

# Unit 4

## BUSINESS RECORDS KEEPING AND FINANCIAL REPORTS

### Unit Outcomes

*At the end of this unit, students will be able to:*

- understand the nature of accounting.
- identify the importance of accounting.
- understand how to record business transactions.
- prepare the three basic financial reports namely: Income Statement, Capital Statement and Balance Sheet.

### Introduction

The primary purpose of this unit is to explore the nature of accounting information and the environment in which it is developed and used. The unit emphasizes the financial reporting process, including the role played by financial statements. The basic financial statements-, Income Statement, Capital Statement and Balance Sheet will be discussed, as well.

### Contents of the Unit

In order to be able to achieve the above objectives, you will learn the following topics:

- What is accounting?
- Importance of Accounting
- The Beginning Balance Sheet
- Recording the Opening Entry
- Posting the Opening Entry
- Income and Expense Accounts
- The Six-Column Work Sheet
- The Financial Statements
- The Petty Cash Fund

### 4.1 What is Accounting?

Some people think of accounting as a highly technical field, which is practiced and understood only by professional accountants. Actually nearly everyone practices “accounting” in one form or another on almost a daily basis. Whether you are paying school fees, preparing reports for large organizations or selling goods in retail shops, you are working with accounting concepts and accounting information.

**Accounting is the process of identifying, measuring, recording, and communicating economic information about an organization or other entity, in order to permit informed judgments by users of the information.**

Bookkeeping is the process of keeping records in a prescribed manner. It encompasses the record-keeping aspect of accounting and therefore provides much of the data to which accounting principles are applied in the preparation of financial statements and other financial information. Obviously, accounting goes much beyond bookkeeping to satisfy the needs of users including activities such as processing, summarizing, reporting and interpreting the financial reports.

A person who earns a living by recording financial activities of a business is called an accounting clerk. Accounting clerks are often referred to as Bookkeepers. A person who earns a living by undertaking activity of accounting is called accountant.

### Accounting and Bookkeeping Distinguished

Accounting is the process of identifying, measuring, recording, and communicating economic information about an organization or other entity, in order to permit informed judgments by users of the information. Bookkeeping is the process of keeping records in a prescribed manner. It encompasses the record-keeping aspect of accounting and, therefore, provides much of the data to which accounting principles are applied in the preparation of financial statements and other financial information. Obviously, accounting goes much beyond bookkeeping to satisfy the needs of users including activities such as processing, summarizing, reporting and interpreting the financial reports.

Personal record keeping often uses a simple single-entry system, in which amounts are usually recorded in column form. Such entries include the date of the transaction, its nature, and the amount of money involved. Record keeping of organizations, however, is based on a double-entry system, whereby each transaction is recorded on the basis of its dual impact on the organization's financial position or operating results or both.

### 4.2 Importance of Accounting

The basic purpose of accounting is to provide decision makers with information useful in making economic decisions such as investment, taking a loan, deleting a loss incurring department or not. These decisions concern the allocation and use of scarce economic resources, such as money and labor. The manner in which we allocate and use economic resources shapes the world's economies. Just as there are

many different types of economic decisions, there are many types of accounting information.

### Types of accounting (Specializing Areas in Accounting)

As a specialized field of study, Accounting will have the following types of specializing areas:

- a. **Financial Accounting:** this is an area in accounting devoted to the preparation of financial statements and the provision of information to external users of accounting information. It is governed by what are called generally accepted accounting principles to facilitate comparability of financial statements of different periods and different organizations.
- b. **Cost Accounting:** is an area of accounting that emphasizes the determination and control of cost of producing goods and services and it will help the company achieve different cost classifications and analyses (both actual and prospective costs). It is primarily concerned about manufacturing processes and production of tangible finished goods.
- c. **Management Accounting:** this is an area of accounting that is concerned about the provision of financial information of internal users of accounting information. It uses both actual and estimated data in assisting management in daily operations and in planning future operations.
- d. **Auditing:** is an area of accounting that is concerned about providing attestation and verification services that reports prepared by business enterprises are authentic and dependable in material respects. This is evaluated in their adherence to generally accepted accounting principles. In addition to retaining external auditors (who are called public accountants) most companies will employ internal auditors who will determine whether the various units are following management's policies and procedures.
- e. **Tax Accounting:** is an area of accounting that encompasses the preparation of tax returns (reports) for the different governmental units about taxable amounts and the consideration of the tax consequences of proposed business transactions and or alternative courses of action. Hence, it guides companies of legal ways of minimizing taxes and other areas of taking tax advantages. Accountants in this specializing area shall be familiar with the tax statutes affecting their employers and clients and shall keep up to date on court decisions on tax related cases.
- f. **Accounting Information Systems (AIS):** is an area of accounting that is concerned with the analysis, design, implementation and revision of procedures for

the accumulation, processing and reporting of financial data to various users. Accountants specializing in this area will apply different components of information technology in well designed information system to collect and process financial data into useful information, to provide timely and accurate financial information for decision makers and to safeguard company properties including its data.

- g. **Fund Accounting:** also called not for profit accounting, fund accounting is an area of accounting that specializes in recording, reporting and planning the operations of nonprofit, governmental and most nongovernmental entities such as hospitals, schools, etc. It will help management to adhere to restrictions and other requirements imposed by law, other institutions or individual donor groups.
- h. **International Accounting:** is concerned with the special problems associated with the international trade of multinational business organizations. This area of accounting has increased in importance because of increase in the number of international companies in response to globalization and expansion of international trade. Accountants specializing in this area shall have familiarity about the influences that custom, law, and taxation of various countries will place on international operations and accounting principles.
- i. **Accounting Instruction:** this is an area of accounting that involves the teaching of accounting at various levels. It involves research, publications and related activities that are intended to integrate accounting theory with accounting practice. Certain accounting concepts and principles govern the accounting practices.

### Accounting Concepts and Principles

**Concepts and principles** are the best possible guidelines in the preparation and reporting of financial statements. In a small business enterprise, the business is managed by the owners themselves and financial reports are used by the owner managers. But, when companies grow in size and complexity management and outsiders became clearly differentiated and from the latter group came demand for accurate financial information for use in judging the performance of management. In addition, when the size and complexity of the business unit increased, the accounting problems involved in the issuance of financial statements became more complex. With these developments comes the need for a framework of concepts and generally accepted accounting principles to serve as guidelines for the preparation of the basic financial statements.

Accounting information is processed based on generally accepted principles and practices in order to bring uniformity and comparability in the reports prepared by different organizations. Such principles are collectively called generally accepted account-



ing principles (GAAP). They may be entitled as concepts, assumptions, standards or principles. Such principles unlike the principles in natural sciences are subject to change and revision. Some of the basic principles are the following:

1. **Business Entity Concept:** the business entity concept assumes that the affairs of an enterprise shall be separate from the affairs of the owners, other business enterprises and creditors etc. Hence, each enterprise is considered as a separate economic unit that has its own objectives, resources, and obligations regardless of its legal form.
2. **Continuity principle/Going Concern Concept:** the continuity principle assumes that a business enterprise starter once started will continue indefinitely for unlimited period of time earning profit. This doesn't mean the business will be eternal. But it assumes that the business will continue until unknown future. Of course, it is possible to assume that a business enterprise will have a limited life span. However, the way accounting information is recorded, processed and reported will be totally different under the two assumptions.
3. **Periodicity Principle:** the periodicity (time period) principle argues that the life of an organization is divided into arbitrary time periods of reporting. Though the company's true picture is measured between the beginning and the end of its life, because decisions are made before that, companies always prepare and report periodic performance to the users. Such arbitrary time period may be a period of one month, one quarter, semiannual period or a period of one year.
4. **Monetary Unit of Measurement:** the monetary principle assumes that accounting information is always expressed in terms of money. Money is a common factor and feasible unit of measurement in accounting to compare the operations of different types of business organizations.
5. **Cost Principle:** the cost principle assumes that goods and services acquired to be used in business operations shall be recorded at cost. Cost is the agreed amount between an independent buyer and an independent seller. A single item may have different monetary values at different times. Hence, the basis of recording and reporting is the cost of the item.

#### Activity: 1

- Describe the importance of accounting by taking a particular business enterprise in your locality.
- What types of assets do business organizations own when they start business?

### 4.3. The Beginning Balance Sheet

The Balance Sheet is the main report of overall financial condition. It shows the assets, liabilities and capital of a company at a particular date, usually on the last date of a fiscal year. The balance sheet shows what a company owns or controls and what the source of the assets are.

In accounting a business form that lists (1) what is owned, (2) what is owed, and (3) what a business is worth on a specific date is called a **balance sheet**. Because the purpose of a balance sheet is to show the financial position of a business on a particular date, it is sometimes known as a **position statement**. After a business knows what it owns, what it owes and what it is worth a balance sheet is prepared. The balance sheet has three main sections: Assets, Liabilities and Capital which are explained briefly.

#### 4.3.1 Assets

All of the valuable resources that a business has gathered together for its use or what businesses or individuals own are called Asset. Assets are of two types: **current Assets** and **Fixed Assets**. Assets used to support the day-to – day operations of a company are **Current Assets or Working Capital**. These assets normally can be converted into cash, sold or used within a short time, usually a year or less. Cash and other assets that will be turned into cash or quickly consumed in the operation of a business are called current assets. Current assets include such things as cash, Accounts receivables, inventory and supplies. **Accounts receivables** are the amounts owed to the company for goods or service provided to customers but money not yet received. They are current assets because they represent the cash expected in a short time. **Inventories** are goods held on hand for production process or for sale to final consumers. **Supplies** are items such as stationeries, which can be consumed within a year or less. **Fixed Assets** are relatively permanent goods or resources owned by a company. Most companies do not expect to turn out their fixed assets into cash on a regular basis. Examples include factories, office buildings, durable equipment and other long lasting facilities of a business. The fixed assets of a company provide the long-term setting in which operations take place. In sum what is owned and has got value (sales value or use value) is referred to as asset. Note that, for example, a table no more useful at home and cannot command price in the market is not an asset in that it does not have value.

### 4.3.2 Liabilities

The sums the company owes to other businesses or individuals are called liabilities. Liabilities consist of the claims of its creditors against its assets. Debts that are owed and payable within a short time are classified as **current liabilities**. Amounts owed to trade creditors- such as purchases of merchandise on account with in short period of time is classified as current liabilities. For example, if merchandise is purchased on account to be paid within 30 or 40 days, the liability is a current liability. All liabilities that will come due and be payable within one year should be treated as current liabilities.

Debts that will not be due for several years are called **long term liabilities**. Examples of long-term liabilities are money borrowed from bank, which will be paid over long period of time such as 5 years or more.

### 4.3.3 Capital

The amount that remains after total liabilities are subtracted from the total assets is called **capital**. Sometimes it is also known as proprietorship.

**For example:**

Total assets of Ato Teshome Tesfaye Company.....	Birr 72.000.00
Less total Liabilities (amount owed from bank and persons)	<u>2.000.00</u>
Equals the amount of the owner's (Ato Teshome's) capital.....	70.000.00

#### Activity: 2

- Give examples of assets at your school.
- Identify assets that are possessed by your family

### 4.3.4 Accounting Equation

Since all the assets of a business are subject to claims by its creditors and owners, total assets should equal the total claims of creditors and owners. The claims against assets are called **equities**. There are two types of equities. They are the equity of the creditors and the equity of the owners. The total amount of the assets should be equal to the total amount of liabilities plus the amount of the proprietorship. In other words, the total assets or what is owned should equal to the total equities. The statement that assets equal liabilities plus capital is known as the **accounting equation** and expressed as follows:

**Assets = Liabilities + Capital**

The accounting equation can be stated as follows:

What is owned (Asset) by Ato Teshome Company

Cash .....	5,000.00
Inventories .....	6,000.00
Accounts Receivables.....	<u>4,000.00</u>
Total Assets .....	<u>15,000.00</u>

Loan (liabilities)

Loan from commercial Bank of Ethiopia ...	<u>6,000.00</u>
Ato Teshome Capital .....	<u>9,000.00</u>
Total liab & capital.....	<u>15, 000.00</u>

**Total Assets (15,000.00) = Total Liabilities (6,000.00) + Total Capital (9,000.00).**

Regardless of whether a business grows or contracts, this equality between the assets and the claims against the assets is always maintained.

**Activity: 3**

- If total assets are three times (thrice) the total liabilities and total capital is Birr 400,000 calculate the total liabilities and total assets.

**4.3.5 Body of the Balance Sheet**

The body of a balance sheet has three sections that show; (1) What is owned, (2) what is owed, and (3) What the business is worth, i.e.

- Assets are listed on the left-hand side of the balance sheet .
- Liabilities are listed on the right hand side of the balance sheet.
- Capital is listed on the right hand side of the balance sheet.

**Diagrammatically, it means the following:**

**Balance Sheet**

<b>Assets (1)</b> <b>What is owned</b>	<b>Liabilities (2)</b> <b>What is owed</b>  <b>Capital (3)</b> <b>What the business is worth</b>
<b>Left hand side (Debit )</b>	<b>Right hand side (Credit )</b>

**Steps in preparing a balance sheet**

1. Write the heading on three lines; center each item in the heading  
The heading of a balance sheet contains three lines:



**Line 1:** WHO? Name of business → **Haregewoin Aboye Beauty Salon**

**Line 2:** WHAT? Name of the form → **Balance Sheet**

**Line 3:** WHEN? Date of the form → **December 31, 2010**

2. Prepare the assets section on the left-hand side, as follows:
  - Write the word Assets in the center of the first line of the wide column on the left.
  - List the name and amount of each asset, using a brief title to describe it. Begin on the next line.
3. Prepare the liabilities section on the right-hand side, as follows:
  - Write the word liabilities in the center of the first line of the wide column on the right.
  - List the name and amount of each liability, using a brief title to describe it. Begin on the next line.
  - Rule a single line across the amount in the amount column directly under the last amount.
  - Write the total of the liabilities in the amount column and label these amount total liabilities.
4. Prepare the capital section on the right-hand side, beneath the liabilities as follows.
  - Skip one line and write the word capital in the center of the wide column.
  - Write the name of the owner and the word capital on the next line.
  - On a separate sheet of paper, find the amount of the capital by subtracting the total liabilities from the total assets.
  - Write the amount of the capital in the amount column on the same line as the name of the owner.
5. Determine if the balance sheet is “in balance” and complete its preparation as follows:
  - Rule a single line across the amount column on the right-hand side directly under the amount of the capital. Rule a single line across the amount column on the left-hand side on the same line as the single line on the right-hand side.
  - Add each column and compare the totals. The two totals should be the same. If the two totals are the same, this proves that the total of the assets equals the combined total of the liabilities and the capital. (If the final totals are not the same; the error or errors must be found and corrected.)

- Record the totals directly under the addition line on each side. Do not skip a space.
- Write the words Total Assets on the same line as the left-hand total.
- Write the words Total Liabilities and Capital on the same line as the right-hand total. If necessary, the words on this line may be abbreviated to Total Liab. and Cap.
- Rule double line across both amount columns directly under each total. The double lines show that the work is completed and that the balance sheet is “in balance.”

**Haregewoin Aboye Beauty Salon  
Balance Sheet  
December 31, 2001**

<b>Assets</b>		<b>Liabilities</b>	
Cash	650.00	Ato Teshome Tesfaye Co.	
		Commercial Bank	150.00
Operating Supplies	250.00	of Ethiopia	850.00
Beauty Salon Equipment	3600.00	Total Liabilities	<u>1000.00</u>
Office Furniture	<u>500.00</u>	<b>Capital</b>	
		Haregewoin	
		Aboye ,capital	<u>4000.00</u>
Total assets	<u>5000.00</u>	Total liab and cap	<u>5000.00</u>

**Activity: 4**

i. Find the missing amount in the bookkeeping equation for each of the items listed below.

<b>Item</b>	<b>Assets</b>	<b>=</b>	<b>Liabilities</b>	<b>+</b>	<b>Capital</b>	<b>Answers</b>
a.	Birr 10,000	=	Birr 4,000	+	?	_____
b.	6,000	=	?	+	4,500	_____
c.	?	=	23,000	+	4000	_____

ii. The following are the assets and liabilities of M. Dry Cleaners owned by Ato Kebede Gemechu.

Assets		Liabilities	
Cash	Birr 844.00	W/o Ayelech G/Selassie Co.	Birr 110.00
Delivery Equipment	2,266.00	W/o Bizunesh Tilahun Co.	785.00
Office Equipment	480.00		
Dry Cleaning Equipment	1660.00		

**Instruction:** Prepare a balance sheet for M. Dry Cleaners. Use the date September 1 of the current year.

- *How do business organizations maintain information about what they have before they start operations or business activities?*

## 4.4 Recording the Opening Entry

Normally, a new accounting system should begin with a balance sheet that shows the financial condition of the business at the time the new system is started. A balance sheet, however, is written on a piece of paper, which may be misfiled or lost. Therefore, the information shown on the balance sheet should be recorded in a permanent record book. A book in which the records of a business is first written is called a **journal**. Each record in a journal is called an **entry**. The entry that records the information shown on a beginning balance sheet is called an **opening entry**.

### 4.4.1. The Source of a Journal Entry

The entry that the bookkeeper makes in a journal is usually taken from some business paper. The business paper from which a journal entry is made is called a **source document** like receipt, memo, sales invoice, purchase invoice and beginning balance sheet. The source document for making an opening entry is the beginning balance sheet.

### 4.4.2. Types of Journals

Businesses use different kinds of journals. Some journals are used to record only one type of entry such as entries for sales or entries for purchases. A journal that is used to record only one type of entry is called a **special journal**. A journal that is used to record entries that cannot be recorded in special journals is called a **general journal**.

#### 4.4.2.1. The General Journal

The all purpose two-column journal is called the general journal or simply the journal, can be used for entries that do not fit into any of the special journals. For example, adjusting and closing entries are recorded in the general journal. By the way in the absence of special journals, all transactions are normally recorded in the general journal. The two-column general journal, shown below, is used by the Haregewoin Aboye Beauty Salon to record its beginning balance sheet.

#### General Journal

Page No. \_\_\_\_\_

Date	Account Title	Post Ref.	Debit	Credit

#### 4.4.2.2. Two-column General Journal

When a beginning balance sheet is recorded in a two-column general journal, the amounts on the left-hand side of the balance sheet are recorded in the left-hand amount column of the journal. The left-hand amount column of a two-column general journal is called the **debit column**. The amounts on the right hand side of the balance sheet are recorded in the **right-hand** amount column of the journal. The right-hand amount column of a two-column general journal is called the **credit column**.

#### 4.4.2.3. The Source Document for the Opening Entry

The beginning balance sheet of the Haregewoin Aboye Beauty Salon, in the preceding discussion is the source document from which the opening entry is made in the general journal.

**Parts of a journal entry:** Every journal entry has four parts: (1) a date (2) a debit part (3) a credit part and (4) a brief description of the source document.

#### 4.4.2.4. Steps in Recording the Opening Entry

The steps in recording the opening entry of the general journal of Haregewoin Aboye Beauty Salon are as follows:

**Step 1: Date of entry:** Write the date of the opening entry in the Date column as follows:

- a. Write the year in small figures at the top of the column.
- b. Write the month below the year on the first line in the first column.
- c. Write the day of the month on the first line in the second column immediately after the name of the month.



**Step 2: Debit part of the entry:** Write the debit part of the entry as shown below:

- Write the name of each asset at the extreme left edge of the Account Title column
- Write the amount of each asset in the Debit column.

**Step 3: Credit part of the entry:** Write the credit part of the entry as shown below:

- Write the name of each liability and the name of the proprietor, followed by the word Capital, in the Account Title Column. Indent each name about one-half inch from the left edge of the Account Title column. Indenting these items helps to separate the debit part of the entry from the credit part.
- Write the amount of each item in the Credit column

**Step 4: Source of the entry:** Write a brief description of the source document as shown below.

- Write a brief description of the source document in the Account Title column immediately below the last credit column.
- Indent each line of the description about one inch from the left edge of the Account Title column.

The purpose of the description is to identify the source of the journal entry in case reference must be made to the source document.

### General Journal

Page 1

Date		Account Title	Post Ref.	Debit	Credit
2010					
Dec.	1	Cash		650.00	
		Operating supplies		250.00	
		Beauty salon equipment		3600.00	
		Office Furniture		500.00	
		Ato Teshome Tesfaye Co.			150.00
		Commercial Bank of Eth			850.00
		W/ro Haregowin Aboye			
		Capital			4000.00
		Dec.1 balance sheet			

Activity: 5

Africa Garage is owned and operated by W/o Degitu Tollesa. The record shows the following assets:

Cash .....	birr 567.00
Supplies .....	300.00
Garage Equipment .....	3,861.00
Office Equipment .....	740.00

The Garage owes Belay Company Birr 641.00 and Dagnachew Sapre parts Birr 217.00. The amount of W/o Degitu Tollesa's capital is Birr 4,610.00. Use September 1 of the current year as the date.

Instructions:

- a. Prepare a balance sheet for W/o Degitu Tollesa Garage.
- b. Record the opening entry on page 1 of a General Journal.

### 4.5 Posting the Opening Entry

The Opening entry in a journal is a complete record of the assets, the liabilities and the proprietorship at the time an accounting system is installed. The system, however, should show not only accommodate what a business has- assets, liabilities and proprietorship but also the change that occur in these items.

As a business carries on its day-to-day operations, changes occur in the value of its assets, liabilities and proprietorship. Goods and services are bought and sold. Cash is received and paid out. Debts are owed and paid. When the business makes a profit, the amount of the proprietorship increases. When the business incurs a loss, the amount of the proprietorship decreases. An accounting form that is used to sort and summarize the changes caused by business operations is called **an account**. A group of all accounts is called a **ledger**.

#### 4.5.1. Standard Forms of Account

There are several forms of account. One of the standard forms of account, a two-column account, is shown below.

Account Title				Account No. _____			
Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit

The standard form of account is divided into a left half and a right half. Each half of an account is ruled alike. The left-hand side of an account is called the debit side. The right hand side of an account is called the credit side.

The amount column on the left-hand side has the heading Debit. The amount column on the right-hand side has the heading Credit. The headings of all the other columns are the same on each side of an account.

When amounts are recorded in the Debit column of an account, the account is said to be **debited**. When amounts are recorded in the Credit column of an account, the account is said to be **credited**.

#### 4.5.2 Chart of Accounts

There is an account in the ledger for each item on the beginning balance sheet. The name given to an account is called the **account title**. The account title is written at the top of the account. The number given to an account to show its location in the ledger is called an **account number**. Since the accounts are arranged in the ledger in numerical order, they can be located quickly. A list of account titles that shows the arrangement of the accounts in the ledger and the number assigned to each account is called a **chart of accounts**. The part of the chart of accounts of Haregewoin Aboye Beauty Salon needed for this unit is shown below.

**Haregewoin Aboye Beauty Salone**  
**Chart of Accounts**

<b>(1) Assets</b>	<b>Account No</b>	<b>(2) Liabilities</b>	<b>Account No.</b>
Cash	11	Ato Teshome Tesfaye Co.	21
Operating Supplies	12	Commercial Bank of Eth.	22
Beauty Salon Equip- ment	13	(3) <u>Capital</u> W/ro Haregewoin Cap.	31
Office Furniture	14		

The first digit of each account number tells in which division of the ledger the account is placed. In the partial chart of account given above, all asset account num-

bers begin with 1; all liability account numbers begin with 2; the capital account numbers begin with 3. The second digit of each account number tells the position of the account within its division of the ledger. For example, the account number for office furniture is 14. This number shows that the office equipment account is in the first division of the ledger, the asset division, and that it is the fourth account in that division.

### 4.5.3. Posting the Opening Entry to the Ledger

Each of the amounts in the opening entry is transferred to the proper account in the ledger. Transferring the entries in a journal to the accounts in a ledger is called **posting**.

#### Steps in posting the opening entry:

The steps required in posting from journal to ledger are diagrammed and explained below.

#### General Journal

Page 1

Date	Account Title	Post Ref.	Debit	Credit
2010 Dec. 1	Cash		650.00	
	Operating supplies		250.00	
	Beauty salon equipment		3600.00	
	Office Furniture		500.00	
	Ato Teshome Tesfaye Co.			150.00
	Commercial Bank of Eth.			850.00
	W/o Haregowin Aboye Capital			4000.00
	Dec.1 balance sheet			

Step 2

Step 1

#### Account Cash

#### Account No.11

Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit
2010 Dec.1	Balance Step 3		650.00				



**Step 1: Write the amount of the cash debit, 650, in the Debit column of the cash account in the ledger as shown above.**

In manual bookkeeping, the amount is written first because it is the most important part of the entry.

**Step 2: Write the date of the journal entry, 2010, December 1, in the Date column of the ledger account as follows:**

- a) Write the year, 2010 at below of the Date column line.
- b) Write the month, December, in the first column under the heading Date on the same line as follows.

The year and the name of the month are written only once on the side of the account that is used.

- c) Write the day of the month, 1 in the column immediately after the name of the month.

**Step 3: Write the word Balance in the Items column of the account.**

Bookkeepers distinguish between the beginning amount in an account and the amounts recorded later as a result of normal business operations. The beginning amount or balance in the cash account is therefore labeled with the single word Balance in the Items column.

**General Journal**

Date	Account Title	Post Ref.	Debit	Credit
2010 Dec. 1	Cash	11	650.00	
	Operating supplies		250.00	
	Beauty salon equipment	Step 4	3600.00	
	Office Furniture		500.00	
	AtoTeshome Tesfaye Co. Commercial Bank of Eth. W/o Haregowin			Step 5 150.00
	Aboye Capital			850.00
	December 1 balance sheet			4000.00

**Account Title: Cash**

**Account No.11**

Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit
2010 Dec.1	Balance	J1	650.00				

**Step 4: Write J1 in the post. Ref. Column of the cash account. J1 is written in the post.** Ref. column of the account to show that this debit to cash came from page 1 of the general journal. J is the abbreviation for general journal. Post. Ref. is the abbreviation for posting Reference.

**Step 5: Return to the journal and write in the post Ref. column of the journal the account number of the account, 11 to which the item was posted.**

Writing the number 11 in the post Ref. column of the general journal shows that this item was posted to account number 11 and that all the details of the posting of this line have been completed. For this reason, the post. Ref. figure in the journal is written as the last step in posting. When the bookkeepers are interrupted in posting, the proper use of post. Ref. number enables them to resume their posting quickly at the right place.

### Posting the remaining debit items of the opening entry

The same steps used in posting the first debit item of the opening entry are followed in posting the remaining debit items. Each account is a separate page of the ledger.

**Account Title: Operating supplies Account No. 12**

Date		Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit
2010								
Dec	1	Balance	J1	250.00				

**N.B.** Other debits shall be posted in the same way.

### Posting the credit items of the opening entry

The credit items in the general journal are posted in the same manner as the debit items, except that the credit items are posted to the credit side of the accounts. The five steps in posting the first credit item are illustrated in the diagram that follows.

General Journal

Page 1

Date	Account Title	Post Ref.	Debit	Credit
2010	Cash	11	650.00	
Dec. 1	Operating supplies	12	250.00	
	Beauty salon equipment	13	3600.00	
	Office Furniture	14	500.00	
	Ato Teshome Tesfaye Co. Commercial Bank of Eth. W/o haregowin Aboye Capital	21		150.00
	Dec.1balance sheet	22		850.00
		31		4000.00

Account Title: Ato Teshome Tesfaye Company

Account No. 21

Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit
2010				Dec 1	Balance	J1	150.00

**N.B.** Others credits shall posted in the same way

Use of Post Reference numbers

The numbers in the posting reference columns in the journal and in the ledger are useful for cross reference. Anyone looking at an entry in the journal can find the number of the account to which the journal entry was posted. With this information the bookkeeper can quickly locate the account in the ledger. Also anyone looking at an item in the ledger can find the number of the journal page from which the posting was made.

Activity: 6

- a. The balance sheet on July 1 of Dechassa Plumbing and Heating, owned by w/o Birkti Tesfu is as follows:

**Dachassa Plumbing and Heating**  
**Balance sheet**  
**July 1, 2010**

<b>Assets</b>			<b>Liabilities</b>		
Cash	1,140	00	Bayou Heating Comp	550	00
Plumbing Supplies	1,360	00	Plumbing Service Com	<u>141</u>	35
Office equipment	280	00	Total Liabilities	691.	35
Plumbing equipment	1,445	50			
Truck	<u>2,895</u>	<u>50</u>	<b>Proprietorship</b>		
			Birikti Tesfu Capital	6429	65
Total Assets	<u>7,121</u>	<u>00</u>	Tot. Liab. And Cap.	<u>7,121</u>	<u>00</u>

**Instructions:**

- i. Record the opening entry for Dachassa plumbing and Heating on page 1 of a general journal. Use July 1 of the current year as the date.
- ii. Open accounts in a ledger for all the account titles listed on the balance sheet. Number the accounts as follows: Asset accounts, 11 to 15; liability accounts 21 and 22 and the proprietor's capital account, 31.
- iii. Post the opening entry.

- *How do business owners know that they are generating profit or incurring loss during their business operations?*

**4.6. Business Transactions**

As a business conducts day-to-day operations, changes occur in the value of its assets, liabilities, and capital. Goods and services are bought and sold. Cash is received and paid out. Debts are incurred and paid.

An exchange of property or services is called a business transaction. Each business transaction causes a change in the amount of some balance sheet items. An accounting system must show not only what a business has, but also the changes in its assets, its liabilities, and its capital.



## Analysis of Business Transactions

When accountants get business paper for transactions, it is necessary to answer the following questions:

- **What happened?** What kind of business took place? Did we charge our customer for something, get money for something, buy something, etc.?
- **What accounts will change?** An account (Asset, Liability, Owner's Equity) is where we keep information on anything we wish to know about individually. For example, we have an account for money (cash) where we keep track of the increases, decreases and balance. Any time there is a transaction, at least two accounts will change.
- **How will they change?** Will the account increase or decrease?
- **Do they get a Debit or Credit ?** T-accounts may help you in the analysis. It is a method to help the analysis. It is a method to help your thoughts process without the formality of general journal entries. The actual recoding and posting of expense and income transactions are treated in following topic.

### 4.7. Income and Expense Accounts

Most businesses are in operation for the purpose of earning a profit. To make a profit, a business must engage in business transactions that increase its proprietorship. For example, owners of hotels receive cash from renting rooms; medical Doctors receive fees for services performed, Beauty salons receive from hairdressing, farmers sell their products and so on and so forth. An increase in proprietorship that results from the operation of the business is called **income**. Income is sometimes called revenue.

All income transactions cause an increase in proprietorship. A business may have several kinds of income. For example, in addition to receiving income from room sales, some motels receive income from restaurant operations and from selling beverages. All income increases are recorded on the credit side.

All businesses have operating costs. For example, a business pays for electricity, rent, telephone service and other costs. Operating costs decrease proprietorship. A decrease in proprietorship that results from the operation of the business is called an **expense**.

All expense transactions cause a decrease in proprietorship. A business may have a variety of expenses. For example, most Beauty Salons pay for telephone, water, elec-

tricity and advertising. All increase in expense accounts are recorded on the debit side because they had a negative impact on the activity of the business.

**4.7.1 Income Transactions**

The following transactions illustrate the income and expense accounts.

**Transaction No. 1:** December 20, 2010 received cash, Birr 75.00 from sales of beauty salon service.

**The steps required to analyze the transaction is shown as follows:**

**Step 1:** Determine the name of accounts affected: Cash and sales

**Step 2:** Determine the classification of each account affected.

Cash is an asset account and Sales is an income account.

**Step 3:** Determine how the balance of each of these account is changed.

- a) Haregowin Aboye Beauty Salon has more cash as a result of receiving birr 75 from its sales of one day. The balance of the cash account, an asset account is increased by 75 birr. The balance side of every asset account is the debit side. The cash account is therefore debited for the amount of the increase, birr 75.
- b) The income of Haregewoin Aboye has been increased by birr 75 as a result of receiving cash from service rendered by Beauty Salon. The balance side of every income account is the credit side. Therefore. The income sale is credited for the amount of the increase birr 75.

**Account: Sales**

**Account No.41**

Date	Item	Post Ref.	Debit	Date	Items	Post Ref.	Credit
				2010 Dec 20			75.00

**4.7.2 Expense Transactions**

The following topic deals with the steps in analyzing expense transaction.

**Transaction number 2:** December 30, 2010 paid cash 200.00 for rent of the house for December.

**Analyzing Transaction No. 2**

**The steps in analyzing transaction No. 2 are:**

**Step 1:** Determine the names of the accounts affected: Rent expense and cash

**Step 2:** Determine the classification of each account affected.

Rent Expense is an expense account and Cash is an asset account.

**Step 3:** Determine how the balance of each of these accounts is changed.

- a) The operating expenses of Haregewoin Beauty Salon have been increased by 200 birr as a result of paying the monthly rent. The balance side of any expense account is the debit side. Therefore, the expense account, Rent expense, is debited for the amount of the increase, birr 200.00.
- b) Haregewoin Beauty Salon has less cash as a result of having paid the monthly rent. The balance of the cash account, an asset account, is decreased by 200.00 birr. All decreases in any account balance are always recorded on the side opposite of the balance side. The cash account is therefore credited for the amount of the decrease, birr 200.00.

#### Activity: 7

Analyze the following transactions:

- a. Paid cash, Birr 13.00 for telephone expense.
- b. Received cash, Birr 243.00 from delivery income.
- c. Paid cash, Birr 12.50 for advertising expense.
- d. Paid cash, Birr 2.00, for washing the delivery truck. (Use Delivery Truck Expense.)
- e. Paid cash, Birr 3.50, for leather work gloves. ( Use Miscellaneous Expense)

### 4.8. The Six-Column work Sheet

The analysis to determine the profit or the loss of a business is made on a single sheet of paper with six or more amount columns. Accounting paper with a number of amount columns that are used for analysis purpose is known as a **work sheet (Working paper)**.

The length of time for which an analysis of business operations is made is called a **fiscal period**. The fiscal period may be any length of time desired such as four weeks, or (a month), three months, six months or one year.

The six amount columns of the work sheet are composed of pairs of Debit and Credit columns under the major sections headings of Trial Balance, Income statement and Balance sheet.

The proof of the equality of the debits and the credits in the ledger is called a **trial balance**. A trial balance is taken to prove the accuracy of the ledger. In the income

statement section, the amount of each expense is listed in the debit column and the amount of each income, in the credit column. When the income is larger than the expenses, the amount of the difference is called **net income**. When the expenses are larger than the income, the difference is called **net loss**.

The balance sheet section shows the amount of each asset in the Debit column, and the amount of each liability and the amount of the proprietorship in the credit column.

### Preparing a Six-Column Work Sheet

**The steps listed below should be followed when preparing a work sheet.**

- Step 1:** Write the heading on three lines; center each item in the heading
- Write the name of the business € Haregewoin Aboye **Beauty** salon.
  - Write the name of the form € Work sheet, on the second line.
  - Write the length and the closing date of the fiscal period for which the analysis is made €for month Ended December 31, 2010, on the third line.
- Step 2:** Write the column headings, the column headings of the six-column work sheet are Account Titles, Account Number, Trial Balance Debit and Credit, Income statement Debit and Credit, and Balance sheet Debit and Credit.
- Step 3:** Record the trial balance. When a work sheet is prepared at the same time a trial balance is taken, the trial balance is recorded directly on the work sheet. In this section all accounts with debit balance will be recorded on the debit side and all accounts with the credit balance are recorded on the credit side.
- Step 4:** Extend the balance sheet items into the balance sheet section as follows:
- Extend the amount of each asset from the Trial Balance Debit columns in the Balance sheet Debit column.
  - Extend the amount of each liability and the proprietorship from the Trial Balance Credit column in the Balance sheet Credit column.
- Step 5:** Extend the income and expense items into the Income Statement section, as follows:
- Extend the amount of each income from the trial Balance Credit column into the Income Statement credit column.
  - Extended the amount of each expense from the Trial Balance Debit column into the Income Statement Debit column.



**Step 6:** Total the Income Statement columns and the Balance sheet columns.

- a) Rule a single line across the Income statement columns and the Balance sheet columns to indicate addition.
- b) Add each column and write the totals on the same line as the Trial Balance totals.

**Step 7:** Calculate and record the net income (or the net loss).

- a) subtract the smaller total in the Income Statement columns from the larger total, as follows:

If the total of Income Statement credit column (income) is greater than the total of Income Statement Debit Column (expenses) the difference is net income. If total of Income statement Debit Column (expenses) is greater than total of Income Statement credit column (income) the difference is Net Loss.

**Step 8:** Extend the net income (net loss) into the Balance sheet column.

- a) Extend the amount of the net income, into the Balance Sheet Credit column to show the increase in proprietorship as a result of the net income earned by the business during the time.
- b) If there is a net loss for the month, the proprietorship is decreased. The amount of a net loss is therefore extended into the Balance Sheet Debit column because this is the column in which deductions in proprietorship must be shown.

**Step 9:** Rule double lines below the final totals of the Income Statement columns and the Balance sheet columns. The double lines show that all work has been completed and is assumed to be correct.

## Haregewoin Aboye Beauty Salon

## Work Sheet

For the Month Ended December 31, 2010

Account Titles	Acct. No	Trial Balance		Income Statement		Balance Sheet	
		Debit	Credit	Debit	Credit	Debit	Credit
Cash	11	2834.00				2834.00	
Operating Supplies	12	250.00				250.00	
Beauty Salon Equipment	13	3600.00				3600.00	
Office Furniture	14	500.00				500.00	
Ato Teshome Tesfaye Com.	21		150.00				150.00
Commercial Bank of Ethiopia	22		850.00				850.00
W/o Haregewoin Aboye Cap.	31		5092.00				5092.00
Sales	41		1318.50		1318.50		
Advertising Expense	51	18.00		18.00			
Fuel Expense	52	73.50		73.50			
Miscellaneous Expense	53	31.50		31.50			
Rent Expense	54	35.00		35.00			
Utilities Expense	55	68.50		68.50			
Total		<u>7410.50</u>	<u>7410.50</u>	226.50	1318.50	7184.00	6092.00
Net Income				<u>1092.00</u>			<u>1092.00</u>
				<u>1318.50</u>	<u>1318.50</u>	<u>7184.00</u>	<u>7184.00</u>

## Activity: 8

The account balances in the ledger of XYZ Company, on November 30 of the Current year, the end of a fiscal period of one month, are:

Cash.....	Birr 1,444.80	Ato Belay Tilahun, Capital .....	Birr 8,638.85
Automobile.....	2,800.00	Sales .....	1,501.00
Equipment .....	4,110.00	Insurance Expense .....	30.00
Office Furniture .....	987.10	Miscellaneous .....	34.80
Office Machines ....	714.10	Rent Exzpanse .....	10.00
Arega Company .....	40.00	Salary Expense .....	275.00
Tsehay Company ....	349.25	Utilities Expense .....	18.80
Dereje Company .....	95.50		

**Instruction:** Prepare a six-column work sheet for XYZ Company.

## 4.9. The Financial Statements

Information about the operations of a business for a fiscal period is summarized on the work sheet. The work sheet does not show this information in its most convenient form. For this reason, financial reports are prepared in a form that gives more meaning to the information. The most commonly used financial reports are (1) The Income Statement (2) Capital statement (3) The Balance Sheet.

### 4.9.1 The Income Statement

An income statement is an accounting report that shows the revenue and expenses during a certain period of time. One of its main purposes is to show the profit or loss resulting from operations. The income statement is often called a “**profit and loss account**” or an “**operating statement.**” It shows income and expenses. It reports the financial results of a period of operations, usually a month, a quarter, half year or a year. The income statement has three main sections: **income, expense and net income (net loss).**

### 4.9.2. Preparing the Income Statement

The information needed to prepare an income statement is found in three parts of the work sheet.

#### 4.9.2.1. Heading of the Income Statement

Each income statement covers a definite fiscal period. The fiscal period is the same as that shown on the work sheet from which the statement is prepared.

The heading of the income statement of Haregewoun Abouye’s Beauty Salon includes:

Line 1 – Name of the Business € Haregewoin Aboye Beauty Salon

Line 2 – Name of the form € Income Statement

Line 3 – Length of the accounting period € For the month ended Dec. 31, 2010.

#### 4.9.2.2. Income Section of an Income Statement

The information for preparing the income section of the income statement is obtained directly from the Income Statement credit column of the work sheet.

#### 4.9.2.3. Expense section of an income statement

Expenses are usually subdivided into selling and general or administrative expenses. Selling expenses are incurred as a direct result of the sales activities of the firm. Such items as salaries of sales clerk, advertising and delivery costs are examples of selling

expenses. General expenses are costs connected with the general operation of the business. Office salaries such as salary paid for a secretary, rent, taxes and office supplies are examples of general or administrative expenses.

The information for preparing the expense section of the income statement is obtained directly from the Income Statement Debit column of the work sheet.

#### Activity: 9

- Mention possible expenses that would be incurred by garages.
- Mention possible expenses that are incurred at your home.

#### 4.9.2.4. Net Income

The difference found by subtracting the total operating expenses from the gross revenue of the business is known as the **net income**. In some instances the total operating expenses may exceed the gross revenues. Should this occur, the difference between these two amounts would be known as **net loss**. The final figure on an income statement and the one that represents the results of all operations of a business is the net income or net loss. The amount of the net income shown on the income statement should, of course, agree with the amount of the net income shown on the work sheet.

#### Activity: 10

Calculate the net income or net loss.

a. Total Revenue (Income)	5600.00
Total Expenses	7200.00
b. Total Revenue (Income)	4500.00
Total Expenses	3700.00

#### 4.9.2.5 Preparing the Income Statement

##### **Steps in preparing the Income Statement**

Five steps are followed in preparing the income statement:

##### **1. Prepare the heading**

- Write the heading on three lines; center each item in the heading.

##### **2. Prepare the revenue section.**

- The heading of the revenue section of an income statement is the word revenue. The heading is written on the first line, beginning at the vertical line at the left. The title of the revenue account, a sale is written on the second line, indented



about one-half inch. Since Haregewoin Aboye Beauty Salon receives revenue from sales only, the amount of the sales is also the total revenue. The amount of sales is therefore written in the second amount column which is used for totals.

### 3. Prepare the expense section.

- The heading of the second section of the income statement is the word expenses. This heading is written at the left margin. The titles of each of the individual expenses are listed. Each account title is indented one-half inch from the vertical line. The amount of each expense account is written in the first amount column of the income statement. A single line is drawn across the first amount column to indicate the addition of all expense amounts. The words total expenses are written on the line beneath the last expense account title and the amount of the total expenses is written in the second amount column.

### 4. Figure out the net income (net loss).

- A single line is ruled across the second amount column to indicate subtraction of the total expenses from the total revenues. The result is written beneath the single ruled line in the second amount column. The word Net Income or Net Loss is written at the left margin.

### 5. Rule the Income Statement.

- Double lines are ruled across the amount columns to show that all work has been completed and is assured to be correct.

**Haregewoin Aboye Beauty Salon  
Income Statement  
For month ended December 31, 2010**

<b>Revenue</b>		
Sales		1318.50
<b>Expenses</b>		
Advertising Expense		
Fuel Expenses	18.00	
Miscellaneous Expenses	73.50	
Rent Expenses	31.50	
Utilities Expenses	35.00	
Total Expenses	<u>68.50</u>	
		<u>226.50</u>
<b>Net Income</b>		<u>1092.0</u>

Activity: 11

Using the following information, prepare an income statement:

<b>Sales</b>	<b>20,000.00</b>
<b>Expenses:</b>	
Advertising Expenses	5,000.00
Fuel Expenses	3,000.00
Miscellaneous Expense	4,000.00
Rent Expenses	2,000.00
Utilities Expenses	850.00

**Additional Information:**

**The Name of the Enterprise: Balcha Duferra Clinic**

**The Date: For the Month Ended October 31, 2010**

**4.9.3 The Balance Sheet**

The information needed to prepare a balances sheet is found in three parts of the work sheet. They are (1) The Heading, (2) the Account Titles column, and (3) the Balance sheet columns. The heading of the work sheet contains the name of the business and the date for which the balance sheet is prepared. The Account Titles column supplies the names of the accounts listed on the balance sheet. The Balance sheet columns of the work sheet contain all the amounts needed in preparing the balance sheet.

**Haregewoing Aboye Beauty Salon  
Balance Sheet  
December 31, 2010**

<b>Asset</b>		<b>Liability</b>	
Cash	2834.00	Ato Teshome Trsfaye Co.	150.00
Operating supplies	250.00	Commercial Bank of Ethiopia	850.00
Beauty Salon Equipment	3600.00	Total Liabilities	<u>1000.00</u>
Office Furniture	500.00	<b>Capital</b>	
	<u>          </u>	W/o Haregewoin Aboye, Capital	6184.00
Total Assets	<u>7184.00</u>	Total Liab. And Capital	<u>7184.00</u>

#### 4.9.4. The capital statement

At the end of the fiscal period, the owner of a business is interested in learning what changes occurred in proprietorship. A financial report that summarizes the changes in the proprietor's capital that have occurred during the fiscal period is called **capital statement**. The owner of the business can review the capital statement to determine if and why the capital is increasing or decreasing. Changes in the amount of capital occur:

- a. When Additional capital is invested.
- b. When cash, merchandise or other assets are withdrawn.
- c. .When the business earns a profit or incurs a loss from its operation.

Data needed to prepare the income statement are: 1) the beginning balance of capital, 2) additional investment made during the fiscal period and 3) the withdrawals during the fiscal period 4) the net income or net loss for the fiscal period.

For example W/o Haregewoin Aboye's beginning capital was Birr 4,000.00 at the beginning of the fiscal year. During the time of the operation she added additional capital amounting to Birr 1,000.00. She has withdrawn Birr 1000.00 from the business at the end of the fiscal year. The income of the statement of the business shows that the net income is Birr 1092.00. Accordingly the capital statement of the company can be prepared using the following steps:

**Step 1:** Write the heading on three lines.

**Line 1:** the name of the business €Haregewoin Aboye beauty Salon.

**Line 2:** the name of the report € Capital Statement.

**Line 3:** the fiscal period covered by the capital statement €For the Month ended December 31, 2010.

**Step 2**

- Write the words, Hargewoin Aboye, Capital, December 1, 2010 at the extreme left of the wide column
- Write the amount of capital, in the first amount column.

**Step 3**

- Write the words plus additional investment on the net line at the extreme left of the wide column to show that an amount is added to the beginning capital.
- Write the amount of the additional investment, in the first amount column on the line immediately below the beginning capital.

**Step 4**

- Add the amount of the beginning capital and the amount of the additional investment and write the total, in second amount column .
- Write the word, Total, at the extreme left of the wide column.

- Write the amount of the net income, in the first amount column.

**Step 5**

- Write the words Net Income for December 2010 at the extreme left of the wide column

**Step 6**

- Write the words less withdrawal for December 2001 in the wide column, Indented about a half inch.
- Write the amount of the withdrawals in the first amount column.

**Step 7**

- Subtract the amount of the withdrawals from the amount of the net income.
- Write the net increase or decrease at the extreme left of the wide column. If the net income exceeds the withdrawals the amount it is called net increase in capital. If the Withdrawals exceeded the net income the amount is called net decrease in capital.

**Step 8**

- Add the net increase or subtract the net decrease to /from the total and write the sum in the second amount column.
- Write Haregewoin Aboye capital, December 31, 2010 at the extreme left of the wide column to identify the amount.
- Rule double lines across both amount columns

**Haregewoin Aboye Beauty Salon  
Capital Statement  
For Month Ended December 31, 2010**

Haregewoin Aboye Capital, December 1, 2010	4000.00	
Plus :Additional Capital	<u>1,000.00</u>	
Total		5000.00
Net Income for December, 2001	1092.00	
Less :Withdrawals for December, 2001	<u>1000.00</u>	
Net Increase in Capital		<u>92.00</u>
Haregewoin Aboye, Capital, December 31, 2001		<u><u>5,092.00</u></u>



**Activity: 12**

Using the following information, prepare the capital statement for the month ended September 31, 2010.

<b>Haimanot Olango capital, September 1, 2010</b>	<b>Birr</b>	<b>15,000</b>
<b>Additional capital</b>		<b>2,000</b>
<b>Net Loss</b>		<b>3,000</b>
<b>Withdrawals</b>		<b>1,000</b>
<b>Additional Information</b>		
<b>The name of the Business: Haimanot Olango Repair Service</b>		

- *Do you think that business owners should record every small payments in their respective accounts? What will be the problems if they do so?*

### 4.10 The Petty Cash Fund

A company may make minor cash payments during a certain period for which the voucher system is not feasible. Such payments are not made haphazardly for they are minor because they will be major when accumulated. Hence, there must be some mechanism of handling such payments. This is done by establishing a petty cash fund. A petty cash fund is a fund of some amount established to make minor cash payments. It is established by withdrawing cash from the bank account and placing it in the custody of some responsible individual called petty cash custodian or cashier. In establishing a petty cash fund, the petty cash account is debited and the cash in bank account is credited.

**Example:** On June 5, 2011 LM Co established petty cash fund of Br 520 and placed it in the custody of the main secretary. The entry to record the establishment is:

2011	Petty Cash.....	520
June 5	Cash in bank.....	520

To establish petty cash fund.

If the company uses the voucher system, the establishment of the petty cash fund will be done in two steps:

Petty Cash.....	520
Voucher payable...	520

The cash withdrawal from the bank is recorded as follows:

Voucher Payable...	520
Cash in bank .....	520

When payments are made from the fund, no journal entry is made except memorandum information. The petty cash cashier inserts a voucher or petty cash receipt in the fund. When the fund reaches a certain minimum balance, it is replenished by a cash withdrawal from the bank account. The entry to record the replenishment of the fund debits various expenses indicated in the voucher and credits the cash in bank account.

**Example:** Assume the petty cash fund of LM Co shows the following composition on June 15, 1991:

- Urgent supplies.....Br 150
- Miscellaneous expenses.... 110
- Urgent merchandise..... 220
- Amount of cash in the fund is determined to be Br 22.5

The entry to replenish the fund is:

Supplies expenses	150	
Miscellaneous expenses	110	
Purchase	220	
Cash in Bank		477.5
Cash short and over		2.5

To replenish of the petty cash fund.

## Summary

The systematic Recording of the financial operations of a business or of an Individual is called bookkeeping. A Book in which the records of a business are first written is called a Journal. The name given to an account is called the account title. The number given to an account to show its location in the ledger is called an account number.

An increase in proprietorship that results from the operation of the business is called Income. A decrease in proprietorship that results from the operation of the Business is called an expense. Analysis paper on which the financial condition of a business is summarized is called a work sheet. The length of time for which an analysis of business Operations is made is called a fiscal period.

The income statement shows the financial progress of a business over a period of time. The balance sheet shows the financial condition of a business on a specific date. A financial report that summarizes the changes in the proprietor's capital that have occurred during the fiscal period is called capital statement. On the other hand, income statement reports the financial results of a period of operations.

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## Review Questions

### Part I. Choose the best answer from the given alternatives.

1. One of the following is not the purpose of accounting
  - a. Providing information for decision makers
  - b. Summarizing financial affairs of a company
  - c. Providing bulk data of day to day records of a company
  - d. Invaluable input for business development
  - e. None of the above
2. Identify the wrong statement from the following
  - a. Accounting and bookkeeping are one and the same
  - b. Bookkeeping is the recording phase of accounting
  - c. The accountant often supervises the bookkeeper
  - d. Accounting goes beyond reporting financial information by providing comparisons and other analysis
  - e. None of the above
3. One of the following is internal user of a company
  - a. The owners
  - b. The creditors
  - c. Employees and their trade unions
  - d. The production manager
  - e. None of the above
4. One of the following didn't contribute to the development of accounting internationally
  - a. Industrial revolution
  - b. Corporate organizations
  - c. Income tax laws
  - d. Government influence of business affairs
  - e. None of the above
5. The organization that converts raw materials into finished goods is
  - a. A merchandising business
  - b. A manufacturing business
  - c. A service giving business
  - d. Organized only as a corporation
  - e. None of the above
6. A statement that reports the operating results of a company is a/an
 

a. Balance sheet	d. Cash flow statement
b. Income statement	e. None of the above
c. Owner's equity statement	
7. An accounting principle that states that affairs of a business organization shall be kept separate from the affairs of the owner or those of other business organizations is
 

a. Going concern concept	d. Periodicity principle
b. Cost principle	e. Monetary principle
c. Business entity concept	



**Part II. Define and explain the following key terms.**

- |                |                           |                    |
|----------------|---------------------------|--------------------|
| a. Net loss    | g. Asset                  | m. Entry           |
| b. Net income  | h. Fiscal period          | n. Source document |
| c. Bookkeeping | i. Proprietor             |                    |
| d. Work sheet  | j. General Journal Income |                    |
| e. Liability   | k. Special journal        |                    |
| f. Expense     | l. Journal                |                    |

**Part III. Answer the following questions.**

1. State the bookkeeping equation that is true of all completed balance sheets.
2. Why should the information on the beginning balance sheet be recorded in a permanent record book?
3. What is a purpose of writing a brief description of the source document in the opening entry?
4. Why is the word Balance written in the Items column of the ledger account when posting each item of the opening entry?
5. Give three examples of business transactions that increase proprietorship?
6. Why is a separate ledger account kept for each kind of item?
7. Why is the amount of the net loss that is obtained from the Income Statement columns of the work sheet extended to the Balance sheet Debit column?
8. What is the primary use of the financial statements?
9. How does the heading of Balance sheet differ from the heading of the Income Statement?
10. What is the purpose of preparing the Capital Statement?

**IV. Project**

- A. Hill owns and operates a service giving business enterprise, Hill Photographic Studio. The chart of accounts is given below.

**Hill Photographic Studio  
Chart of Accounts**

<b>Balance Sheet Accounts</b>		<b>Income Statement Accounts</b>	
<b>(1) Assets</b>	<b><u>A/C No.</u></b>	<b>(4) Revenue</b>	<b><u>A/C No.</u></b>
Cash	11	Sales	41
Accounts Receivable	12	<b>(5) Expenses</b>	
Supplies	14	Salary Expense	52
Prepaid Rent	15	Miscellaneous Expense	59
Photographic Equipment	18		
<b>(2) Liabilities</b>			
Accounts Payable	21		
<b>(3) Capital</b>			
A. Hill, Capital	31		
A. Hill, Drawing	32		

**The following business transactions were completed during the month of March, 2011.**

March 1. The owner invested the following assets in the enterprise: Cash, Birr3,500; Accounts Receivable, Birr950; Supplies, Birr1,200; and Photographic Equipment, Birr 15,000. There were no liabilities transferred to the business.

1. Paid Birr2,400 on a lease rental contract, the payment representing three months' rent of quarters for the studio.
4. Purchased additional photographic equipment on account from Palmer Photographic Equipment Inc. for Birr2,500.
5. Received Birr850 from customers in payment of their accounts.
6. Paid Birr125 for newspaper advertisement.
10. Paid Birr500 to Palmer Photographic Equipment Inc. To apply on the Birr2,500 debt owed them.
13. Paid receptionist Birr575 for two weeks' salary.
16. Received Birr1,980 from sales from the first half of March.
20. Paid Birr650 for supplies.
27. Paid receptionist Birr575 for two weeks' salary.
31. Paid Birr69 for telephone bill for the month.
31. Paid Birr175 for electric bill for the month.
31. Received Birr1,870 from sales for the second half of March.
31. Sales on account totaled Birr1,675 for the month
31. Hill withdrew Birr1,500 for her personal use.

**Required:**

1. Analyze and record the transactions in a general journal.
2. Post to the ledger using four column accounts.
3. Prepare a Trial Balance.
4. Prepare financial statements (Income statement, capital statement and balance sheet). Assume that there is no adjustment during on March 31,2011