margin of the Account Titles and Explanation column to distinguish them from debited accounts.

5. Enter the credit amounts in the Credit column on the same line as the accounts to be credited.

6. Enter a brief explanation of the transaction on the line below the entry. This explanation is indented about half as far as the credited account titles to avoid confusing an explanation with accounts.

7. Skip a line after each journal entry for clarity.

The following figure shows how the first transaction of M. Ali mentioned above are recorded in a General Journal.

Date	Titles of accounts and explanation	Ref	Amount E£	
			Debit	Credit
1 Jan	Cash		60,000	
	Capital			60,000
	Investment by the owner			

Example(1):

You are required to journalise the following transactions:

1- On January 1, 2020, Omar started a new business and invested E£100,000.

2- On Jan 3, he purchased goods for cash E£20,000.

3- On Jan 6, he sold goods for cash E£10,000

4- On Jan 10, he purchased furniture for cash 10,000

5- On Jan 12, he sold goods to Osama (on account) £E5,000

6- On Jan 15, he purchased goods from Hassam (on account) E£8,000

7- On Jan 20, he received the full amount from Osama

8- On Jan 22, he paid the whole amount he owes to Hassam

9- On Jan 24, he withdraw goods for personal use cost E£1,000

10- On Jan 25, he paid telephone bills E£200 and electricity bills 400

11- On Jan 28, he paid rent E£1,000 and salaries E£5,000

12- On Jan 29, Omar invested an additional E£10,000.00 into the business.

Solution

Journal Entries:

General Journal

Date	Titles of accounts and explanation	Debit E£	Credit E£
2020	Cash	100,000	
Jan 1	Capital		100,000
	Owner investment in the business		
3	Purchases	20,000	
	Cash		20,000
	Cash Purchases		
6	Cash	10,000	
	Sales		10,000
	Goods sold in cash		
10	Furniture	10,000	
	Cash		10,000
	Furniture purchased in cash		
12	Accounts Receivables	5,000	
	Sales		5,000
	Selling goods on account		
15	Purchases	8,000	
	Accounts Payable		8,000
	Purchases on account		
20	Cash	5,000	
	Accounts Receivable		5,000
	Collection from Osama		

22	Accounts payable Cash Payment to Hossam	8,000	 8,000
24	Drawings Purchases Withdrawals for personal use	1,000	 1,000
25	Telephone Expenses Electricity Expenses Cash Expenses paid in cash	200 400	 600
28	Rent Salaries Cash Paying rent and salaries in cash	1,000 5,000	 6,000 10,000
29	Cash Capital Additional investment by the owner	10,000	
	Total	183,600	183600

Note:

- For the transaction on Jan 29, the entry would be similar to what we did in the first transaction (i.e. increase cash and increase the capital account of the owner).

  - On Jan 24, in the previous example, the owner withdraws goods for his personal use, if instead, the owner paid the fees of his son's school E£1,000, what would be the journal entry.

<u>Example (2):</u>

Record the following transactions in the Journal of Zead in January 2020 Amount (E£)

-January 1 Zead started business with cash 100,000

-January 2 Goods purchased for cash 20,000

-January 4 Machinery Purchased from Mohamed 30,000

-January 6 Rent paid in cash 2,000

-January 8 Goods purchased on credit from Ali 25,000

-January 10 Goods sold for cash 40,000

-January 15 Goods sold on credit to Nabil 30,000

-January 18 Salaries paid. 12,000

-January 20 Cash withdrawn for personal use 5,000

Tabular Analysis of Business Transactions

Date	Transaction	Affected Accounts	Type of Account	Increase or Decrease
2013 **Jan 1**	Starting the business	Cash Capital	Asset Capital	Increase Increase
Jan 2	Purchasing goods in cash	Purchases Cash	Asset Asset	Increase Decrease
Jan 4	Purchasing Machinery on account	Machinery Mohamed	Asset Liabilities	Increase Increase
Jan 6	Paying rent in cash	Rent Cash	Expense Asset	Increase Decrease
Jan 8	Goods purchased on Account	Purchases Ali	Asset Liabilities	Increase Increase
Jan 10	Selling goods for cash	Cash Sales	Asset Revenue	Increase Increase
Jan 15	Selling Goods	Nabil	Asset	Increase

	on Credit	Sales	Revenue	Increase
Jan 18	Paying salaries in cash	Salaries Cash	Expense Asset	Increase Decrease
Jan 20	Cash withdrawals	Drawings Cash	Capital Asset	Decrease Decrease

The Account

An **account** is a detailed record of increases and decreases in a specific asset, liability, or equity item. Information is taken from accounts, analysed, summarized, and presented in useful reports and financial statements for users. Separate accounts are kept for each type of asset, liability, and equity item.

A **ledger** is a record containing all accounts used by a business. This is often in electronic form and is what we mean when we refer to the *books*. Manual systems will record accounts on separate pages in a special booklet. Each company will have its own unique set of accounts to suit its type of operation. The remainder of this section introduces accounts that are important to most organizations.

Asset Accounts

Assets are resources controlled by an organization that have current and future benefits. They have value and are used in the operations of the business to create revenue. For example, Furniture is an asset held by Finlay Interiors for the purpose of creating rental revenue in current and future periods. A separate account is maintained for each asset.

- ✓ **Cash** increases and decreases are recorded in a Cash account. Examples are coins, currency, cheques, money orders, and chequing account balances.
- ✓ **Receivables** are amounts that the business is expecting to receive in the future.

Types of receivables include:

- ✓ **Accounts receivable**, which occur when services are performed for or goods are sold to customers in return for promises to pay in the future.

These transactions are said to be *on credit* or *on account*. Accounts receivable are *increased* by services performed or goods sold on credit and *decreased* by customer payments.

- ✓ **Notes receivable** (or a **promissory note**), which is an unconditional written promise to pay a definite sum of money on demand or on a defined future date(s).
- ✓ **Prepaid Expenses** contain payments made for assets that are to be used in the near future. As these assets are used up, the costs of the used

assets become expenses. Examples include Office Supplies, Store Supplies, Prepaid Rent, and Prepaid Insurance. A prepaid cost can be initially recorded as an expense *if* it is used up before the end of the period.

- ✓ **Equipment** includes assets such as computers, printers, desks, chairs, counters, showcases and cash registers. These assets are used in the operations of a business for more than one accounting period.
- ✓ **Buildings** are assets owned by an organization that can provide space for a store, an office, a warehouse, or a factory. Buildings are assets because they provide benefits.
- ✓ **Land** owned by a business is shown as an asset. The cost of land is separated from the cost of buildings located on the land to provide more useful information in financial statements.

Liability Accounts

Liabilities are obligations to transfer assets or provide services to other entities.

An organization often has several different liabilities, each of which is represented by a separate account that shows amounts owed to each creditor. The more common liability accounts are described here.

- ✓ **Payables** are promises by a business to pay later for an asset or service already received. Types of payables include:

- ✓ **Accounts payable**, which occur with the purchase of merchandise, supplies, equipment, or services made by a promise to pay later.
- ✓ **Notes payable**, which occur when an organization formally recognizes a promise to pay by signing a promissory note.
- ✓ **Unearned revenues** result when customers pay in advance for products or services. Because cash from these transactions is received before revenues are earned, the seller considers them unearned revenues in accordance with the revenue recognition principle. Unearned revenue is a liability because a service or product is *owed* to a customer. It will be earned when the service or product is delivered in the future. Examples of unearned revenue include magazine subscriptions collected in advance by a publisher, sales of gift certificates by stores, airline tickets sold in advance, and rent collected in advance by a landlord.
- ✓ **Other Liabilities** include wages payable, taxes payable, and interest payable. Each of these is often recorded in a separate liability account. If they are not large in amount, two or more of them may be added and reported as a single amount on the balance sheet.

Equity Accounts

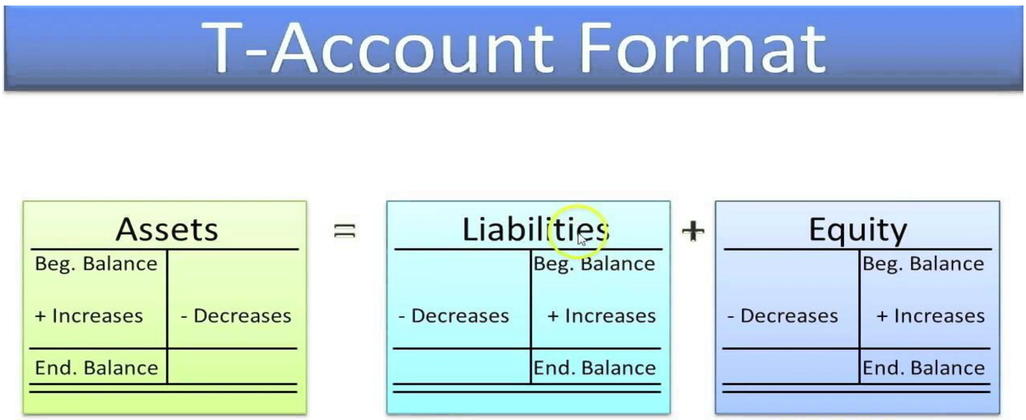
We described in the previous chapter four types of transactions that affect owner’s equity: (1)

investments by the owner, (2) withdrawals by the owner, (3) revenues, and (4) expenses.

- ✓ **Owner Capital** records owner investments. The capital account is identified by including the owner's name. The owner's capital account includes transactions in addition to owner investments.
- ✓ **Owner withdrawals** are recorded in an account with the name of the owner and the word *Withdrawals*. This account is also sometimes called the owner's *Personal* account or *Drawing* account.
- ✓ **Revenues and expenses** incurred for a period is information required by decision makers. Businesses use a variety of accounts to report revenues earned and expenses incurred on income statements. Examples of revenue accounts are Sales, Commissions Earned, Professional Fees Earned, Rent Revenue, Earned Subscription Fees, and Interest Earned. Examples of expense accounts are Advertising Expense, Store Supplies Expense, Office Salaries Expense, Office Supplies Expense, Rent Expense, Utilities Expense, and Insurance Expense.

T-Account

A **T-account** is a helpful learning tool that represents an account in the ledger. It shows the effects of individual transactions on specific accounts. The T-account is so named because it looks like the letter T. It is shown in the following figure.



As can we see from the above figure, the format of a T-account includes: (1) the account title on top, (2) a left or debit side, and (3) a right or credit side. Debits and credits are explained in the next section. A T-account provides one side for recording increases in the item and the other side for decreases.

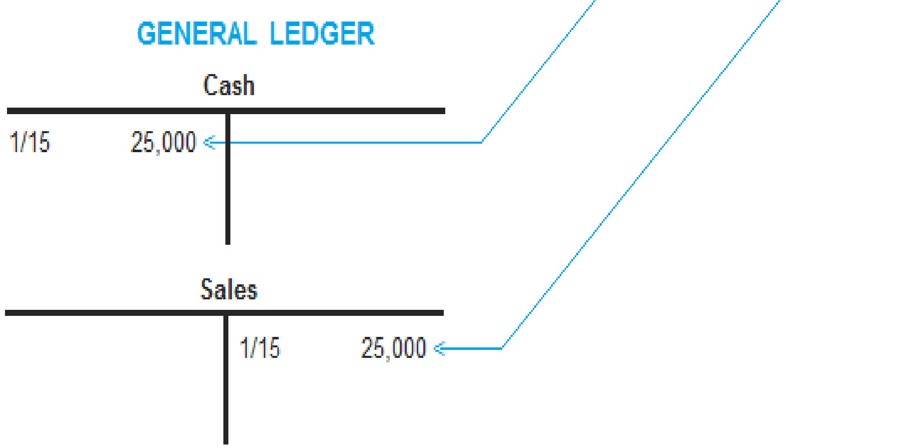
3.8 Posting Journal Entries:

To ensure that the ledger is up to date, entries are posted as soon as possible. This might be daily, weekly, or when time permits. All entries must be posted to the ledger by the end of a reporting period. This is so that account balances are current when financial statements are prepared. Because the ledger is the final destination for individual transactions, it is referred to as the *book of final entry*.

When posting entries to the ledger, the debits in journal entries are copied into ledger accounts as debits, and credits are copied into the ledger as credits. The Following figure illustrate how to post journal entries to the ledger accounts:

GENERAL JOURNAL

Date	Account title and explanation	Debit	Credit
2015 Jan. 15	Cash	25,000	
	Sales		25,000
	(Sold goods for cash)		



Notice that posting does not create new information; posting simply transfers (or copies) information from the General Journal to the appropriate account in the ledger.

Balancing a T-Account

An **account balance** is the difference between the increases and decreases recorded in an account. To determine the balance, we:

1. Compute the total increases shown on one side (including the beginning balance)

2. Compute the total decreases shown on the other side

3. Subtract the sum of the decreases from the sum of the increases, and

4. Calculate the account balance.

The following figure show how to determine the balance of a bank account:

Dr		Bank			Cr
		$			$
Apr 1	Balance b/f	4,300	Apr 9	Baking equipment	12,000
1	Capital	15,000	15	Drawings	500
7	Loan	5,000	19	Salaries	4,000
17	Services rendered	10,500	May 13	Creditors	200
19	Debtors	5,000	13	Loan	4,000
			31	Balance c/f	19,100
		39,800			39,800
	Balance b/f	19,100			

As can we see from the bank account shown above, the total increases in Bank account are E£39,800, the total decrease are E£20,700, and the account balance is E£19,100.

Debits and Credits

The left side of a T-account is always called the **debit** side, often abbreviated Dr.

The right side is always called the **credit** side, abbreviated Cr. To enter amounts on the left side of an account is to *debit* the account. To enter amounts on the right side is to *credit* the account. The difference between total debits and total credits for an account is the **account balance**. When the sum of debits exceeds the sum of credits, the account has a *debit balance*. It has a *credit balance* when the sum of credits exceeds the sum of debits. When the sum of debits equals the sum of credits, the account has a zero balance. This dual method of recording transactions as debits and credits is an essential feature of *double-entry accounting.*

3.9 Trial Balance

As we all know, double-entry accounting records every transaction with equal debits and credits. We also know that an error exists if the sum of debit entries in the ledger does not equal the sum of credit entries. This also means that the sum of debit account balances must equal the sum of credit account balances. *Step Four* of the accounting cycle requires the preparation of a trial balance to check whether debit and credit account balances are equal. A **trial balance** is a list of accounts and their balances at a point in time. Account balances are reported in the debit or credit column of the trial balance. The following shows how a trial balance look like.

Golden-Key Auto Service

Trial Balance, December 31, 2015

Acc. No	Account Name	Debit E£	Credit E£
101	Cash on Hand	15,800	
305	Accounts Receivable	1,200	
601	Land	52,000	
310	Equipment	12,000	
420	Building	36,000	
510	Loan		30,000
230	Accounts Payable		7,000
440	Capital		80,000
	Total	**117,000**	**117,000**

Another use of the trial balance is as an internal report for preparing financial statements. Preparing statements is easier when we can take account balances from a trial balance instead of searching the ledger. The preparation of financial statements using a trial balance is illustrated in the demonstration problem at the end of the chapter.

Preparing the Trail Balance

Preparing a trial balance involves five steps:

1. Identify each account balance from the ledger.
2. List each account and its balance. Debit balances are entered in the Debit column and credit balances in the Credit column.
3. Compute the total of debit balances.
4. Compute the total of credit balances.
5. Verify that total debit balances equal total credit balances.

Notice that the total debit balance equals the total credit balance for the trial balance, as can be seen in the above trail balance. If these two totals were not equal, we would know that one or more errors exist. However, equality of these two totals does not guarantee the absence of errors.

We know that one or more errors exist when a trial balance does not balance (when its columns are not equal).When one or more errors exist, they often arise from one of the following steps in the accounting process:

1. Preparing journal entries
2. Posting entries to the ledger
3. Computing account balances

4. Copying account balances to the trial balance
5. Totalling the trial balance columns

Key Terms

Account: A place or location within an accounting system in which the increases and decreases in a specific asset, liability, or equity are recorded and stored.

Account balance: The difference between the increases (including the beginning balance) and decreases recorded in an account.

Accounting cycle: The steps repeated each reporting period for the purpose of preparing financial statements for users.

Accounts payable: Obligations that arise when a promise to pay later is made in connection with purchases of merchandise, supplies, or equipment.

Accounts receivable: When services are performed for or goods are sold to customers in return for promises to pay in the future, an *account receivable* is recorded. These transactions are said to be *on credit* or *on account*. Accounts receivable are *increased* by services performed or goods sold on credit and *decreased* by customer payments.

Compound journal entry: A journal entry that affects at least three accounts.

Credit: An entry that decreases asset, expense, and owner's withdrawals accounts or increases liability, owner's capital, and revenue accounts; recorded on the right side of a T-account.

Debit: An entry that increases asset, expense, and owner's withdrawals accounts or decreases liability, owner’s capital, and revenue accounts; recorded on the left side of a T-account.

Double-entry accounting: An accounting system where every transaction affects and is recorded in at least two accounts; the sum of the debits for all entries must equal the sum of the credits for all entries.

General Journal: The most flexible type of journal; can be used to record any kind of transaction.

Journal: A record where transactions are recorded before they are recorded in accounts; amounts are posted from the journal to the ledger; also called the *book of original entry*.

Journalizing: Recording transactions in a journal.

Ledger: A record containing all accounts used by a business.

Normal balance: The debit or credit side on which an account increases. For example, assets increase with debits, therefore the normal balance for an asset is a debit. Revenues increase with credits, therefore a credit is the normal balance for a revenue account.

Note receivable: An unconditional written promise to pay a definite sum of money on demand or on a defined future date(s); also called a *promissory note*.

Notes payable: Obligations that arise when an organization formally recognizes a promise to pay by signing a promissory note.

Posting: Transfer journal entry information to ledger accounts.

Prepaid Expenses: An asset account containing payments made for assets that are not to be used until later.

T-account: A simple characterization of an account form used as a helpful tool in showing the effects of transactions and events on specific accounts.

Trial balance: A list of accounts and their balances at a point in time; the total debit balances should equal the total credit balances.

Unearned revenues: Liabilities created when customers pay in advance for products or services; created when cash is received before revenues are earned; satisfied by delivering the products or services in the future.

Remember

Records	**سجلات-دفاتر**
Belong to	**يخص**
Deduct	**يطرح**
Adding up	**يجمع**
Identify	**يحدد**
Net Worth	**صافي الثروه**
Resources	**موارد**
Assume	**يفترض**
Owner	**مالك**
Describe	**يصف**
Special Terms	**مصطلحات خاصه**
Present	**يعرض**
Common	**شائع**

Deal	**معامله**
Point of View	**وجهه نظر**
Investment	**استثمار**
Switch	**يحول**
Produce	**ينتج**
Production	**انتاج**
Mass Production	**نظام الانتاج الكبير**
Alternate	**بديل**
Replace	**يبدل**
Fact	**حقيقه**
Revert	**اعاد**
Consist of	**يتكون**
Comprise	**يتكون**
Property	**ملكيه**
Inventory-stock	**مخزون**
Goods	**بضاعه**
Incur	**تحمل**
Borrow	**يقترض**
Retained earnings	**ارباح محتجزه**
Statement of Financial	**قائمه المركز المالي**
Express	**يعبر**
Series	**سلسله**

Deposit	يودع
Creditor	دائن
Notes payable	حسابات اوراق الدفع
Accounts payable	حسابات قابله للدفع
Latter	اخير-ثان
Later	في وقت لاحق
Letter	خطاب
litter	فضلات-نفايات
Create	يخلق
Creation	خلق
Prevent	يمنع
Notes Receivable	حسابات اوراق القبض
Accounts Receivable	الحسابات المستحقة
Partial	جزئي
Inject	حقن
Revenues	ايرادات
Gains	مكاسب
Withdrawals	مسحوبات
Rarely	نادرا
Rare	نادر
Instead of	بدلا من
Require	يتطلب

محتمل	**Potential**
يتعقب	**Track**
عمليه القيد في دفتر اليوميه	**Journalising**
مصروفات مدفوعه مقدما	**Prepaid expenses**
المعادله الرياضيه	**Mathematical equation**
أخذ	**Receiver**
عاطي	**Giver**
يؤكد	**Assure**
صافي الاصول	**Net assets**
اسمي	**Nominal**
حقيقي	**Real**
شخصي	**Personal**
فريد-فذ	**Unique**
المتبقي	**Remainder**
علي الحساب	**On Account – on credit**
اصول ملموسه	**Tangible assets**
اصول غير ملموسه	**Intangible assets**
عمليه الترحيل	**Posting**
ميزان المراجعه	**Trial Balance**

Questions

Question (1):

Supply the missing amount for each of the following cases:

Assets = Liabilities + Capital

L. E L. E L. E

	Assets		Liabilities	Capital
A)	4,000	=	2,500	+ ……..
b)	12,800	=	……….	+ 5,700
c)	……….	=	2,800	+ 3,900
d)	5,650	=	……….	+ 2,820
E)	57,000	=	28,000	+ ……….

Question (2):

Complete the gaps in the following table:

Assets	=	Liabilities	+	Capital
12,500	**=**	**1,800**	**+**	**?**
28,000	=	4,900	+	?
16,800	=	?	+	12,500
19,600	=	?	+	16,450
?	=	6,300	+	19,200
?	=	11,650	+	39,750

Question (3):

Complete the gaps in the following table:

Assets = Liabilities + Capital

	Assets		Liabilities		Capital
a)	**55,000**	**=**	**16,900**	**+**	**?**
b)	?	=	17,200	+	34,400
c)	36,100	=	?	+	28,500
d)	119,500	=	15,400	+	?
e)	88,000	=	?	+	62,000
f)	?	=	49,000	+	110,000

Question (4):

Mohamed opened a small shop called "2Late So 4Gave Me Lo" by investing 5,000 L.E cash on the first day of May. The following transactions occurred during the month of May.

- Purchased 2,000 L.E of merchandise on account from supplier.
- Purchased store equipment for 1,500 L.E cash.
- Sold merchandise for cash: cost, 1.200 L.E; selling price, 1,600 L.E
- Paid salary expense for the month, 500 L.E.
- Paid rental expense for the month, 350 L.E.
- Sold merchandise for cash: cost, 700 L.E; selling price, 1,200 L.E.
- Purchased merchandise for 2,500 L.E; paid 1,100, the remainder on account.

- Withdrew 1,000 L.E for personal use. Record the transaction and running balances in the form provided below.

Required: Record the above transaction and find the balances for each account**.**

Question (5):

Sunny shop retail store had the following transactions during October 2016.

- Oct 4: Purchased merchandises on account from Dina shop, L.E
- 12,000. Terms 2/10, n/30.
- Oct 7: Purchased merchandise on credit from Palm Co. L.E 8000. Terms 2/10, n/30, with transportation costs of L.E 120 paid in cash.
- Oct 8: Sold merchandise on account to Mohamed Co. for L.E 3000, terms 2/10, n/30.
- Oct 9: Purchased office supplies for cash, L.E 400.
- Oct10: Returned merchandise purchased on October 4, from Dina shop, which had a gross invoice price of L.E 1500.
- Oct13: Paid Dina shop the remaining amount owed for purchases of October 4, after allowing for the purchase return of October 10.
- Oct15: Purchased merchandise for cash, L.E 6900.
- Oct16: Received cash from sale on account of October 8 to Mohamed Co.

- Oct17: Purchased land and a small office building for a total price of L.E 75,000, of which L.E 20,000 was

the value of land. Paid L.E 40,000 in cash and signed a note payable for the remaining.
- Oct 20: Paid Palm Co. for purchases of October7.

Required: Prepare journal entries to record above transactions.

Question (6):

Prepare journal entries to record the following transactions (Group B May 2012)

- Oct.1: Sold merchandise to Mary on credit, terms 2/10, L.E.40000.
- Oct.2: Purchase merchandise for L.E.28000 on credit from Trout Company, terms 2/10, n/30.
- Oct.3: Purchased store supplies on credit from Tracy company, terms n/20, L.E.3000.
- Oct.8: Purchased merchandise for L.E.100000.on credit from R.C. Company, terms 2/10, n / 30
- Oct. 10: Received full payment from Mary for her Oct. 1, purchase.
- Oct. 12: Paid Trout Company for purchase of Oct.2.
- Oct. 13: Sold merchandise on credit to Tom, terms, 2/10, n/30, L.E.60000.
- Oct.14: Returned for credit L.E.3000 of merchandise received on Oct.8.
- Oct.18: Paid R.C. Company for purchase of Oct.8.
- Oct.23: Received full payment from Tom for his Oct. 13 purchase.

Question (7):

During October 2013, Hassam store entered into the following transactions with Omar store. (May 2014 - Group D)

- Oct.2: Hassam store sold merchandise to Omar store on credit, the sale totaled L.E.10, 000 and was made under the following terms 5/10, n/60.
- Oct.4: Omar store returned L.E. 1,000 of the merchandise because it was defective.
- Oct.9: Hassam store made an additional sale of L.E.5, 000 on account to Omar store. The terms were 2/10, n/30.
- Oct.10: Hassam store received the required payment for Oct.2 sale.
- Oct.25: Hassam store received full payment on the Oct.9 sales to Omar store.

Required: Prepare all the required entries for both Hassam store and Omar store.

Question (8):

During October 2013, Hassam store entered into the following transactions with Omar store. (May 2014 - Group D)

- Oct.2: Hassam store sold merchandise to Omar store on credit, the sale totaled L.E.10, 000 and was made under the following terms 5/10, n/60.
- Oct.4: Omar store returned L.E. 1,000 of the merchandise because it was defective.

- Oct.9: Hassam store made an additional sale of L.E.5, 000 on account to Omar store. The terms were 2/10, n/30.
- Oct.10: Hassam store received the required payment for Oct.2 sale.
- Oct.25: Hassam store received full payment on the Oct.9 sales to Omar store.

Required: Prepare all the required entries for both Hassam store and Omar store.

Question (9):

Osama, a mechanical engineer, starts his new business by opening a service centre “Golden-Key Auto Service”. The following transactions occurred during the month of January 2020:

1. Jan 1 Osama, the owner, invested E£80,000 cash in the business
2. Jan 3 Representing Golden-Key Auto Service, Osama negotiated with both the City Council and Upper Egypt Bus Company to purchase an old garage, as the City Council owned the land, while the bus company owned the building. On Jan 7, Golden-Key purchased the land from the Council for E£52,000 cash.
3. Jan 10 Golden-Key completed the acquisition of its business location by purchasing the old building from the bus company. The purchase price was E£36,000, Golden-Key paid E£6,000 cash and issued a three-month, non-interest bearing note payable for the remaining E£30,000.

4. Jan 15 Golden-Key Purchased tools and equipment on account (on credit) from the Nile Tools company. The purchase price was E£13,000, due in 2 months.
5. Jan 20 Golden-Key found that it had purchased more tools than they needed. So, it sold the excess tools on account to Tarek Centre at a price of E£1,800. The tools were sold at a price equal to their cost, so there was no profit or loss on this transaction.
6. Jan 24 Golden-Key received E£600 in partial collection of the accounts receivables (Debtors) from Tarek Centre.
7. Jan 28 Golden-Key made a E£6,800 partial payment of its accounts payable to the Nile Tools company.

Required:

- Journalise the above transactions in the books of Golden-Key Auto Service.
- Prepare the ledger accounts and the trial balance on the basis of these transactions.

Chapter Four
Financial Statements

Chapter Four
Financial Statements

4.1 Introduction:

After transactions are identified, recorded, and summarized, three financial statements are prepared from the summarized accounting data:

1- An income statement presents the revenues and expenses and resulting net income or net loss of a company for a specific period of time.

2- An owner's equity statement summarizes the changes in owner's equity for a specific period of time.

3- A balance sheet reports the assets, liabilities, and owner's equity of a business enterprise at a specific date.

Each statement provides management, owners, and other interested parties with relevant financial data.

4.2 Income Statement:

Income statement measures the income of business enterprise during a particular period of time. It is of greater importance than even the balance sheet the main objective of running a business enterprise is the maximize business wealth and this depends to a great extent upon the income which a business makes year after year. An income statement is a one-page financial statement summarizes the profitability of the business enterprise over a specific period of time (month, quarter, six months, or a year).

The heading of the statement identifies the company, the type of statement, and the time period covered by the statement. Note that the primary focus of the income statement is on reporting the success or profitability of the company's operations over a specified period of time. To indicate that it applies for a period of time, the income statement is dated "For the Month Ended September 30, 2015"

SOFBYTE
Income Statement
For the Month Ended September 30, 2020

Revenues:		
Service revenue		**4700**
Expenses:		
Salaries expense	**900**	
Rent expense	**600**	
Advertising expense	**250**	
Utilities expense	**200**	
Total expenses:		**1950**
Net income		**2750**

<u>Example(1):</u>
The following account balances were obtained from the records of El- Eiman Company at December 31, 2020. Beginning inventory 21.000 – Ending inventory 28.000 – Sales 105.000 – Purchases 40.000 – Salaries expense 12.000 – Telephone expense 9.000 – Advertising expense 6.000 - Rent expense 14.000.
Required: Prepare the income statement.

<u>Solution</u>

El-Ekman Company
Income Statement
For period ended at December 31, 2020

Sales		**105.000**
Less Cost of goods sold		
Beginning inventory	**21.000**	
Purchases	**<u>40.000</u>**	
Cost of goods available for sale	**61.000**	
Less: Ending inventory	**<u>(28.000)</u>**	
Cost of goods sold		**<u>(33.000)</u>**
Gross profit		**72.000**
<u>Less: Operating expenses</u>		
Salaries expense	**12.000**	
Telephone expense	**9.000**	
Advertising expense	**6.000**	
Rent expense	**14.000**	

Total operating expense		**(41.000)**
Net Income		**31.000**

Example(2):

The following balances were obtained from the ledger accounts on Dec.31/2020 for XYZ firm:

Merchandise inventory, Jan.1/2020	20,000
Sales	40,000
Sales discounts	1,000
Sales returns & allowances	2,000
Purchases	30,000
Purchases returns& allowances	2,000
Purchases discounts	2,000
Freight-in	3,000
Selling expenses	6,000
Administrative expenses	8,000

Required: Prepare a 2020 income statement, if you learn that ending

inventory amounts L.E.15,000.

Solution

X Y Z Company

Income statement

For the year ended December 31, 2020

Sales Revenues:				
Sales			**40000**	
Less: sales returns & allowances		**2,000**		
Sales discount		**1,000**	**(3000)**	
Net sales				**37000**
<u>Cost of goods sold:</u>				
Inventory, jan1.			20,000	
Purchases		30000		
Less: Purchases returns & allowances	2000			
Purchases discount	2000	(4,000)		

Net purchases		26000		
Add: Fright- in		3000		
Cost of goods purchased			29000	
Cost of goods available for sale			**49000**	
Less: Inventory,Dec31			(15000)	
Cost of goods sold				**(34000)**
Gross Profit				**3000**
Operating expenses				
Selling expenses			6000	
administrative expense			8000	
Total operating expense				(14,000)
Net loss				**(11000)**

4.3. Owner's Equity Statement:

The statement of Owner's Equity summaries the increases and decreases during the accounting period in the amount of owner's equity. Increase, often, result from earning net income and from additional investments by the owner ; decreases, on the other hand, result from net losses and from withdrawals of assets by the owner.

The heading of this statement identifies the company, the type of statement, and the time period covered by the statement. The time period is the same as that covered by the income statement and therefore is dated "For the Month Ended September 30, 2015".

The beginning owner's equity amount is shown on the first line of the statement. Then the owner's, investments, net income, and the owner's drawings are identified in the statement. The information provided by this statement indicates the reasons why owner's equity has increased or decreased during the period.

Let's assume that during the month of September, 2015, SOFTBYTE profit L.E.2750. the presentation in the owner's equity statement of a net profit appears in table (2.3.)

SOFBYTE
Owner's Equity Statement
For the Month Ended September 30, 2020

Ahmed Capital September 1		**0**
Add: Investment	**15000**	
Net income	**2750**	**17750**
		17750
Less: Drawings		**(1300)**
Ahmed Capital, September 30		16450

4.4. Balance Sheet:

It is known that the balance sheet lists the amounts of the enterprise's assets, liabilities, and owner's equity at the end of the accounting period.

The balance sheet is prepared from the column headings and the month-end data shown in the last line .The heading of a balance sheet must identify the company, the statement, and the date. To indicate that the balance sheet is at a specific date, it is dated "September 30, 2015". Observe that the assets are listed at the top, followed by liabilities and owner's equity. Total assets must equal total liabilities and owner's equity.

The balance sheet is like a snapshot of the company's financial condition at a specific moment in time (usually the month-end or .year-end)

SOFBYTE
Balance Sheet
September 30, 2020

Assets:	
Cash	**8050**
Accounts receivable	**1400**
Supplies	**1600**
Equipment	**7000**
Total assets	**18050**
Liabilities:	
Accounts Payable	1600

Owner's Equity:	
AHAMED Capital	16450
<u>Total Liabilities and Owner's Equity</u>	**18050**

Table 2-2

On the income statement, revenues are listed first, followed by expenses. Finally net income (or net loss) is determined.

Note that investment and withdrawal transactions between the owner and the business are not included in the measurement of net income.

<u>Example (3):</u>

The accounting data for Star Business at December 31, 2020 are shown below:

Accounts Payable	**111000**	**Cash**	**130000**
Accounts receivable	**75000**	**Notes receivable**	**45000**
Supplies	**15000**	**Salaries payable**	**6000**
Land	**168000**	**Building**	**138000**
Office equipment	**39000**	**Ahmed Capital**	**??**
Notes payable	**54000**		

Required: Prepare a balance sheet at December 31, 2020.

Solution

START BUSINESS

Balance sheet

December 31, 2020

Assets		**Liabilities& Owner's**	
Cash	**138000**	**Equity**	**54000**
Notes receivable	**45000**	**Liabilities**	**111000**
Accounts	**75000**	**Notes payable**	**6000**
receivable	**15000**	**Accounts payable**	
Supplies		**Salaries payable**	
Land	168000	**Total Liabilities**	171000
Building	138000		
Office	39000	**Owner's equity**	447000
equipment		**Ahmed Capital**	
		Total	
Total			
	618000		**618000**

4.5 Statement of cash flows:

Rather than setting out separate requirements for presentation of the statement of cash flows, IAS 1.111 refers to IAS 7 Statement of Cash Flows. The following figure shows how the cash flow statement looks like:

Cash Flow Statement

Cash Flow Statement Company XYZ FY Ended 31 Dec 2003 all figures in USD		
Cash Flow From Operations		
Net Earnings		2,000,000
Additions to Cash		
Depreciation		10,000
Decrease in Accounts Receivable		15,000
Increase in Accounts Payable		15,000
Increase in Taxes Payable		2,000
Subtractions From Cash		
Increase in Inventory		(30,000)
Net Cash from Operations		2,012,000
Cash Flow From Investing		
Equipment		(500,000)
Cash Flow From Financing		
Notes Payable		10,000
Cash Flow for FY Ended 31 Dec 2003		**1,522,000**

4.6 Notes to the financial statements:

The notes must: [IAS 1.112]

- ✓ Present information about the basis of preparation of the financial statements and the specific accounting policies used
- ✓ Disclose any information required by IFRSs that is not presented elsewhere in the financial statements and
- ✓ Provide additional information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them

Notes are presented in a systematic manner and cross-referenced from the face of the financial statements to the relevant note. [IAS 1.113]

IAS 1.114 suggests that the notes should normally be presented in the following order:

- ✓ A statement of compliance with IFRSs
- ✓ A summary of significant accounting policies applied, including: [IAS 1.117]
  - The measurement basis (or bases) used in preparing the financial statements
  - the other accounting policies used that are relevant to an understanding of the financial statements
- ✓ Supporting information for items presented on the face of the statement of financial position (balance sheet), statement(s) of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows, in the order in which each statement and each line item is presented
- ✓ Other disclosures, including:
  - Contingent liabilities and unrecognised contractual commitments
  - Non-financial disclosures, such as the entity's financial risk management objectives and policies

4.7 Other disclosures:

Judgements and key assumptions

An entity must disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements. [IAS 1.122]

Examples cited in IAS 1.123 include management's judgements in determining:

- ✓ When substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities
- ✓ Whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue.

An entity must also disclose, in the notes, information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. [IAS 1.125] These disclosures do not involve disclosing budgets or forecasts. [IAS 1.130]

Questions

Question (1):

The following balances were taken from the books of the Swimming Club at 31/3/2005.

Swimming lessons revenue.	**LE. 19000**
Salaries expense	LE. 11500
Accounts Receivable	LE. 6000
Capital	LE. 150000
Equipment	LE. 50000
Land and Building	LE. 100000
Supplies expense	LE. 5000
Withdrawals	LE. 4000
Pool rental revenue	LE. 7500
Utilities Expense	LE. 3000
Insurance expense	LE. 500
Cash	LE. 13000
Liabilities	L.E.19000
Additional investments during the month	LE. 8000

Using the above accounts answer the following questions:

1- The total revenue is:

a) L.E 19000. b) L.E 7500.
c) L.E 26500. d) L.E 8000.

2- The total of fixed assets is:

a) L.E 100000. b) L.E 50000.
c) L.E 150600. d) L.E 150000.

3-The total of expenses is:

a) L.E 8000. b) L.E 20000.

c) L.E 19500. d) L.E 24000.

4- The Net income or loss for the years is:

a) Net income of L.E 6500. b) Net income of L.E 11000.

c) Net Loss of L.E 1000. d) Not loss of L.E 500.

5- The total of current assets is:

a) L.E 21600. b) L.E 19000.

c) L.E 6000. d) L.E 13000.

6- The Owner's equity is:

a) L.E 150000. b) L.E 158000.

c) L.E 47500. d) L.E 160500.

Question (2):

The total assets and the total liabilities of a business at the beginning and at the end of the year were as follows:

	Assets	Liabilities
Beginning of the year	L.E30 000	L.E10, 000
End of the year	45,000	15,000

Determine the net income from operations for the year under each of the following assumptions:

1. There had been no additional investments and no withdrawals by the owner during the year.

   A. L.E 20000. B. L.E 30000.

   C. L.E 10000. D. L.E 50000.

2. The owner withdrawn L.E8, 000 during the year.

A. L.E 8000. B. L.E 28000.

C. L.E 38000. D. L.E 18000.

3. The owner had made no withdrawals but had made an additional investment of L.E3, 000 during the year.

A. L.E 7000. B. L.E 3000.

C. L.E 13000. D. None of the above.

4. The owner had withdrawn L.E6, 000 and had mad an additional investment Of L.E20, 000 during the year.

A. L.E 6000 B. L.E 20000.

C. L.E 26000. D. None of the above.

Question (3):

The transactions appearing below are those of "2Late So Forgave Me" Company for the month of May 2016. This was the first month of the operation of the business.

Transactions:

- Owner invested Cash, LE50.000.
- Purchased cleaning equipment on account, LEI5.000.
- Earned service revenue on account, LEI2.000.
- Collected cash on account LE4.000.
- Paid wages, LE3.000.
- Paid rent, LE2.000.
- Received bill for advertising for May, LE600.
- Paid on account payable, LEI5.000.
- Additional investment by owner for LE 5600.
- Owner withdrew LE1000 cash for personal use

Required:

- Prepare a summary of transactions using column headed: Cash, accounts Receivables, Cleaning Equipment, Accounts Payable; and Owners' Equity. Determine new balances after each transaction.

- Prepare an income statement for May 2016.
- Prepare a balance sheet as of May

Question (4):

Egyptian store is a wholesale store maintaining its accounts on a December 31,2014 the trial balance appeared as follows (LE) (May 2015)

Cash	**46750**	
Notes receivable	41000	
Accounts receivable	82000	
Inventory	111500	
Unexpired insurance	4500	
Office supplies	2000	
Land	40000	
Building	150000	
Accumulated depreciation: Building		6000
Equipment	40000	
Accumulated depreciation: Equipment		12000
Accounts payable		120500
Owner's Capital		248000
Owner's drawing	45000	
Sales		815000
Sales returns and allowances	900	
Sales discount	2750	
Cost of goods sold	519500	
Advertising expense	8000	

Salaries expense	60000	
Interest expense	2500	
Delivery expense	5100	
General expenses	40000	
Total	1201500	1201500

Other data:

- Insurance premiums expired during the year, LE. 3000,
- Supplies on hand at Dec. 31 were estimated to an amount LE, 400
- Accrued salaries payable as of Dec. 31 were LE. 2500
- The building is being depreciated over 25-year useful life. The equipment is being depreciated over 10-year useful life.

Required:

Prepare the classified Income statement for the year ended Dec. 31, 2014.

Question (5):

Mohamed's retail store is maintaining its accounts on a calendar year basis and using a periodic inventory system. The business records purchases at net cost. At December 31, 2017 the trial balance appeared as follows:

	Debit (LE)	**Debit (LE)**
Cash	87000	
Inventory (January 2017)	30000	

Accounts receivable	32000	
Notes receivable	12000	
Marketable securities	23700	
Unexpired insurance	4800	
Office supplies	2000	
Land	60000	
Building	180000	
Accumulated depreciation: Building		14400
Accounts payable		42000
Notes payable		15000
Bank loan (due in 10 years)		75000
Mohamed, Capital		184000
Mohamed, drawing	16000	
Sales		360000
Sales returns & allowances	8000	
Sales discount	10000	
Purchases	197000	
Purchases returns & allowances		12000
Purchases discount		21000
Transportation-in	5000	
Rent revenue		24000
Salaries expense	42000	
Utilities expense	18600	
Advertising expense	14000	
Interest expense	2900	
Delivery expense	2400	
Total	747400	747400

Other data:

- Unexpired insurance at the end of the year amounted to LE. 2800,
- Office supplies on hand at December 31, 2017were LE. 500,
- The building is being depreciated over a 50-years useful life and the store uses straight line method for computing depreciation
- The current market value of the Land is LE. 96000,
- Salaries earned by employees but not yet paid amount to LE. 4000 at December 31, 2017.
- Accrued rent revenue as of December 31, 2017 was amounted to LE. 6000.
- Inventory of merchandise on December 31, 2017 was LE. 2000.

Required;

- Prepare the adjusting entries at December 31, 2017.
- Prepare the classified income statement for the year ended December 31, 2017.
- Prepare the statement of owner's equity for the year ended December 31, 2017.
- Prepare the classified balance sheet at December 31, 2017.

Question (6):

Zahran store is a wholesale store maintaining its accounts on a calendar year basis & using the periodic inventory system. At December 31, 2000 the trial balance appeared as follows:

Account Titles	**Dr.**	**Cr.**
Cash	35.200	
Accounts receivable	18.000	
Inventory (9 Jan. 1)	60.000	
Unexpired insurance	4.400	
Equipment	22.000	
Accumulated depreciation		6.600
equipment		21.000
Accounts payable		65.000
Zahra capital	18.000	
Zahra drawing		560.000
Sales	20.000	
Sales returns & allowances	6.000	
Sales discounts	350.000	18.000
Purchases		
Purchases return & allowances	11.000	
Transportation-in	28.000	
Advertising expense	30.000	
Rent expense	66.000	
Salaries expense	2.000	
Office supplies		
Total	670.600	670.600

Other data:

- A physical inventory taken at December 31 showed the ending inventory to be L.E 52,000.
- The equipment is being depreciated over a 10-years useful life.
- Insurance premiums expired during the year L.E 2,800.
- Accrued salaries payable as of December 31 were L.E 6,000.
- Supplies on hand at December 31 were estimated to amounts L.E 500.

Required:

- Prepare the adjusting entries as at Des. 31, 2015.
- Prepare the classified income statement for the year ended Dec. 31, 2015.
- Prepare the classified balance sheet at Dec. 31, 2015.

Question (7):

Use the following information to complete the balance sheet of FAGR Business on June30, 2020:

- The business started on July 1, 2014 and has operated for one year.
- The land and building were purchased for a total price of L.E. 170,000 on January 11, 2014.
- Cash and accounts receivable together amount to four times as accounts payable.
-

FAGR BUSINESS
Balance sheet
June 30, 2020

Assets		**Liabilities& Owner's Equity**	
Cash	**35000**	**Liabilities**	
Accounts receivable	**?**	**Notes payable**	**?**
Land	**70000**	**Accounts payable**	**?**
Building	**?**	**Total Liabilities**	60000
Machinery& Equipment	**40000**	**Owner's equity**	?
Supplies	**3000**	**Ahmed Capital**	
Total Assets	**?**	**Total Liabilities& Owner's Equity**	**393000**

Question (8):

Hazem business is maintaining its accounts on a calendar year basis. At December 31, 2020. The trial balance (before adjustments) appeared as follows:

	Debit L.E	Credit L.E
Cash	56000	
Accounts receivable	45000	
Inventory, January 1, 2017	48000	
Unexpired insurance	3600	
Office supplies	1700	
Land	120000	
Building	140000	
Accumulated dep; building		20000
Notes payable		24000
Accounts payable		34700
Sherif, Capital		229000

Sherif, drawing	15000	
Sales		420000
Sales returns	3500	
Sales discount	12000	
Purchases	215000	
Purchase returns		15000
Purchase discount		18000
Transportation- in	3800	
Advertising expenses	14000	
Delivery expenses	8000	
Salaries expenses	48000	
Utilities expenses	25600	
Interest expenses	1500	
	760700	**760700**

Other data:

1- 12-month insurance policy was purchased on April 1,2020

2- Office supplies on hand at Dec.31,2019 were L.E.500

3- The building is being depreciated over a 50-year useful life (double declining balance method)

4- Accrued salaries payable as of Dec.31 were L.E. 4000

5- Accrued interest on notes payable at Dec. 31 amounted L.E. 500

6- Inventory of merchandise on Dec. 31 was L.E. 42000

Required:

- Prepare adjusting entries.

- Prepare classified income statement for the year ended Dec.31,2020.

- Prepare a statement of owner's equity for the year ended Dec. 31 , 2020 and Prepare a classified balance sheet at Dec.31,2017**. (May 2002).**

Chapter Five
Errors & Suspense Accounts

Chapter Five
Errors & Suspense Accounts

5.1 Introduction:

It is known that the basic information for the preparation and presentation of *Final Accounts* is supplied by the *Trial Balance*. Hence, the accuracy of the *Trial Balance* determines, to a great extent, the accuracy of the information provided by *Final Accounts*. Nevertheless, the *Trial Balance* provides only proof of the arithmetical accuracy of the books of accounts. Trial Balance simply guarantees that for every debit there is an equivalent credit entry. This means that despite an agreed *Trial Balance*, it is not necessary that there are no errors in the books of accounts. For instance, if a transaction is not at all recorded in the books of accounts, the trial balance will tally or equalise, but the books of accounts cannot be termed as accurate.

Anyway, if the two sides of the trial balance do not agree, it is a sharp proof of this fact that there are certain errors in the books of accounts. Thus, errors may be there in recording, classifying and summarising the financial transactions, whether the *Trial Balance* tallies or not.

5.2 Classification of Errors:

In practice, errors can broadly be classified into the following common categories:

{*1*} Errors of Omission
{*2*} Errors of Commission
{*3*} Errors of Principle
{*4*} Compensating Errors

5.2.1 Errors of Omission:

Errors of omission are incurred in those cases when a transaction is completely omitted or deleted from the books of accounts. In other words, this type of errors happens when a transaction is not recorded in the books of original entry. For example, if a purchase of goods or fixed assets on credit from Said Ramadan has not at all been recorded in the books of accounts, such an error will be termed as an error of omission.

As, there has been neither a debit entry nor a credit entry, therefore, the two sides of the *Trial Balance* will not be at all affected because of this error. Accordingly, such errors cannot be located out very easily. Such errors come to the attention when statement of accounts are received from or sent to creditors or debtors.

5.2.2 Errors of Commission:

Errors of commission include errors resulting from wrong balancing of an account, wrong posting, wrong carry forwards, wrong totalling, and so on. For example, if a sum of E£1,000 received from Ronaldo is credited to his account as E£10,000, this is an error of commission. Similarly, if the total of the debit side of an account is carried forward from one page to another and the mistake is committed in such carry forward (for example, total of E£886 is carried forward as E£688), such an error is an error of commission. Errors of commission affect the agreement of the Trial Balance and, therefore, their location is easier.

On the other hand, some types of errors of commission do not cause a trial balance to disagree. This refers to when a transaction has been entered on both sides of the ledger and in the correct class/type of account but one of the entries is in the wrong account. For example, stationery has been entered in the purchases account in error, or cheques posted to the wrong personal account.

5.2.3 Errors of Principle:

Errors of principle are committed in those cases where a proper distinction between revenue and capital items is not made. A capital expenditure is taken as a revenue expenditure or vice-versa. Similarly, a capital receipt may have been taken as a revenue receipt. For example, a sale of old car of E£15,000 should be credited to the Car Account, but if it is credited to the Sales Account, it will be termed as an error of principle. Sale of old car is a capital receipt and if it is credited to Sales Account, it has been taken as a revenue receipt. Such errors by themselves do not affect the agreement of the Trial Balance. Therefore, they also are difficult to be located.

5.2.4 Compensating Errors:

Compensating errors, as the name indicates, are those errors which compensate each other. For instance, if a sale of E£10,000 to Mohamed is debited as only of E£1,000 to his account, while a sale of E£1,000 to Adel is debited as of E£10,000 to his account, it is a compensating errors. These errors also do not affect the agreement of the Trial Balance and, accordingly, their location is also difficult.

From the above presentation of errors, it is appeared that errors of omission, errors of principle and compensating errors by themselves alone do not affect the agreement of the Trial Balance. In case these errors get combined with errors of commission, they may affect the agreement of the Trial

Balance. For example, if a sale of old car of E£15,000 is credited to the Sales Account only as of E£1,500, the error combines in itself both an error of principle as well as error of commission. Therefore, such error will cause the trial balance to disagree.

5.3 Location of Errors:

Logically, location of an error will depend upon the type of such error. For example, location of errors of principle, errors of compensating nature and errors of omission is slightly difficult. The reason is that such errors do not affect the balance or agreement of the Trial Balance. Accordingly, the location of such errors may be considerably delayed. On the other hand, location (discovery) of errors of commission is relatively easier because they affect the agreement of the Trial Balance. Therefore, the errors can be classified into two categories from the point of view of locating them:

- Errors which do not affect the agreement of the *Trial Balance.*
- Errors which affect the agreement of the *Trial Balance.*

5.3.1 Errors which do not affect the agreement of the Trial Balance:

Errors of omission, errors of commission and errors of compensating nature by themselves don't affect the agreement of the Trial Balance. Hence, their location is a difficult process. They are usually discovered or found out when statement of accounts are received by the business or sent to the customers or during the process of internal or external audit and sometimes by chance. For instance, if a credit purchase of E£5,000 from Ramsey has not been recorded in the accounting records, the error will not affect the agreement of the Trial Balance, and therefore, at the time of finalising the accounts it may not be found out.

Nevertheless, this will be traced out when a statement of account is sent to Ramsey showing the money due to him or when a statement of account is received from Ramsey showing the money recoverable by him. When these errors are found they have to be corrected. The entries have to be made in the double entry accounts. Furthermore, an entry should be made in the journal, to explain the correction.

In the following sections, an example will be given for each type of error.

1. Error of omission

The sale of goods, E£2,000 to Sandra, has been completely omitted from the books. This error must be corrected by entering the sale in the books by the following Journal entry:

The Journal

	Dr L.E	**Cr L.E**
Sandra	2,000	
Sales		2,000
Correction of omission of Sales Invoice No.... from Sales journal		

2. Error of commission

A purchase of goods, E£1,500 from Samira, was entered in error in Samar's account. To correct this, it must be cancelled out of Samar's account, and then entered where it should be in Samira's account. The double entry will be:

The Journal

	Dr L.E	Cr L.E
Samar Samira Purchase Invoice No.... entered in wrong personal account	1,500	 1,500

3. Error of principle

The purchase of a machine, E£20,000, is debited to Purchase account instead of being debited to Machinery account. We therefore cancel the item out of the Purchase account by crediting that account. It is then entered where it should be by debiting the Machinery account.

The Journal

	Dr L.E	Cr L.E
Machinery account Purchase account Correction of error: purchase of fixed asset debited to purchases account.	20,000	 20,000

4. Compensating error

The sales account is overcast by E£4,000, as also is the wages account. The trial balance therefore still "balances". This assumes that these are the only two errors found in the books.

The Journal

	Dr L.E	Cr L.E
Sales Wages Correction of overcasts of E£4,000 each in the sales account and the wages account which compensating for each other.	4,000	 4000

5. Error of original entry

Where the original figure is incorrect, yet double entry is still observed using this incorrect figure. An example of this could be where there were sales of E£5,000 goods but an error is made in calculating the sales invoice. If it were calculated as E£3,500, and E£3,500 were credited as sales and E£3,500 were debited to the personal account of the customer Ahmed, the trial balance would still "balance".

The Journal

	Dr L.E	Cr L.E
Ahmed Sales Correction of error whereby sales were understated by E£1,500.	1,500	 1,500

6. Complete reversal of entries

Where the correct accounts are used but each item is shown on the wrong side of the account. Suppose we had paid a check to Walled for E£3,000, the double entry of which is Cr Bank E£3,000, Dr Walled E£3,000. In error it is entered as Cr Walled E£3,000, Dr Bank E£3,000. The trial balance totals will still agree. This is somewhat more difficult to adjust. First must come the amount needed to cancel the error, then comes the actual entry itself. Because of this, the correcting entry is double the actual amount first recorded.

The Journal

	Dr L.E	Cr L.E
Walled	6,000	
Bank		6,000
Payment of check E£3,000 debited to bank and credited to Walled in error.		

1.3.2 Errors which affect the agreement of the Trial Balance:

Normally, such errors are easy to be discovered because they are caught at an early stage. Once the Trial Balance does not tally, the accountant can start to find out these errors. These errors could be as a result of the following:

- Incorrect additions in any account.
- Making an entry on only one side of the accounts, a debit but no credit; a credit but no debit.
- Entering a different amount on the debit side from the amount on the credit side.

The procedures which will be followed for locating of such errors may be as below:

1- The difference of the two sides of the *Trial Balance* should be found out. The amount should then be divided by two. The two sides of the *Trial Balance* should then be checked to find out if there is an amount equal to that figure. It is possible that the amount may have been placed to a wrong side resulting in difference in the totals of the *Trial Balance*. For instance, if the total of the debit side of the *Trial Balance* is E£9,000 more than the credit side of the *Trial Balance*, E£9,000 should be divided by 2, thus giving a figure of E£4,500. The debit side should then be checked to find out if there is an amount of E£4,500 appearing on that side. If it is so, it should be seen whether the amount has been correctly put to that side or it should have gone to the credit side.

2- If the mistake is not found out by taking step No. 1, the difference should be divided by 9. If the difference is completely divisible, it can be an error of transposition of figures. For example, if the figure of 698 is written as 896, the difference is of E£198. This figure is completely divisible by 9. Thus it can be concluded that in such cases where the difference is divisible by 9, there can be a probability of this type of error.

3- In case, the difference is still not traceable, the following further possibilities should be checked:

   (a) If the difference is in a round figure, there is a possibility of wrong summing or wrong carry forwards of the totals of a subsidiary book or there is an error in balancing the accounts.

   (b) In case, the difference is not in a round figure, there is a possibility of error being committed in posting the transactions from the Journal to the Ledger.

   (c) If the difference is of a substantial amount, it will be appropriate to compare the *Trial Balance* of the current year with the *Trial Balance* of the last year and see whether there is any abnormal difference between the balances of important accounts of the two *Trial Balances.*

4- Since cash and bank accounts are not maintained usually in the Ledger, it will be also advisable to check whether the balances of the cash and bank accounts have been taken in the Trial Balance or not.
5- The schedules of sundry debtors and sundry creditors should be checked to find out whether all balances of debtors and creditors have been included in these schedules or not.
6- The totals of the subsidiary books such as the Sales Book, Purchases Book should be checked and it should be seen whether posting has been done from these two books correctly to Sales, Purchases or other accounts as the case might be.
7- If the error is still not traceable, check thoroughly the books of original entry and their posting into the Ledger and finally the balancing of different accounts.
8- An organization may keep ledgers on sectional/self balancing system. In such a case, there are three ledgers: *(1)* Sales Ledger containing personal accounts of all trade debtors, *(2)* Purchases Ledger containing personal accounts of all trade creditors, and *(3)* General Ledger containing all other real, nominal and personal accounts except those of trade debtors and trade creditors. Nevertheless, there will be two total accounts in this ledger: *(a)* Total Debtors Account, and *(b)* Total Creditors Account. The balance of the Total Debtors Account should agree with the total of the Schedule of Debtors as prepared from the Sales Ledger. Similarly, the balance of the Total Creditors Account should agree with the total of the Schedule of Creditors as prepared from the Purchases Ledger. To this point, in case the

balance of Total Debtors Account does not tally with the total of Schedule of Debtors, the personal accounts in the Sales Ledger should be checked and the other Ledger may not be touched. Regarding the Total Creditors Account and the Schedule of Total Creditors, same is true.

5.4 Suspense Accounts and Errors:

The accountant should take the above mentioned steps one after the other to locate the difference in the totals of the Trial Balance. However, many errors will mean that Trial Balance totals will not be equal. In case the accountant is not in a position to determine the difference and he/she is in a hurry to close the books of accounts, he/she may transfer the difference to an account known as "Suspense Account". Accordingly, Suspense Account is an Account to which the difference in the trial balance has been put temporarily.

When the errors are located in the beginning or during the operations of the following year, appropriate accounting entries are done and the Suspense Account is closed. On the other hand, it should be considered that Suspense account should be opened by the accountant only when failing to find out the errors in spite of doing the best efforts.

Note: you will often notice the use of the expression 'to cast', which means 'to add up'. ***Overcastting*** means incorrectly adding up a column of figures to give an answer which is greater than it should be. ***Undercasting*** means incorrectly adding up a column of figures to give an answer which is less than it should be.

It should be tried very hard to find errors immediately when the trial balance totals are not equal. When they cannot be found, the trial balance totals should be made to agree with each other by inserting the amount of the difference between the two sides in a *suspense account*. This could be shown as below, where there is a E£500 difference.

Trial Balance as on 31 December 2012

	Dr L.E	Cr L.E
Totals after all the accounts have been listed	200,000	199,500
Suspense account		500

To make the two totals agree, a figure of E£500 for the suspense account has been shown on the credit side. A suspense account is opened and the E£500 difference is also shown there on the credit side.

Suspense Account

		Difference per Trial Balance	500

5.4.1 Suspense Account and the Balance Sheet

If the errors are not located before the final accounts are prepared, the suspense account balance will be included in the balance sheet. Where the balance is a credit balance, it should be included on the capital and liabilities side of the balance sheet. When the balance is a debit balance it should be shown on the assets side of the balance sheet.

5.4.2 Correction of Errors

When the errors are found they must be corrected, using double entry. Each correction must also have an entry in the journal describing it.

Examples relating to one error only:

Example 1: Assume that the error of E£500 as shown above is found in the following year on 31 March 2013. The error was that the sales account was undercast by E£500. The action taken to correct this is:

Debit suspense account to close it: E£500.

Credit sales account to show item where it should have been: E£500.

The accounts now appear as below.

Suspense Account

2013	E£	2012	E£
Mar 31 Sales	500	Dec 31 Difference per trial balance	500
	===		===

Sales Account

		Mar 31 Suspense	500

This can be presented in journal entry form as:

The Journal

	Dr L.E	**Cr L.E**
31 Mar Suspense	500	
Sales		500
Correction of undercast of sales by E£500 in last year's accounts.		

Example 2 The trial balance on 31 December 2013 had a difference of E£1,000. It was a shortage on the debit side.

A suspense account is opened, the difference of E£1,000 is entered on the debit side. On May 2014 the error was found. We had made a payment of E£1,000 to Mahmoud to close his account. It was correctly entered in the cash book, but it was not entered in Mahmoud's account.

First of all, ***(a)*** the account of Mahmoud is E£1,000, as it should have been in 2013. Second ***(b)*** the suspense account is credited with E£1,000 so that the account can be closed.

Suspense Account

2013	E£	2014	E£
May 31 Difference per Trial balance	1,000	May 31 Mahmud	1,000
	===		===

Mahmoud Account

2014		E£	2014		E£
May 31	Suspense	1,000	Jan 1	Balance b/d	1,000

This can be shown in journal entry form as:

The Journal

	Dr L.E	**Cr L.E**
31 Mar Mahmoud	1,000	
Suspense		1,000
Correction of non-entry of payment last year in Mahmoud's account.		

Examples relating to more than one error:

Example 3 In this example, the suspense account was caused by more than one error. The trial balance at 31 December 2012 showed a difference of E£7,700, being a shortage on the debit side. A suspense account is opened, and the difference of E£7,700 is entered on the debit side of the account.

On 31 March 2013 all the errors from the previous year were found.

1 A check of E£15,000 paid to Kamal had been correctly entered in the cash book, but had not been entered in Kamal's account.

2 The purchases account had been undercast by E£2,000.

3 A check of E£9,300 received from Sabry had been correctly entered in the cash book, but had not been entered in Sabry's account.

These three errors resulted in a net error of E£7,700, shown by a debit of E£7,700 on the debit side of the suspense account. These are corrected as follows:

(a) Make correcting entries in accounts for 1, 2 and 3.

(b) Record double entry for these items in the suspense account.

Kamal Account

2013 E£				
Marc	31	Suspense	1	
15,000				

Purchases Account

2013 E£				
March	31	Suspense	2	
2,000				

Sabry Account

	2013	E£
	Mar 31 Suspense 3	9,300

Suspense Account

2013				E£	2013		E£
Jan	1	Balance	b/d	7,700	Mar 31	Kamal 1	15,000
Mar	31	Sabry	3	9,300	Mar 31	Purchases 2	2,000
				17,000			17,000
				=====			=====

These can be shown in journal entry form as:

The Journal

	Dr L.E	**Cr L.E**
31 Mar Kamal	15,000	
Suspense		15,000
Check paid omitted from Kamal's account.		
Mar 31 Purchase	2000	
Suspense		2,000
Undercasting of purchases by E£2,000 in last year's accounts		
Mar 31 Suspense	9,300	
Sabry		9,300
Check received omitted from Sabry's account.		

Only those errors which make the trial balance totals different from each other have to be corrected via the suspense account.

Example 4: A sale of E£500 to Karim was entered in the sales book as of E£5,000, from where he was debited by E£50,000. This is a multiple type of error. It affects more than two accounts. The accounts involved are *(a)* Karim, *(b)* Sales Account, and *(c)* Suspense Account.

The total of the Sales Book is posted to the Sales Account. The sale has been recorded as of E£5,000 in the sales boo; from where the posting must have been done to the sales account. Thus, the sales Account has been credited by E£5,000 instead of E£500. It has been credited more by E£4,500. In order to rectify the error, it should, therefore, be debited by E£4,500. The account of Karim should have been debited by E£500 only but it has been debited by E£50,000. It has, therefore, been debited more by E£49,500. In order to rectify the matters, it should be credited by E£49,500. These two errors must have created difference in the trial balance which should have gone to the Suspense Account.

Sales Account comes on the credit side of the trial balance. It has been credited by E£4,500 more and, therefore, the credit side of the trial balance will be more by this amount on account of this error. On the other hand, Karim is a debtor, his account has been excess debited by E£49,500. The debit side of the trial balance should, therefore, be more by this amount.

The net effect is that the debit side of the trial balance must have been more by E£45,000 which must have been put to the Suspense Account by giving credit to it. The rectifying entry will therefore be as follows:

The Journal

	Dr L.E	Cr L.E
Suspense a/c	45,000	
Sales a/c	4,500	
Karim a/c		49,500

Thus, on the basis of the above examples, the following rules can be formed out:

a. Find out the accounts affected by the error.
b. Find out what should have been done and what has been done.
c. Credit or debit the respective account in order to set the matters right.
d. Put the differences to Suspense account.

Example 5 A sale of E£10,000 to Sarah was entered in the purchases book from where the account of Sarah was debited by E£1,000.

The preceding error affects the following accounts: *(a)* Sales Account, *(b)*Purchases Account, and *(c)* Account of Sarah.

Sales account should have been credited by a sum of E£10,000. It has not been done since it has been recorded in the Purchases Book. Accordingly, sales account should be credited- what should have been done.

Purchases account has been debited since the transaction has been entered in the purchases book from where it must have been posted to the purchases account. It has been debited by a sum of E£10,000 unnecessarily. It should, therefore, be credited to remedy what has been done wrongly.

Account of Sarah should have been debited by E£10,000. In the normal course, since the transaction has been recorded in the purchase book, his account should have been credited.

However, the accountant has debited his account by E£1,000 instead of E£10,000. His account should therefore be debited by E£9,000 more in order to give full debit to his account.

The difference, if any, should be transferred to the Suspense Account as given in rule *d.* presented above. The rectifying journal entry will be as follows:

The Journal

	Dr L.E	Cr L.E
Suspense a/c	11,000	
Sarah a/c	9,000	
Purchase a/c		10,000
Sales		10,000

Comprehensive illustration 1

The trial balance of ElMasry on 31st December 2012 showed a difference of E£5,800 (excess debit). It was put to a suspense account and the books were closed. On going through the books in January 2013, following errors were located. You are required to pass appropriate correcting journal entries and prepare the Suspense Account.

1. E£5,400 received from Maher was posted to the debit side of his account.

2. E£1,000 being Purchases Returns was posted to the debit side of Purchases Account.

3. E£2,000 discount received, entered in the cash book was not posted to the ledger.

4. E£5,740 paid for repairs to motor-car was debited to the motor-car account as E£1,740.

5. A sale of E£3,500 to Suzy was entered in the Sales Book as of E£5,300.

6. While carrying forward total of one page in Sami's Account, the amount of E£2,500 was written on the credit side instead of debit side.
7. The purchase of machinery on 1st January 2012 for E£60,000 was entered in the Purchase Account.

The Journal

	Dr L.E	**Cr L.E**
Suspense a/c	10,800	
Maher a/c		10,800
Suspense	2,000	
Purchases		1,000
Purchase Returns		1,000
Suspense a/c	2,000	
Discount Received		2,000
Repairs a/c	5,740	
Motor Car		1,740
Suspense a/c		4,000
Sales a/c	1,800	
Suzy a/c		1,800
Sami a/c	5,000	
Suspense a/c		5,000
Machinery a/c	60,000	
Purchases a/c		60,000

Dr. **Suspense Account** **Cr.**

	E£		E£
Maher A/c	10,800	Balance b/d	5,800
Purchases A/c	1,000	Repairs A/c	4,000
Purchases Returns	1,000	Sami A/c	5,000
Discount A/c	2,000		
	14,800		14,800

Note: While passing the rectifying journal entries, you should put the difference to the Suspense Account, in case it has been opened and no other account is available.

Comprehensive illustration 2

The Trial Balance of KLM did not agree. A Suspense Account was opened with the amount of the difference. The following errors were discovered on scrutiny.

1- The addition of the Analysis Column on the Tabular Purchase Journal posted to Goods Purchased for Resale Account was found to be short by E£1,500 although the addition of the total column was correct.

2- A dishonoured bills receivable for E£4,000 returned to the firm by bank had been credited to Bank Account for collection of bills and debited to Bills Receivable Account. A check was later received from the customer for E£4,000 and was dully paid into the firm's bank account.

3- An amount of E£4,500 treated as paid in advance on account of Insurance in the previous year was not brought forward.

4- Sales on approval amounting to E£20,000 were included in the Sales Account. Half of these were returned but no entries were passed in respect of these. However, the returned goods have included in the closing stock at their cost price of E£5,000.

5- Of the total amount of E£383,560 shown as sundry debtors, E£12,600 represent credits given to customers when the payments against sales invoices were received. However, these invoices themselves were not entered in the books. A discount of 10% is allowed on the selling price in all such invoices.

Instructions

Pass rectifying entries making use of the Suspense Account, wherever necessary.

The Journal

	Dr L.E	**Cr L.E**
Purchases for Resale A/c....	1,500	
Suspense A/		1,500
Customer's A/c....	4,000	
Bills Receivable A/c....		4,000
Insurance A/c....	4,500	
Suspense A/c....		4,500
Sales A/c....	10,000	
Customer's A/c		10,000
Discount A/c....	1,400	
Customer's A/c....	12,600	
Sales		14,000

* Payment being equal to 90%, the gross sale is E£14,000 (12,600 × 100/90).

5.5 The Effect of Errors on Profits

Some of the errors will have meant that original profits calculated will be wrong. Other errors will have no effect upon profits. Errors committed in a year may affect the profit of that year. This happens when the error relates to such accounts which are taken into account while computing gross or net profit of the business.

In other words, if the errors relate to such accounts which find their place in the Trading Account or the Profit and Loss Account, the errors will affect the profit of the business. For instance, errors involving Purchases Account, Sales Account, Expense Account, and Income Account will all affect the profit of the business.

In case on account of errors such accounts are either not debited or unnecessarily credited, this will result in increase in profit of the business. For example, if repairs of machinery amounting to E£5,000 has been debited to Machinery Account by mistake, the net profit will increase by E£5,000.

Similarly, if on account of such errors such accounts are unnecessarily debited or are not unnecessarily credited, the errors will decrease the net profit of the firm. For instance, if a sale of E£1,000 is recorded in the books as only a sale of E£100, it will result in reducing the net profit of the business by E£900. The following illustration will clear and explain the matters.

Comprehensive illustration 3

Using the information presented in illustration 1, compute the effects:

(1) On profit for the year 2012 of the errors committed, and

(2) On profit of 2013 of the errors being corrected.

Solution

Effect of Errors on Profit of 2012

	Increase (+) E£	Decrease (−) E£
1- No effect on profit since no account relates to Trading or Profit & Loss Account.	-	-
2- The net profit will decrease by E£2,000 because both the Purchases and Sales accounts relate to Trading Account.		2,000
3- The net profit will decrease by E£2,000, since the account not credited relates to Profit & Loss Account.	5,740	2,000
4- the net profit will increase by E£5,740, since the account not debited relates to Profit & Loss Account.	1,800	
5- The net profit will increase by E£1,800, since excess credit has been given to an account which relates to Trading Account.	-	-
6- No effect on profit since no account relates to Trading or Profit & Loss Account.		60,000
7- The net profit will decrease by E£60,000; since the account given unnecessarily debit relates to Trading Account.	7,540	64,000

Accordingly, on the whole, the net profit of the business for the year would decrease by E£56,460 (64,000-7,540).

Effect of Errors on Profit of 2013

	Increase (+) E£	Decrease (−) E£
1- No effect on profit since no account relates to Trading or Profit & Loss Account.	-	-
2- The net profit would increase by E£2,000 since both the accounts credited relate to Trading Account.	2,000	
3- The net profit will increase by E£2,000, since the account credited relates to Profit & Loss Account.	2,000	
4- The net profit will decrease by E£5,740, since the account debited relates to Profit & Loss Account.		5,740
5- The net profit will decrease by E£1,800, since the account debited relates to Trading Account.		1,800
6- No effect on profit since neither account relates to Trading or Profit & Loss Account.	-	-
7- The net profit will increase by E£60,000; since the account credited relates to Trading Account.	60,000	-

	64,000	7,540

Accordingly, on account of correction of errors, the net profit of 2013 will increase by E£56,460.

Important note:

According to the preceding illustration, it is clear that if the net profit has decreased because of committing of errors, it will increase because of correcting those errors or *vice-versa*. Thus, the effect on net profit can be found out simply by preparing one statement either showing the effect of errors on net profit or showing the effect of correction of errors on net profit. If one effect is found out, the other will be just reverse of it.

Questions and Practical Problems:

1. State whether each of the following statements is '**True'** or '**False'**.

a. Error of omission does not affect the agreement of the Trial Balance.

b. Errors of Principle affect the agreement of the Trial Balance.

c. If the two sides of the Trial Balance tally, the books of accounts can be taken as absolutely accurate.

d. Errors of commission are committed in those cases where proper distinction between revenue and capital items is not made.

e. All errors affect the agreement of the Trial Balance.

f. In case the difference of the two sides of the Trial Balance is divisible by 9, it can be presumed that the amount has been put on the wrong side.

2. Choose the best answer for each of the following:

(1) Sales to Ramey E£3,360 posted to his account as E£3,630 would affect:
- a- Sales Account.
- b- Ramey's Account.
- c- Cash Account.

(2) Sales to Ramey of E£5,000 not recorded in the books would affect:
- a- Sales Account.
- b- Ramey's Account.
- c- Sales Account and Ramey's Account.

(3) Carriage charges paid for a new plant purchased if debited to carriage account would affect:

a- Plant Account.
b- Carriage Account.
c- Plant and Carriage Account.

(4) A sale of E£1,000 to X recorded in the Purchase Book would affect:

a- Sales Account.
b- Purchases Account
c- Sales Account, Purchases account, and X's Account.

(5) A purchases returns of E£2,000 to *A* if entered in the Sales Book would affect:

a- *A'*s Account.
b- Purchases Returns Account.
c- Sales Account.
d- Purchases Returns Account and Sales Account.

(6) An amount of E£2,000 received from *X* credited to *Y* would affect:

a- Accounts of *X* and *Y*.
b- Cash Account.
c- *Y'*s Account.

(7) A sum of E£2,000 written off as bad debt now received credited to the account of the debtor would:

a- Increase the net profit by E£2,000.
b- Decrease the profit by E£2,000.
c- No effect on profit.

(8) Goods purchased from *A* for E£20,000 passed through the Sales Book. The correction of error will result in:

a- Increase of gross profit.
b- Decrease of gross profit.
c- No effect on gross profit.

3. Write out the journal entries to correct the following errors using a Suspense Account:

(1) The total of "Discount Allowed" from the Cash Book for the month of December 2012 amounting to E£3,500 was not posted.

(2) An amount of E£1,750 entered in the Sales Returns Book has been posted to the debit of Mr. Ronaldo who returned the goods.

(3) Bad debts aggregating E£2,500 were written off during the year in the sales ledger but were not adjusted in the general ledger.

(4) Goods of the value of E£5,000 returned by Mr. Sameh were entered in the Sales Day Book and posted therefrom to the credit of his account.

(5) A sales of E£8,000 made to Mr. Peter was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Armando as E£800.

[Answer Key: Opening Balance of Suspense Account (Dr E£17,200)].

4. In 2012, Mr. Baraka found that his books for the year 2011 contained some errors in spite of an agreed trial balance. The errors were.

(1) An invoice for E£500 for goods purchased from Mr. Balkawi was entered in Sales Returns Book; in the ledger, this was debited to the account of Mr. Balkawi.

(2) Goods bought on credit from Mr. Kishk for E£1,500 were entered in the Sales Book as E£1,050. Mr. Kishk's account was credited with this amount of E£1,050.

(3) The Sales Book for the month of April, 2011 was overcast by E£1,500.
(4) A sale of E£2,570 to Mr. Duff was entered in the Sales Book as E£5,270. Mr. Duff was debited with E£7,520.
(5) E£790 paid for freight on machinery was debited to Freight Account as E£970.

Instructions

Give journal entries to correct the errors using a Suspense Account where is necessary.
[Answer Key: Suspense Account shows a closing credit balance of E£170, showing that some errors are still to be traced].

5. Pass journal entries to correct the following errors:
(1) A check of E£7,500 received for loss of stock by fire had been deposited in the proprietor's Private Bank Account.
(2) An item of purchase of E£1,510 was entered in the Purchases Book as E£150 and posted to the Supplier's Account as E£510.
(3) A sale return of E£500 was not entered in the financial account although it was duly taken in the stock book.
(4) An amount of E£3,000 was received in full settlement from a customer after he was allowed a discount of E£500, but while writing the books, the amount received was entered in the Discount Column and the Discount Allowed was entered in the Cash Column.
(5) Bill Receivable from Mr. ***A*** of E£10,000, was posted the credit of Bill Payable Account and also Credited to the account of Mr. ***A.***

[Answer Key: Opening balance in Suspense Account E£20,360 (Dr)].

6. State which of the following errors will affect the agreement of the Trial Balance and which will not. Give correcting journal entries wherever relevant assuming the difference in Trial Balance has been placed to Suspense Account.

(1) Purchase of a second-hand Motor Car for E£150,000 has been debited to Motor car Maintenance Account.

(2) A sale of E£50,000 to Sharkawi has been wrongly entered in the Sales Day Book as E£5,000.

(3) An entry in the Purchases Returns Book of E£20,000 has been omitted to be posted in the Account of Sheri Ramsey, the supplier.

(4) An amount of E£20,000 received from Sheriff has been posted to the credit of Shereem as E£2,000.

(5) The total of the Sales Day Book for the month of July, E£1,500,000 has been omitted to be posted in the ledger.

[Answer: Errors (3), (4), and (5) will affect the agreement of the Trial Balance.

7. An accountant could not tally the Trial Balance. The difference was temporarily placed to Suspense Account for preparing the final accounts. The following errors were later discovered.

(a) The Sales Book was undercast by E£500.

(b) Entertainment expenses of E£950, although entered in the Cash Book were omitted to be posted in the Ledger.

(c) Discount column of the receipt side of the Cash Book was wrongly added as E£1,400 instead of E£1,200.

(d) Commission E£250 paid, was posted twice, once to discount account and once to commission account.

(e) A sale of E£1,390 to Radwan though correctly entered in the sales book, was posted wrongly to his account as E£1,930.

(f) A purchase from Nor Alden of E£920 although correctly entered in purchase book, was wrongly debited to his personal account.

Instructions

(1) Pass the necessary rectifying journal entries.

(2) Prepare Suspense Account.

(3) State the effect of each of the rectification on the profit. What would be the correct profit if the profit originally arrived at was E£100,000?

[Answer Key: Suspense Account, opening balance E£2,380 (Cr). Correct profit E£100,000].

8. Messrs Modern Contracting was unable to agree the Trial Balance on 30th of June, 2012 and have prepared a Suspense account for the difference. Later the following errors were discovered and rectified and the Suspense Account was balanced.

(a) The addition of the Sundry Purchases column in the Tabular Purchases Journal was short by E£1,500 and other totals were in order.

(b) A Bill of Exchange (received from Gabber) for E£20,000 had been returned by the Bank as dishonored and had been credited to the Bank and debited to Bills Receivable Account.

(c) Goods of the value of E£1,050 returned by the customer, Tohamy, had been posted to the debit of Tohamy and also to the Sales Returns.

(d) Sundry items of Furniture sold for E£30,000 had been entered in the Sales Day Book, the total of which had been posted to the Sales Account.

(e) An amount of E£6,000 due from Fuzzy, a customer, had been omitted from the schedule of Sundry Debtors.

(f) Discounts amounting to E£300 allowed to a customer had been duly posted in his account, but not posted to Discount Account.

(g) Insurance premium of E£4,500 paid on 30th of June, 2011 for the year ended 30th June 2012 had not been brought forward.

Instructions

1- Pass Journal Entries to correct the above mistakes.

2- Draw up the Suspense Account after correcting the above mistakes and explain how the above errors affect the book profits for the year ended 30th June, 2012.

[Answer Key: Suspense Account Opening Balance (Dr) E£10,200; Profit for 2011/2012 overstated by E£36,300].

9. Show the journal entries necessary to correct the following errors:

(a) A sale of goods of E£6,780 to Mr. Haron had been entered in Mr. Hamon's account.

(b) The purchase of a machine on credit from Mr. Labeb for E£43,900 had been completely omitted from our books.

(c) The purchase of a motor van E£38,000 had been entered in error in the Motor Expenses account.

(d) A sale of E£2,210 to Mr. Fuzzy had been entered in the books, both debit and credit, as E£2,120.
(e) Commission received E£2,570 had been entered in error in the Sales account.
(f) A receipt of cash from Mr. Tewfik E£770 had been entered on the credit side of the cash book and the debit side of Mr. Tewfik's account.
(g) A purchase of goods E£1,890 had been entered in error on the debit side of the Drawing account.
(h) Discounts Allowed E£3,660 had been entered in error on the debit side of the Discounts Received account.

10. Show the journal entries needed to correct the following errors:

(a) Purchases E£6,990 on credit from Mr. Kamal had been entered in Mr. Kamel's account.
(b) A check of E£1,890 paid for advertisements had been entered in the cash column of the cash book instead of in the bank column.
(c) Sale of goods E£4,430 on credit to Mr. Gordon had been entered in error in Mr. Gorman's account.
(d) Purchase of goods on credit from Mrs. Rose E£890 entered in two places in error as E£990.
(e) Cash paid to Mr. Mandau E£890 entered on the debit side of the cash book and the credit side of Mr. Mandau's account.
(f) A sale of fittings E£5,000 had been entered in the Sales account.
(g) Cash withdrawn from bank E£1,000, had been entered in the cash column on the credit side of the cash book, and in the bank column on the debit side.

(h) Purchase of goods E£4,280 has been entered in error in the Fittings Account.

11. After preparing its draft final accounts for the year ended December 31st, 2012, and its draft balance sheet as at 31st December 2012, a business discovered that the stock lists used to compute the value of stock as at 31st December 2012 contained the following entry:

Stock item	***Number***	***Cost per unit***	***Total Cost***
M 2013	**100**	**E£13.90**	**E£13,900**

Instructions

(a) What is wrong with this particular entry?

(b) What would the effect of the error have been on

(1) The value of stock as at 31st December 2012?

(2) The cost of goods sold for the year ended 31st December 2012?

(3) The net profit for the year ended 31st December 2012?

(4) The total for Current Assets as at 31st December 2012/

(5) The Owner's Capital as at 31st December 2012?

12. Give the journal entries needed to record the corrections of the following.

(a) Extra capital of E£100,000 paid into the bank has been credited to Sales account.

(b) Goods taken for own use E£7,000 had been debited to General Expenses account.

(c) Private insurance E£890 had been debited to Insurance account.

(d) A purchase of goods from Tamer E£8,570 had been entered in the books as E£5,870.

(e) Cash banked E£3,900 had been credited to the bank column and debited to the cash column in the cash book.

(f) Cash drawing of E£4,000 had been credited to the bank column of the cash book.

(g) Returns inwards E£1,680 from Mahmud had been entered in error in Masoud's account.

(h) A sale of a motor van E£10,000 has been credited to Motor Expenses account.

13. Journal entries to rectify the following are required.

(a) Commission received E£8,800 have been credited to Rent Received Account.

(b) Bank charges E£770 have been debited to rent account.

(c) Completely omitted from the books is a payment of Sundry Expenses by check E£230.

(d) A Purchase of fixtures of E£4,780 has been entered in Purchases account.

(e) Returns inwards E£8,330 have been entered on the debit side of the Returns outwards account.

(f) A loan from Sami E£50,000 has been entered on the credit side of the Capital account.

(g) Loan interest of E£5,000 has been debited to Premises account.

(h) Goods taken for own use E£2,500 have been debited to purchases account and credited to Drawings.

14. Tohamy Sami, a retail trader, has very limited accounting knowledge. In the absence of his accounting technician, he extracted the following trial balance as at 31st December 2012 from his business's accounting records:

	Dr E£	CrE£
Stock in trade at 1st January		107,000
Stock in trade at 31st December	78,000	
Discount allowed		3,100
Discount received	4,500	
Provision for doubtful debts	9,600	
Purchases	940,000	
Purchases returns	14,000	
Sales		1,321,000
Sales returns	11,000	
Property: at cost	700,000	
Provision for depreciation	35,000	
Motor vehicle: at cost	150,000	
Provision for depreciation	45,000	
Capital-Tohamy Sami		846,000
Balance at bank	71,000	
Trade debtors		113,000
Trade creditors	76,000	
Establishment and administrative expenditure	166,000	
Drawings	90,000	
E£	2,390,100	2,390,100

Instruction

(a) Prepare a corrected trial balance as at 31st December 2012.

After the preparation of the above trial balance, but before the completion of the final accounts for the year ended 31st December 2012, the following discoveries were made:

(1) The correct valuation of the stock in trade at 1st January 2012 is E£120,000; apparently some stock lists had been mislaid.

(2) A credit note for E£2,100 has now been received from Hashem Limited; this relates to goods returned in June 2012 by Tohamy Sami. However, up to now Hashem Limited had not accepted that the goods were not of merchantable quality and Tohamy Sami's accounting records did not record the return of the goods.

(3) Trade sample goods were sent to Jamal Gabriel in August 2012. These were free samples, but were charged wrongly at E£10,000 to Jamal Gabriel. A credit note is now being prepared to rectify the error.

(4) In September 2012, Tohamy Sami painted the inside walls of his stockroom using materials costing E£1,500 which were included in the purchases figure in the above trial balance. Tohamy Sami estimates that he saved E£8,000 by doing all the painting himself.

(b) Prepare the journal entries necessary to amend the accounts for the above discoveries.

15. Your book-keeper extracted a trial balance on 31st December 2012 which failed to agree by E£3,300, a shortage on the credit side of the trial balance. A suspense account was opened for the difference.

In January 2013 the following errors made in 2012 were found:

(1) Sales day book had been undercast by E£1,000.

(2) Sales of E£2,500 to Caribou had been debited in error to Carina's account.
(3) Rent account had been undercast by E£700.
(4) Discounts Received account had been undercast by E£3,000.
(5) The sale of motor vehicle at book value had been credited in error to Sales account E£3,600.

Instructions

You are required to:

(a) Show the journal entries necessary to correct the errors.
(b) Draw up the suspense account after the errors described have been corrected.
(c) If the net profit had previously been calculated at E£79,000 for the year ended 31st December 2012, show the calculations of the corrected net profit.

16. You have extracted a trial balance and drawn up accounts for the year ended 31st December 2012. There was a shortage of E£2,920 on the credit side of the trial balance, a suspense account being opened for that amount.

During 2013 the following errors made in 2012 were located:

(1) E£550 received from sales of old office equipment has been entered in the sales account.
(2) Purchases day book had been overcast by E£600.
(3) A private purchase of E£1,150 had been included in the business purchases.
(4) Bank charges E£380 entered in the cash book have not been posted to the bank charges account.

(5) A sale of goods to Bakery E£6,900 was correctly entered in the sales book but entered in the personal account as E£9,600.

Instructions

(a) Show the requisite journal entries to correct the errors.

(b) Write up the suspense account showing the correction of the errors.

(c) The net profit originally calculated for 2012 was E£113,700. Show your calculation of the correct figure.

17. Study the following and answer the questions below.

The trial balance of Mansur Harpy as at 31st December 2012 showed a difference which was posted to a suspense account. Draft final accounts for the year ended 31st December 2012 were prepared showing a net profit of E£472,400. The following errors were subsequently discovered:

- Sales of E£4,500 to Taha had been had been debited to Taher.
- A payment of E£2,750 for telephone charges had been entered on the debit side of the Telephone account as E£3,750.
- The sales journal had been undercast by E£20,000.
- Repairs to a machine, amounting to E£3,900 had been charged to Machinery account.
- A check for E£15,000, being rent received from Atlas Ltd., had only been entered in the cash book.
- Purchases from PB, amounting to E£7,650 had been received on 31st December 2012 and included in the closing stock at that date, but the invoice had not been entered in the purchase journal.

Instructions

(a) (i) Give the journal entries necessary to correct the above errors.

(ii) Show the effect of each of these adjustments on the net profit in the draft accounts and the correct profit for the year ended 31st December 2012.

(b) (i) State briefly the purpose of the journal, giving a suitable example of its use.

(ii) State why it is necessary to distinguish between capital and revenue expenditure.

18. Mostafa Ali is the owner of a retail business. He has employed an inexperienced bookkeeper to maintain his accounting records.

(a) On 31st December 2012, the end of the business's accounting year, the bookkeeper extracted the following trial balance from the business's records:

Trial Balance at 31st December 2012	*Dr*	*Cr*
	E£	E£
Fixed assets at cost	183,000	
Provision for depreciation of fixed assets, 1 January 2012	28,000	
Stocks		
1 January 2012	37,000	
31 December 2012		29,600
Trade debtors		18,250
Trade creditors	8,640	
Balance at bank (overdrawn)	3,820	
Capital		268,600
Drawings	77,400	

Sales	260,800	
Purchases		183,270
Running expenses	69,040	
Provision for doubtful debts	900	
Suspense	_______	168,880
	E£668,600	668,600
	======	======

Required:

1 A corrected version of Mostafa Ali trial balance dated 31st December 2012 based on the above information, but with an amended figure for the suspense account.

(b) The following errors were found in the accounting system after a corrected version of the trial balance above was prepared.

(i) The total of the sales day book for September 2012 had been overstated by E£1,200.

(ii) In October 2012 some new office equipment had been purchased for E£3,600; this had been debited to the purchases account.

(iii) A payment by check to a creditor, E£2,160, had been entered in the books as E£2,610.

(iv) A credit note for E£370 sent to a customer had been overlooked (neglected).

(v) The owner had withdrawn a check for E£800 for private use in July 2012; both the bank and drawing account had been credited with this amount.

Required:

In the books of Mostafa Ali

2 Journal entries to correct each of these errors.

3 The suspense account. (Start with the amount in the corrected trial balance given in answer to Required 1

above, and include any entries arising from the correction of the errors.)

4 An explanation of the term ‘error of commission’. (Give an example of such an error to illustrate your answer.)

19. The trial balance as at 30th April 2013 of Food Products Limited was balanced by the inclusion of the following debit balance:

Difference on trial balance suspense account E£25,130.

Subsequent investigations revealed the following errors:

(1) Discounts received of E£3,240 in January 2013 have been posted to the debit of the discounts allowed account.

(2) Wages of E£29,630 paid in February 2013 have not been posted from the cash book.

(3) A remittance of E£9,400 received from Kamal Mishaki in November 2012 has been posted to the credit of Bilal Mishwadi Limited.

(4) In December 2012, the company took advantage of an opportunity to purchase a large quantity of stationery at a bargain price of E£20,000. No adjustments have been made in the accounts for the fact that three quarters, in value, of this stationery was in stock on 30th April 2013.

(5) A payment of E£3,410 to Jody Walhan in January 2013 has been posted in the personal account as E£1,430.

(6) A remittance of E£30,000 received from Doha Nor, a credit customer, in April 2013 has been credited to sales.

The draft accounts for the year ended 30th April 2013 of Food Products Limited show a net profit E£247,600.

Food Products Limited has very few personal accounts and therefore does not maintain either a purchase ledger control account or a sales ledger control account.

Instructions

(a) Prepare the difference on trial balance suspense account showing, where appropriate, the entries necessary to correct the accounting errors.

(b) Prepare a computation of the corrected net profit for the year ended 30th April 2013 following corrections for the above accounting errors.

(c) Outline the principal uses of trial balance.

20. Children Knitwear Ltd is an old-fashioned firm with a handwritten set of books. A trial balance is extracted at the end of each month, and a profit and loss account and balance sheet are computed. This month however the trial balance will not balance, the credits exceeding debits by E£15,360.

You are asked to help and after inspection of the ledgers discover the following errors.

(i) A balance of E£870 on a debtors account has been omitted from the schedule of debtors, the total of which was entered as debtors in the trial balance.

(ii) A small piece of machinery purchased for E£12,000 had been written off to repairs.

(iii) The receipts side of the cash book had been undercast by E£7,200.

(iv) The total of one page of the sales day book had been carried forward as E£81,540, whereas the correct amount was E£85,140.

(v) A credit note for E£1,790 received from a supplier had been posted to the wrong side of his account.

(vi) An electricity bill in the sum of E£1,520, not yet accrued for, is discovered in a filing tray.

(vii) Mr. Sameh whose past debts to the firm had been the subject of provision, at last paid E£7,310 to clear his account. His personal account has been credited but the check has not yet passed through the cash book.

Required:

(a) Write up the suspense account to clear the difference, and

(b) State the effect on the accounts of correcting each error.

21. On going through the trial balance of Green Business, you find that the debit is in excess by E£1,500. This was credited to *Suspense Account*. On a close scrutiny of the books, the following mistakes were located:

(1) The total of debit side of an expense account has been cast in excess by E£500

(2) The Sales Account has been totalled short by E£1,000.

(3) One item of purchase of E£250 has been posted from the day book to ledger as E£2,500.

(4) The sale return of E£1,000 from a party has not been posted to that account, though the party's account has been credited.

(5) A check of E£5,000 issued to the Suppliers' Account (shown under Sundry Creditors) towards his dues has been wrongly debited to the purchases account.

(6) A credit sale of E£500 has been credited to the Sales and also to the Sundry Debtors' Account.

Required:

1- Pass necessary journal entries for correcting the above;

2 - Prepare the Suspense Account as it would appear in the ledger; and

3 - Show how they affect the Profits.

Exercises

The first question:

Determine whether each of the following statements is true(T) or folse (F):

1- The accounting practice only by professional and very specialized accountants.

2- 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.

3- Accounting often is called the "language of system ".

4- accounting is considered as a service activity that is only concerned with recording, classifying and summarizing the economic transactions.

5- accounting is being considered important tool for providing appropriate information To Whom It May Concern.

6- Financial Accounting: is usually interested in providing Special purpose information.

7- Management accounting provides necessary information to the enterprise's management for discharging its functions.

8- Classification of Business organizations depends on the nature of organization operations only.

9- A sole proprietorship is an unincorporated business owned by more person.

10- A sole proprietorships are considered the least common form of business organization because easy to form.

11- A Partnerships are the least common form of business organization, probably because they often result in to many bosses.

12- partnership actually includes three distinct the three types of organizations.

13- The general partner has unlimited personal liability for the debts of the business.

14- A limited liability partnership each partner has unlimited personal liability for her own professional activities, but not for the actions of other partners.

15- A corporation is a legal entity, having an existence separate and distinct from that of its owners.

The second Questions:

Select the correct answer for each of the following question:

1- limited partners their financial risk was:

A- Equal to their capital.

B- Less than their capital.

C- Greater than their capital.

2- A limited liability partnership each partner has unlimited personal liability for:

A- professional activities performed

B- the actions of other partners

C- actions of each partners

3- Sole Proprietorship Legal status is:

A- Separate legal entity.

B- Not a separate legal entity.

C- None of the above.

4- Corporation Legal status is:

A- Separate legal entity.

B- Not a separate legal entity.

C- None of the above.

5- Owners are Personal liability for business debts in:

A- General Partnershs.

B- Corporations.

C- Limited Partnerships.

6- Corporations impose the Taxes on:

A- Income of the owner.

B- Income of the partners.

C- Earnings of the business.

7- The Persons with managerial authority in General Partnershs:

A- Owner

B- Partners

C- Professional managers

8- The basic function of accounting is:

A- Planning.

B- Controlling.

C- Recording.

9- The major purpose of accounting is provide decision makers with:

A- Data useful.

B- Information useful.

C- Financial statements useful

10- The major internal user on Sole Proprietorship for Accounting information is:

A- The management.

B- The owner.

C- All of the above.

11- Management accounting covers a variety of areas such as:

A- Cost accounting.

B- Internal auditing.

C- Financial Accounting.

12- Financial Accounting is interested in providing information for purpose:

A- General.

B- Special.

C- Nothing of above.

13- Management accounting is interested in providing information for purpose:

A- General.

B- Special.

C- Nothing of above.

14- The concept of mutual agency means a partner has:

A- "Authority of an owner".

B- Unlimited liability.

C- All of the above.

15- A limited partnership includes partners:

A- Only general.

B- Only limited.

C- All of the above.

16- An accounting system consists of:

A- The personnel.

B- Procedures.

C- Devices and records.

D- All of the above.

17- The functions of every accounting system are:

A– Interpret and record the effects of business transaction.

B– Classify the effects of similar transaction.

C– Summarize and communicate the information.

D– All of the above.

18– The internal users are:

A– Managers.

B– Investors.

C– Creditors.

D– Customers.

19– A business owned by one person is generally a:

A– Sole proprietorship.

B– Partnership.

C- Corporation.

D- None of the above.

20- The gross increase in owner`s equity resulting from business activities:

A- Drawings.

B- Capital.

C- Expenses.

D- Revenues.

21- The resources owned by businesses called:

A- Liabilities.

B- Owner`s equity.

C- Assets.

D- Profit.

22- The decreases in owner`s equity that result from operating the business are:

A- Revenues.

B- Expenses.

C- Capital.

D- Drawings

23- The basic accounting equation is:

A- Assets = liabilities + owner`s equity

B- Assets = Equities

C- Liabilities = Assets + owner`s equity

D- Both A &B.

24- Each time a business activity occurs, amounts are changed in the:

A- Assets.

B– Capital.

C– Accounting equation.

D– None of the above.

25– When there is an increase in cash and a decrease in equipment:

A– There must also be decrees in capital.

B– There must also be an increase in liabilities.

C– There is no change in equities.

D– None of the above.

26– The three types of financial statements are:

A– The income statement, the statement of owner's equity and balance sheet.

B- The income statement, the statement of owner's equity and the statement of cash flows.

C- The income statement, the balance sheet and report for independent accounts.

D- None of the above.

27- The three main types of business organizations are:

A- Sole proprietorship.

B- Partnership.

C- Corporation.

D- All of the above.

28- If the business has purchased land 10 Years ago for L.E 50,000. Assume that the market value of the land this year was L.E500, 000. The land shown in accounting recorded:

A- L.E 500,000.

B- L.E 450,000.

C- L.E 50,000.

D- None of the above.

29- Private accounting consists of:

A- Cost accounting.

B- Internal auditing.

C- Accounting information System.

D- All of the above.

30- Reviewing the company's operations to determine compliance with management policies and evaluating the efficiency of operations refer to:

A– Cost accounting.

B– Tax accounting.

C– Internal auditing.

D– General accounting.

31– The external uses of financial information are:

A– Taxing authorities.

B– Labor onions.

C– Investors and creditors.

D– All of the above.

32– The excess of total revenues over total expenses incurred for a given period is called:

A– Net income.

B– Net Loss.

C– Owner's equity.

D– None of the above.

33– With an increase in equities there must also be an increase in:

A– Assets.

B– Capital.

C– Notes payable.

D– Loans.

34– The Principal sources (increases) of owner's equity are:

A– Investments by owners.

B– Revenues from business operations.

C- Increasing in assets.

D- A& b.

35- Reductions in owner's equity arte a result of:

A- Withdrawals of assets by owners.

B- Expenses.

C- Losses.

D- All of the above.

36- If an individual asset is increased, there must be a corresponding:

A- Decrease in another asset.

B- Increase in a specific liability.

C- Increase in owner's equity.

D- All of the above.

37- The existing debts and obligations are called:

A– Assets.

B– Liabilities.

C– Owner's equity.

D– Accounts receivable.

38– The actual or expected cash out flows (Payment) is called:

A– Expenses.

B– Liabilities.

C– Losses.

D– None of the above.

39– When an enterprise purchases merchandise on credit, these obligations are called:

A– Debtors.

B– Accounts receivable.

C- Accounts payable.

D- Owner's equity.

40- Persons or entities to who owe money are called:

A- Creditors.

B- Debtors.

C- Owners.

D- Investors.

41- The ownership claim to total assets is known as:

A- Liabilities.

B- Creditors.

C- Owner's equity.

D- Assets.

42- Generally, revenues result from:

A- The sale of merchandis.

B- The performance of services.

C- The rental of property.

D- All of the above.

43- The economic events of the enterprise that are recorded are called:

A- Equations.

B- Transactions.

C- Records.

D- Statements.

44- A company may carry on many activities that do not represent in themselves business transaction like:

A– Hiring employees.

B– Purchasing merchandise.

C– Placing an order for merchandise with a supplier.

D– Both a & c.

45– Which of the following financial statement should be prepared at a specific date?

A– Statement of owner's equity.

B– Balance sheet.

C– Income Statement.

D– None of the above.

46– Which of the following financial statement lists assets, liabilities and owner's equity?

A– Income statement.

B- Balance sheet.

C- Owner's equity statement.

D- None of the above.

47- Which of the following financial statement lists revenues, expenses and net income or net loss?

A- Income statement.

B- Balance sheet.

C- Owner's equity statement.

D- None of the above.

48- Which of the following financial statement lists withdrawals, additional investment and the results of operations?

A- Income statement.

B- Balance sheet.

C- Owner's equity statement.

D- None of the above.

49- Which of the following is not considered a current asset?

A- Cash.

B- Accounts Receivable.

C- Notes receivable.

D- Notes payable.

50- Which of the following is not considered a fixed asset?

A- Supplies.

B- Machinery.

C- Vehicles.

D- Furniture.

51- Which of the following is not considered an expense?

A- Accrued salaries.

B- Prepaid rent.

C- Adverting expense.

D- A& b.

52- Which of the following is not considered an owner's equity?

A- Net income.

B- Additional investment.

C- Unearned rent.

D- Retained Earnings.

53- Which of the following items appears in the Income statement and owner's equity statement?

A– Net income.

B– Withdrawals.

C– Salaries expense.

D– Additional investment.

54– Which of the following appears in the balance sheet and income statement?

A– Ending inventory.

B– Notes receivable.

C– Beginning inventory.

D– Supplies.

55– Net income is the difference between:

A– Total assets and total liabilities.

B– Total revenues and total expenses.

C– Total receivable and total payable.

D- None of the above.

The third Questions:

- Transactions for Ed Petry Company for the month of October 2012 are presented below:
  - October 1, Invested an additional L.E. 40,000 cash in the business.
  - October 2, Purchased land costing L.E. 28,000 for cash.
  - October 5, Purchased equipment costing L.E.12,000 for L.E.3,000 cash and the remaining on credit.
  - October 7, Purchased supplies on account for L.E. 800.
  - October 10, Paid L.E. 1,000 for a one-year insurance policy.
  - October 11, Received L.E. 3,000 cash for services performed.
  - October 15, Received L.E. 4,000 for services previously performed on account.

- October 16, Paid wages to employees for L.E.2,500.
- October 18, Petry withdrew L.E. 1,000 cash from the business.
- October 22, paid telephone expense for L.E.1.000.

Required:

- Journalise the above transactions in the books of the trader.
- Post the journal entries to ledger accounts.

- **Journalize the following business transactions in general journal form for the month of January 2010:**
  - On January 1, 2010, The owner, Mike Derby, invested L.E. 35,000 in cash to start a real estate office, operating as a sole proprietorship.
  - Jan. 3, Purchased L.E. 400 of office supplies on credit.
  - Jan. 5, Purchased office equipment for L.E.8,000, paying L.E. 2,000 in cash and signed a 30-day, L.E. 6,000, note payable.

- Jan. 10, Real estate commissions billed to clients amount to L.E. 4,000.
- Jan. 12, Paid L.E. 700 in cash for the current month's rent.
- Jan. 22, Paid L.E. 200 cash on account for office supplies purchased in transaction 2.
- Jan. 25, Paid L.E. 600 for advertising in the current month.
- Jan. 26, Paid L.E. 2,200 cash for office salaries.
- Jan. 27, Derby withdrew L.E. 1,200 from the business for living expenses.
- Jan. 30, Received a check for L.E. 3,000 from a client, for commissions billed in transaction 4.

- Mark West started his own auto repair services firm, "West Auto Repairs" on June 1, 2013. The following selected events and transactions occurred during June:
  - June 1, Invested L.E 80,000 cash in the business.
  - June 4, Purchased equipment for L.E.30,000 from Watson Company paying L.E. 10,000 cash, and signing a note payable to Watson for L.E. 20,000.

- **June 9, Purchased supplies for L.E. 4,800 from Solo Company, paying L.E. 2,000 cash and the remaining on account.**
- **June 12, Purchased a one-year insurance policy for L.E. 3,600 cash.**
- **June 15, Received L.E. 4,000 cash in advance from Clark Company to provide maintenance services starting July 1.**
- **June 17, Completed services for Madison Company for L.E. 9,000 and received L.E.3,000 cash, and the remaining on account.**
- **June 20, Paid L.E. 1,000 to Solo Company for the supplies purchased on account on 9 June.**
- **June 26, Collected L.E. 2,000 from Madison Company for the services provided on account on June 17.**
- **June 29, Paid L.E. 1,500 in cash for the current month's rent.**
- **June 31, Paid the following expenses in cash: wages L.E. 2,300, utilities L.E. 400.**

Required:

- **Journalise the above transactions in the books of the trader.**
- **Post the journal entries to ledger accounts.**

- **Ahmed started his own business, on July 1, 2014. the following transaction occurred during the month of July:**
  - **July 1, started in business with L.E. 5000 in the bank and L.E. 10000 cash.**
  - **July 2, purchased office supplies on credit from Mahmoud L.E. 2000.**
  - **July 3, purchased goods on credit from Mostafa worth L.E. 2100.**
  - **July 4, sold goods for cash L.E. 340.**
  - **July 5, Purchased a one-year insurance policy for L.E. 1500 cash.**
  - **July 7, purchased a computer on credit from ziad L.E. 1700.**
  - **July 8, paid utilities by cheque L.E. 300.**
  - **July 10, sold goods on credit to Ibrahem L.E. 600.**
  - **July 11, returned goods to Mostafa L.E.550.**

- **July 14, paid wages by cash L.E. 210.**
- **July 17, paid rent by cheque L.E. 225.**
- **July 20, received cheque L.E. 400 from Ibrahem.**
- **July 21, paid to ziad by cheque L.E. 700.**
- **July 22, Paid L.E. 200 cash on account for office supplies purchased in transaction 2.**
- **July 30, Deposited L.E. 2000 in the Bank.**

Required:

- **Prepare journal entries to record the above transactions.**
- **Post the journal entries to ledger accounts.**

- **Ziad started his own delivery service, Donahue deliveries, on June 1, 2011. the following transactions occurred during the month of June:**
  - **June 1, Ziad invested L.E. 30000 cash in the business.**
  - **June 2, purchased a used van for deliveries for L.E. 10000. Ziad paid L.E.2000 cash and signed a note payable for the remaining balance.**
  - **June 3, paid L.E. 500 for the office rent of the month.**

- June 5, performed L.E. 2.400 of services on account.
- June 9, withdrew L.E. 200 cash for personal use.
- June 11, purchased supplies for L.E. 150 on account.
- June 15, received a cash payment of L.E.750 for services provided on June 5.
- June 17, purchased gasoline for L.E. 100 on account.
- June 20, Received a cash payment of L.E.1500 for services provided.
- June 23, made a cash payment of L.E. 500 on the note payable.
- June 26, paid L.E. 550 for utilities.
- June 27, paid for the gasoline purchased on account on June 17.
- June 28, paid L.E. 1000 for employees salaries.
- June 29, paid L.E. 1500 cash for one year insurance policy.
- June 30, purchased furniture for cash L.E.12000.

Required:

- **Prepare journal entries to record the above transactions.**
- **Post the journal entries to ledger accounts.**

- **Ahmed started his own business, on September 1, 2013. the following transaction occurred during the month of September:**
  - **Sept. 1, Ahmed started business with L.E.50000, out of which L.E. 20000 paid into bank.**
  - **Sept. 2, bought furniture for L.E. 5000, and a machine for L.E. 10000 cash.**
  - **Sept. 3, purchased goods for L.E. 14000 cash.**
  - **Sept. 6, sold goods for L.E. 8000 cash.**
  - **Sept. 8, Purchased goods from Mansour company for L.E. 11000 on credit.**
  - **Sept. 10, paid L.E. 500 telephone expense by cheque.**
  - **Sept. 11, bought one computer for L.E. 2100 from universal computer company on credit.**
  - **Sept. 15, Sold goods to kamel for L.E. 12000 on credit.**

- Sept. 17, sold goods to Rajab for L.E.2000 cash.
- Sept. 19, withdrew L.E. 100 from bank for personal use.
- Sept. 21, Received L.E. 11900 cash from Kamel, with discount allowed of L.E. 100.
- Sept. 22, Deposited L.E. 5800 in the Bank.
- Sept. 28, Sold goods to Sami for L.E. 3000 on credit.
- Sept. 30, Sami returned L.E. 100 of goods.
- Sept. 30 issued L.E. 1000 cheque to the land owner for rent of September.

Required:

- Prepare journal entries to record the above transactions.
- Post the journal entries to ledger accounts.

- Dr. Ali Ahmed opened a dental practice on January 1, 2008. during the first month of operations. the following transactions occurred:

1- Purchased dental equipments on January 1 for L.E. 80,000 paying L.E. 20,000 cash and signing a L.E.

60,000, 3-year notes payable, the equipment depreciated L.E. 400 per month.

2- Purchased L.E. 1,600 dental supplies, on January 31, determined that L.E. 600 of the supplies were on hand.

3- wages of L.E. 120 are accrued and unpaid at January 31.

Required: prepare adjusting entries for the month of January.

- Dr. Ali Ahmed opened a dental practice on January 1, 2008. during the first month of operations. the following transactions occurred.

  - Utility expense incurred but not yet paid prior to January 31, totaled L.E. 520.

  - Purchased dental equipment's on January 1 for L.E. 80000 paying L.E. 20000 cash and signing a L.E. 60000, 3-year notes payable. the equipment depreciated L.E. 4800 per year.

Required:

prepare adjusting entries for the month of January.

- **The ledger of Hassan Company, on march 31, 2017, includes these selected accounts before adjusting entries are prepared:**

	Debit	Credit
Supplies	2800	
Equipment	22000	
Accumulated depreciation: equipment		5000
Prepaid insurance	2000	

An analysis of the accounts shows the following:

1- **Insurance expires at the rate of 10% per month.**

2- **The equipment depreciates L.E. 2400 per year.**

3- **Supplies on hand total L.E. 800.**

Required

Prepare adjusting entries on march 31.

- **The ledger of Dream rental agency on march 31 of the current year includes the following selected accounts before adjusting entries have been prepared:**

	Debit	Credit
Supplies	2800	
Equipment	25000	
Accumulated depreciation: equipment		5000
wages expense	1800	

An analysis of the accounts shows the following:

1- The equipment depreciates L.E. 3600 per year.

2- Supplies on hand total L.E. 900.

3- wages incurred but not paid as of March 31 amount to L.E. 400.

Required

Prepare adjusting entries on march 31, assuming that adjusting entries prepared quarterly.

- The ledger of Easy Rental Agency on April 30 of the current year includes the following selected accounts before adjusting entries have been prepared.

	Debit	Credit
Prepaid Insurance	3600	
Supplies	2800	

Equipment	25000	
Accumulated depreciation : equipment		8400
wages expense	1400	

An analysis of the accounts shows the following:

(1) The equipment depreciates L.E. 250 per month.

(2) Supplies on hand total L.E. 800.

(3) Insurance expires at the rate of L.E. 300 per month.

(4) wages of L.E. 800 are accrued and unpaid at April 30.

Required

Prepare adjusting entries for the current month.

- Radwan company accumulates the following adjustment data at December 31, 2010:

1- store supplies of L.E. 300 have been used.

2- Utilities expenses of L.E. 225 are unpaid.

3- Salaries of L.E. 900 are unpaid.

4- Prepaid insurance totaling L.E. 350 has expired.

Required

Prepare the adjusting entries

- **The income statement of Olympic company for the month of July shows net income of L.E. 1400 based on service revenue L.E. 5500, wages expense L.E. 2300, supplies L.E. 1200 and utilities expense L.E. 600 – in reviewing the statement, you discover the following:**

1- insurance expire during July of L.E. 400 was omitted.

2- Supplies includes L.E. 300 of supplies that are still on hand at July 31.

3- Depreciation on equipment of L.E. 150 was omitted.

4- Accrued but unpaid wages at July 31 of L.E. 300 were not included.

Required

Prepare the adjusting entries.

- **Shawky open a company on April 1, 2015. at April 30, the trial balance shows the following balances for selected accounts:**

	Debit	Credit
Prepaid insurance	3600	
Equipment	9600	
Supplies	2000	

An analysis reveals the following additional data:

1- **Prepaid insurance is the cost of 2 year insurance policy, effective April 1.**

2- **the equipment has a 4-year life with no salvage value.**

3- **Supplies on hand total L.E. 900.**

Required

Prepare adjusting entries, for the month of April.

- **A trial balance of khalil company, at December 31, 2013, includes among other items, the following account balances :**

	Debit	Credit
Prepaid insurance	24000	
Prepaid rent	24000	
buildings	188000	
Accumulated Depreciation: buildings		31600
salaries expense	200000	

other data:

1- the balance in the prepaid insurance account is the advance premium for one year from September 1, of the current year.

2- The buildings are expected to last 25 years, with an expected residual value of L.E. 30000.

3- Salaries incurred but not paid as of December 31 amount to L.E. 8400.

4- The balance in prepaid rent is for a one-year period that started march 1, of the current year.

<u>Required</u>

Prepare the annual year-end adjusting journal entries at December 31.

- The following adjusted trial balance was prepared at December 31, 2013, for Clean Environment Enterprise:

Clean Environment Enterprise

Adjusted Trial Balance

December 31, 2013

Account title	Debit	Credit
Consulting fees earned		487,200
Cash	31,850	
Notes payable		112,000
Yousif, drawings	70,000	
Advertising expense	31,500	
Accumulated depreciation: office equipment		13,440
Notes receivable	9,640	
Yousif, capital, December 31, 2012		230,300
Insurance expense	38,720	
Office equipment	33,600	
Supplies	5,300	

Utilities expense	15,040	
Accounts receivable	65,090	
Salaries expense	245,280	
Supplies expense	9,640	
Accounts payable		22,680
Accumulated depreciation: buildings		33,600
Depreciation expense: buildings	4,200	
Rent expense	10,900	
Land	196,000	
Depreciation expense: office equipment	3,360	
Buildings	126,000	
Telephone expense	3,100	
Total	899,220	899,220

Required:

1- Prepare an income statement for the year ended December 31, 2013.

2- Prepare a Balance Sheet at December 31, 2013. (Note- Yousif's capital at December 31, 2013, is 285,760)

The fourth question: You are required to define the following key terms:

1- **Corporation.**
2- **General partner.**
3- **Limited liability partnership.**
4- **Limited partner.**
5- **Limited personal liability.**
6- **Stockholders (or shareholders).**
7- **Unlimited personal liability.**
8- **Account.**
9- **Accounting cycle.**
10- **Balance Sheet.**
11- **Credit.**
12- **Debit.**
13- **Double-entry Accounting.**
14- **Financial statements.**
15- **General journal.**
16- **Journal.**
17- **Owner's equity.**

18- **Public information.**

19- **Statement of owner's equity.**

20- **Transactions.**

Key terms

The term	The meaning
1- Board of directors:	Persons elected by the stockholders of a corporation to set corporate policies and hire managers and officers.
2- Corporation:	A business recognized under the law as an entity separate and distinct from owners. A corporation is charactered by a country and has transferable shares of ownership, called capital stock.
3- Drawing account	The account used to record the withdrawals of cash or other assets by an owner of an unincorporated business.
4- General partner:	A partner in a business organized as a partnership who possesses the traditional rights and responsibilities of a partner, including mutual agency and unlimited personal liability.
5- Limited liability partnership:	A partnership in which all partners may participate in management but have limited liability for the actions of fellow partners. A relatively new form of organization, now widely used in associations of professionals, such as accountants, physicians, and attorneys.
6- Limited partner:	A partner in limited partnership who has the right to participate in profits, but whose liability for losses is limited to the amount of his or her investment, and who doesn't have the right to participate in management. A limited partner's role is that of an investor, rather than of a traditional partner.

7- Limited personal liability:	The concept that some or all of the owners of a business are not personally responsible for the debts of the organization, and their potential losses, accordingly, are limited to the amount of their equity investment. This concept normally applies to stockholders in a corporation and to the limited partners in a limited partnership.
8- Mutual Agency:	The right of each partner to act as an agent for a partnership and to bind (obligate) the business to contracts.
9- Partnership:	An unincorporated business owned by two or more persons voluntarily associated as partners
10- Partnership contract:	An agreement among partners as to the operation of a Partnership. Usually includes the plan for sharing profits and losses.
11- Stockholders (or shareholders):	Owners of a corporation whose ownership is represented by the shares of stock they own. They take no part in the active management of the corporation, and their liability is limited to the amount of their investment in their shares of stock, but they receive any profits that are distributed as dividends.
12- Unincorporated business:	Any business that is not recognized as a corporation. Includes both sole proprietorship and partnerships.
13- Unlimited	The concept that a business owners has unlimited

personal liability:	personal liability for the debits of the business, applies to sole proprietorships and general partners in partnerships.
14-Solvency:	Having the financial ability to pay debts as they become due.
15- Account:	A record used to summarize all increases and decreases in a particular asset, such as cash account, or any other type of asset, liability, owner's equity, revenue or expense.
16-Accounting cycle:	The sequence of accounting procedures applied in recording, classifying, and summarizing accounting information. The cycle begins with the occurrence of business transactions and concludes with the preparation of financial statements.
17-Accounting Equation:	Assets are equal to the sum of liabilities plus owner's equity. (A=L+OE). This equation is expressed in the format of the Balance sheet.
18-Annual Report:	A document issued annually by publicly owned enterprise to their interested parties or users.
19-Balance Sheet:	The financial statement showing the financial position of an entity by summarizing its assets, liabilities, and owner's equity at one specific date.
20-Business entity:	An economic unit that controls resources incurs obligations, and involves in business activities.
21-Credit:	An amount entered on the right –hand side of a ledger

	account. A credit is used to record a decrease in asset or an increase in a liability or in owner's equity.
22- Debit:	An amount entered in the left-hand side of a ledger account. A debit is used to record an increase in an asset or a decrease in a liability or in owner's equity.
23- Disclosure (adequate):	The accounting principle of providing with financial statements any financial facts necessary for the proper interpretation of those statements.
24- Double-entry Accounting:	A system or recording every business transaction with equal pound amounts of both debit and credit entries. as a result of this system, the accounting equation always remains in balance, in addition, the system makes possible the measurement of net income and also the use of error-detecting devices such as a trial balance.
25- Compound journal entry:	A journal entry that affects at least three accounts.
26- Financial Accounting:	The development and use of accounting information describing the financial position of an entity and the results of its operations.
27- Financial position:	The financial resources and obligations of an enterprise, as described in a balance sheet.
28- Financial reporting:	The process of periodically providing general purpose financial information (such as financial statements) to persons outside business organization.

29- Financial statements:	Four related accounting reports that shortly summarize the current financial position of an entity and the results of its operations for the preceding year or other time period.
30- General journal:	The simplest type of journal, it has only two columns - one for debits and one for credits. This journal may be used for all types of transactions, which are later posted to the appropriate ledger accounts.
31- Generally accepted accounting Principles (GAAP):	The accounting concepts, measurement techniques and standards of presentation used in financial statements.
32- Going Concern Assumption:	An assumption by accountants that a business will operates indefinitely unless specific evidence to the contrary exists.
33- Income statements:	A Financial statement indicating the profit (or loss) of an enterprise over a period of time, usually a year.
34- Journal:	A chronological record of transactions, showing for each transaction the debits and credits to be entered in specific ledger accounts. The simplest type of journal is called a general journal.
35- Ledger:	A record containing all accounts used by a business.
36- Liabilities:	Debits or obligations of an entity that have arisen

	from past transactions. The claims of creditors against the assets of an enterprise.
37- Journalizing:	Recording transactions in a journal.
38- Owner's equity:	The excess of assets over liabilities. The amount of the owner's investment in a business, including profit from successful operations which have been retained in the business.
39- Posting:	The process of transferring information from the journal to individual accounts in the ledger.
40- Public information	Information which by law is available to the general public. The annual financial statements of publicly owned businesses are public information.
41- Statement of owner's equity:	A financial statement summarising the changes in owner's equity occurring in a business organized as a sole proprietorship. It covers the same period of time as does the income statements.
42- Transactions:	Events that cause immediate change in the financial position of an entity and that can be measured objectively in monetary terms. In current practice, transactions serve as the basis for recording financial activity.
43- Trial balance:	A list of accounts and their balances at a point in time; the total debit balances should equal the total credit balances.
44- Normal balance:	The debit or credit side on which an account increases. For example, assets increase with debits, therefore the normal balance for an asset is a debit.

	Revenues increase with credits, therefore a credit is the normal balance for a revenue account.
45- Accounts payable:	Obligations that arise when a promise to pay later is made in connection with purchases of merchandise, supplies, or equipment.
46- Accounts receivable:	When services are performed for or goods are sold to customers in return for promises to pay in the future, an account receivable is recorded. These transactions are said to be on credit or on account. Accounts receivable are increased by services performed or goods sold on credit and decreased by customer payments.
47- Note receivable:	An unconditional written promise to pay a definite sum of money on demand or on a defined future date(s); also called a promissory note.
48- Notes payable:	Obligations that arise when an organization formally recognizes a promise to pay by signing a promissory note.
49- Prepaid Expenses:	An asset account containing payments made for assets that are not to be used until later.
50- T-account:	A simple characterization of an account form used as a helpful tool in showing the effects of transactions and events on specific accounts.
51- Unearned revenues:	Liabilities created when customers pay in advance for products or services; created when cash is received before revenues are earned; satisfied by delivering the products or services in the future.

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