

Welcome to this semester class!
Course

Principles of Accounting

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Course: Principles of Accounting

Course Objective

Upon the successful completion of this course, you should be able to:

- summarize and apply basic financial accounting terms;**
- apply accounting concepts, and principles in analyzing, recording, and reporting basic business transactions.**

Course Contents

- 1. Introduction to Accounting and Business**
- 2. Accounting cycle for service-giving business**
- 3. Accounting for Construction Businesses**
- 4. Cash and Receivables**

Chapter 1

Introduction to Accounting and Business

Introduction

- A **business** is an organization in which basic resources (inputs), such as materials and labor, are assembled and processed to provide goods or services (outputs) to customers.
 - Businesses come in all sizes, from a local **coffee house to Starbucks**, which sells over \$9 billion of coffee and related products each year. **Approximately our country annual budget**
- **Why businesses are established?**
 - *What are the types of businesses?*
 - *What are the forms of businesses?*

Types of Businesses

1. Manufacturing Business

Manufacturing businesses change basic inputs into products that are sold to customers. Examples

Manufacturing Companies	Product
General Motors	Cars, trucks, vans
Intel	Computer chips
Boeing	Jet aircraft
Nike	Athletic shoes and apparel
Dire Dawa Textile Factory	Cloths
Sony	CD player and television



Cont'd.....

2. Merchandising Business

Merchandising businesses sell products they purchase from other businesses to customers.

Product	
Wal-Mart	General merchandise
Toys "R" Us	Toys
Circuit City	Consumer electronics
Lifan Motors	Car
Amazon.com retailer	Internet books, music, video



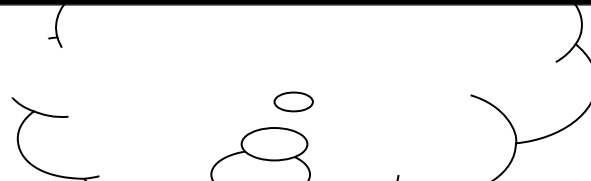
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3. Service Business

• **Provide services rather to customers.**

• **Examples**

	Product
Sodere Resort	Entertainment
Ethiopian Air Lines	Transportation
Ethiopia Hotels	Hospitality and accommodation
Dashen Bank	Financial advice/service
Ethiotelecom	Telecommunication



**There are three
forms of business
organizations**



✓ **Proprietorship**

p = 70

✓ **Partnership** = 10

✓ **Corporation** = 20



A
proprietorship
ip is owned
by one
individual.

Abadir Supper Market



Advantages

- Ease in organizing/for establishing

- Low cost of organizing

Disadvantage

- **Limited source** of financial resources
- **Unlimited liability-** which means the liability of the organization will



A
partnership
is owned by
two or more
individuals.

Shemisu and Abebe's



Advantages

- More financial resources than a proprietorship.
- Additional management skills.

Disadvantage

- **Unlimited liability**
- **Limited life.**



A **corporation** is organized under state or federal statutes as a **separate legal entity**.

Habesha Cement S.C



Advantage

- The ability to obtain **large amounts** of resources by issuing stocks.
 - Easy to transfer ownership
 - **Limited liability**
- ## Disadvantage
- Double taxation.



According to the 1960 Commercial Code of Ethiopia

- **Forms of Business Organizations are**
 - 1. Sole proprietorship**
 - 2. General partnership**
 - 3. Limited partnership**
 - 4. Joint venture**
 - 5. Private limited company**
 - 6. Corporation**

What is the Role of Accounting in Business?



Answer

- **It provides financial information :**
 - for managers to use in operating the business***
 - to other users in assessing the economic performance and condition of the business.***

Definition

- **Accounting** is an information system that provides
 - financial **Information** to **users** (**Stakeholders**)
 - **about the economic activities and condition of a business.**
- **Accounting is a process** of **analyzing, recording, summarizing, reporting and interpreting the economic activities** and condition of a business.
 - Thus, you may think of accounting as the
“language of business.”

Business Stakeholders

A *business stakeholder* is a ***person or entity having an interest in the economic performance*** of the



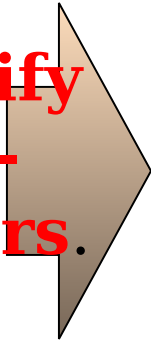
Steps in providing AIS

- **The process by which accounting provides information to users is as follows:**
 - **1. Identify users.**
 - **2. Assess users' information needs.**
 - **3. Design the accounting information system to meet users' needs.**
 - **4. Record economic data about business activities and events.**
 - **5. Prepare accounting reports for users.**

The Process of Providing Information

1

Identify stakeholders.



Stakeholders/Users
Internal:
Managers,
employees



External:
Owners,
Customers
,
creditors,
government

2

Assess stakeholders' informational needs.



The Process of Providing Information

Record economic

data about business activities and events which is called Business Transactions.

Accounting Information System

Design the accounting information system to meet stakeholders'

The Process of Providing Information

STAKEHOLDERS

Internal:

Owners,
managers,
employees



External:

Customers,
creditors,
government

**Prepare
accounting
reports for
stakeholders.**

**Accounting
Information
System**

5



Internal users of AIS

- **Internal users of accounting information include managers and employees.**
 - **These users are directly involved in managing and operating the business.**
 - **The area of accounting that provides internal users with information is called managerial accounting or management accounting.**
 - **The objective of managerial accounting is to provide relevant and timely information for managers' and employees' decision-making needs.**

- **External users of accounting information** include customers, creditors, and the government.
 - These **users are not directly involved in managing and operating the business.**
 - The area of accounting that provides external users with information is called **financial accounting.**
 - **The objective of financial accounting is to provide relevant and timely information for the decision-making needs of users outside of the business.**
 - **General-purpose financial statements** are one type of financial accounting report that is distributed to external users.
 - **The term general-purpose refers to the wide range of decision-making needs**

Profession of Accounting

Accountants employed by a business firm or a not-for-profit organization are said to be engaged in *private accounting*.

Accountants and their staff who provide services on a fee basis are said to be employed in *public accounting*.



Generally Accepted Accounting

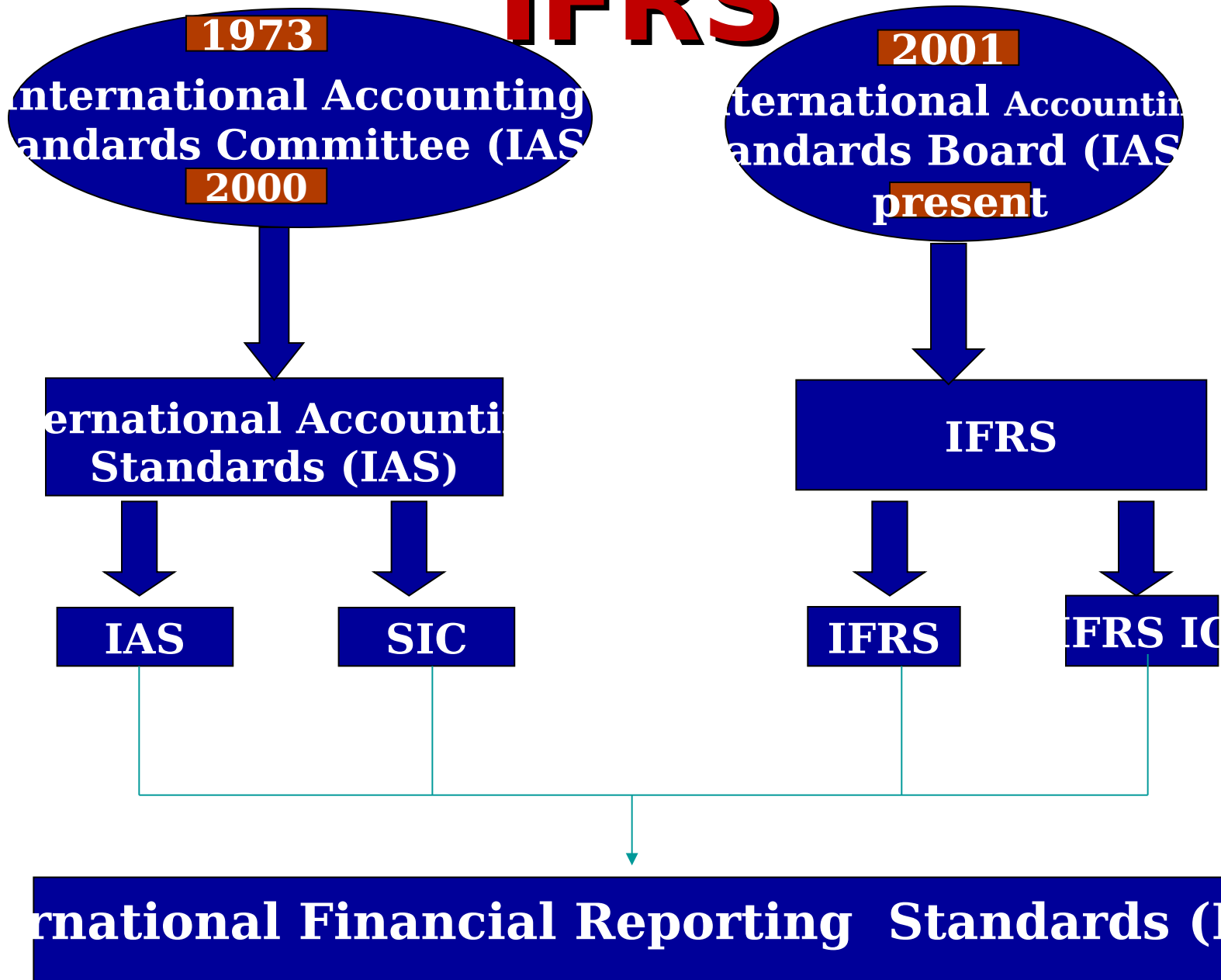
Principles (TEDS)



- ***If a company's management could record and report financial data as **it saw fit/without standard**, comparisons among companies would be difficult, if not impossible.***
 - **Thus, financial accountants follow generally accepted accounting principles (GAAP) in preparing reports.**
 - **These reports allow investors and other users to compare one company to another.**
 - **Within the United States, the Financial Accounting Standards Board (FASB) has the primary responsibility for developing accounting principles.**
 - **Many countries outside the United States use generally accepted accounting principles adopted by the International Accounting Standards Board (IASB).**
- ***The IASB issues International Financial Reporting Standards (IFRSs).***

Transition from IAS to

IFRS



ASSUMPTION

S

1. Economic entity
2. Going concern
3. Monetary unit
4. Periodicity

PRINCIPLES

1. Historical cost
2. Revenue recognition
3. Matching
4. Full disclosure

CONSTRAINT

S

1. Cost-benefit
2. Materiality
3. Industry practice
4. Conservatism

Third level
Recognition and Measurement Concepts

QUALITATIVE CHARACTERISTIC

S

Relevance

Reliability

Comparability

Consistency

ELEMENTS

Assets, Liabilities, and Equity

Distribution to owners (W/D)

Comprehensive income

Revenues and Expenses

Gains and Losses

Second level

Qualitative Characteristics and Basic Elements

OBJECTIVES

1. Useful in **investment and credit decisions**
2. Useful in pretty assessing future cash flows
3. About enterprise resources, claims to resources, and changes in them

First level
OBJECTIVES

LO 2 Describe the FASB's efforts to construct a conceptual framework

Conceptual Framework for Financial Reporting

□ Underlying Assumptions

Going concern :

- The IFRS Framework states that the ***going concern*** assumption is an underlying assumption.
- Thus, financial statements should be prepared assuming that an entity will continue in operation ***indefinitely*** unless management either intends to liquidate the entity or to cease its operation.
- If that presumption is ***not*** valid, ***disclosure*** and ***a different basis of reporting*** are required.

The ***business entity assumption*** limits the economic data in the accounting system to data related directly to the

- The ***cost principle*** is the basis for entering the **exchange price**, or **cost** of an **acquisition in the accounting records**.
- Under the **cost concept**, amounts are **initially recorded** in the accounting records at **their cost or purchase price**.

Class-Work

- **To illustrate, assume that Aaron Publishers purchased the following building on February 20, 2008:**
 - Price listed by seller on January 1, 2008 \$**160,000**
 - Aaron Publishers' initial offer to buy on January 31, 2008 **140,000**
 - Purchase price on February 20, 2008 **150,000**
 - Estimated selling price on December 31, 2010 **220,000**
 - Assessed value for property taxes, December 31, 2010 **190,000**
- **Aaron Publishers records on February 20, 2008 @????**

The **objectivity concept** requires that the accounting records and reports be based upon objective evidence. **Example:**

The **unit-of-measure concept** **or assumptions** requires that all economic data or business transactions should be recorded in birr.

Chapter Two

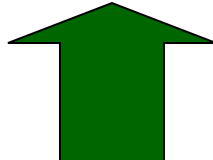
Accounting Cycles

- **Analyzing business transaction**
- **Journalizing (recording transactions in journal)**
- **Posting (transferring records from journal to ledger)**
- **Preparation of trial balance**
- **Preparation of financial reports**
- **Closing of temporary accounts and preparing post-closing trial balances**

e Accounting Equat

The Accounting Equation

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$



The resources
owned by a
business

The resources owned by a business are **assets**. Examples of assets include **cash, land, buildings, and equipment**.

Claims to the Assets of a Business

- **Claims of**
Creditors

- **Liability**

- **Claims of**
Owners

- **Owners**
Equity

The Accounting Equation

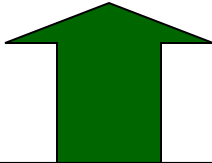
Assets = **Liabilities** + Owner's
Equity

The rights of the creditors,
which represent debts of
the business

The **rights** of creditors in the **asset** of the businesses are the **debts** of the business and are called **liabilities**. Example: Account

The Accounting Equation

Assets = Liabilities + Owner's Equity



The rights of the owners

The rights of the owners in the asset of the businesses are called owner's equity.



Assets	
Liabilities	
Supplies	Owner's Equity
Land	Mr. Abebe, capital

➤ Owner's Equity Account (Capital) balance will be affected by four items. These are **Expenses**, **Revenue**, **Additional Investment** and **Owners Withdrawal**.

Expenses include:

- Wage expenses
- Rent expenses
- Utility expenses
- Miscellaneous expenses

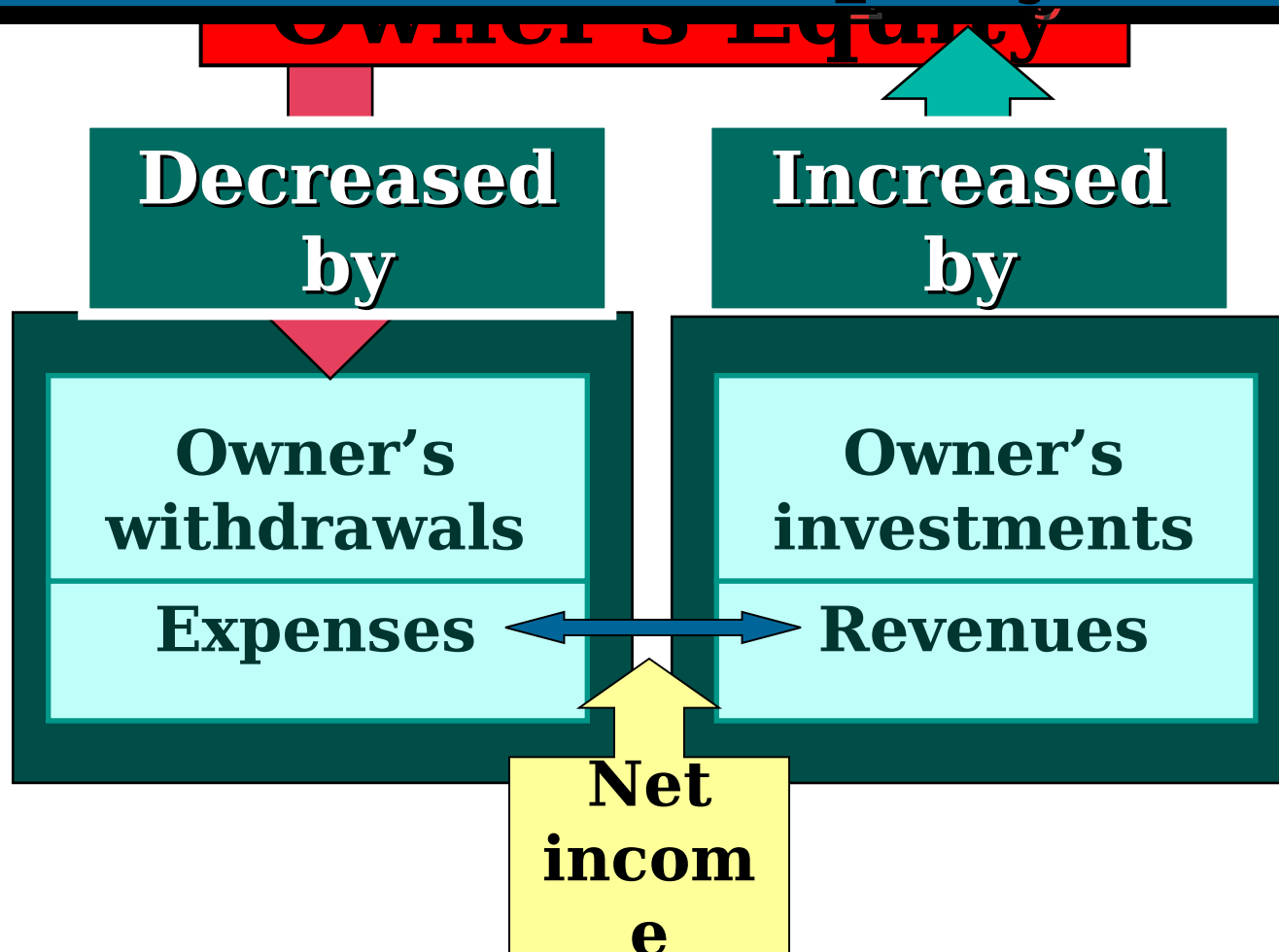
What is a business transaction?



A business transaction is an economic event that affects an entity's financial condition.

Example Selling, purchasing

Effects of Transactions on Owner's Equity





On November
1, 2005, **Mr.**
Abebe begins
a business
which is
known as
NetSolutions



a. Mr. Abebe deposits \$25,000 in a bank account in the name of NetSolutions (Business).

Assets

Cash

25,000

0

=

=

Owner's Abebe,

Equity Capital

25,000

Investment by Mr. Abebe



b. NetSolutions acquired Land for \$20,000.

<u>Assets</u>		=	<u>Owner's Equity</u>
Cash	+	}	Mr. Abebe,
Land			Capital
-25,000			25,000
-20,000			<u>25,000</u>
+20,000	20,000		



c. During the month, NetSolutions purchased supplies for \$1,350 and agreed to pay the supplier in the near future (*on account*).

Assets				=	Owner's Liabilities + Equity	
					Accounts Payable	Capital
Mr. Abebe,	Cash	Supplies	Land			
5,000		20,000			25,000	
	+ 1,350				+ 1,350	
5,000	1,350	20,000			1,350	25,000

**N.B. Purchas can be made in two ways.
On **cash** or on **account** (Accounts Payable)** ⚡

a.

Net Solutions

provided

services to customers,
earning fees of \$7,500 and
received the amount in
cash.

Assets

=

Owner's

Liabilities +

Accounts

Equity

Mr. Abebe,

Cash + Supplies + Land

5,000 Capital 1,350 20,000

7,500

12,500 1,350 20,000

=

1,350

1,350

Payable

25,000

+ 7,500

32,500

Fees
earn
ed



e. NetSolutions paid the following expenses: wages, \$2,125; rent, \$800; utilities, \$450; and miscellaneous, \$275.

Assets				=	Owner's Liabilities + Equity			
					Accounts Payable			
Mr. Abebe,								
Cash	+	Supplies	+	Land				
12,500		1,350		20,000		1,350	32,500	
- 3,650							- 2,125	Wage
							- 800	s
							- 450	Rent
							- 275	Util.
Bal.	8,850	- 1,350	- 20,000		- 1,350			Misc.
	28,850							



f. NetSolutions paid \$950 to creditors during the month.

Assets				Owner's Liabilities + Equity	
				Accounts Payable	
Mr. Abebe,					
Cash	+	Supplies	+	Land	Payable
8,850		1,350		20,000	
- 950					
7,900		1,350		400	28,850



g. At the end of the month, the cost of supplies on hand is \$550, so \$800 of supplies were used.

Assets				=	Owner's Accounts		
					Liabilities	+ Equity	
Mr. Abebe,							
Cash	+	Supplies	+	Land		Payable	
7,900		1,350		20,000	400	28,850	Supplies
		- 800				- 800	expense
7,900		550		20,000	400	28,050	



h. At the end of the month, Chris withdrew \$2,000 in cash from the business for personal use.

Assets				=	Liabilities + Owner's Equity	
					Accounts Payable	
Mr. Abebe,						
Cash	+	Supplies	+ Land			
7,900		550	20,000	=	400	28,050
-2,000						-2,000
5,900		550	20,000		400	26,050

Withdrawal



Major Account Classifications

Liabilities are often identified on the balance sheet by titles that include *payable*.

Assets are resources owned by the business

Cash
Supplies
Building
Accounts
receivable

Accounts payable
Notes payable
Wages payable



Major Account Classifications

Owner's equity is the owner's right to the assets of the business.

Chris Clark,
Capital
Chris Clark,
Drawing

Revenues are increases in owner's equity as a result of selling services or products.

Fees
Earned
Fares
Earned
Commission
Revenue

Expenses are the using up of assets or consuming of services to generate revenue.

Rent
Expense
Salary
Expense
Utilities
Expense





Chart of account

- **It is the list of accounts used by a business.**
- **Each account in a ledger is given a name and a number.**
- **A number given to an account, which shows the account's location in the ledger is called account number.**





A list of the accounts in a ledger is called a ***chart of accounts***.

A **group** of accounts for a business entity is called a ***ledger***.



NetSolutions

Chart of Accounts

Balance Sheet

1. Assets

- 11 Cash
- 12 Accounts Receivable
- 14 Supplies
- 15 Prepaid Insurance
- 17 Land
- 18 Office Equipment
- 19 Accumulated
Depreciation

2. Liabilities

- 21 Accounts Payable
- 22 Wages Payable
- 23 Unearned Rent

3. Owner's Equity

- 31 Chris Clark, Capital
- 32 Chris Clark, Drawing

Income

4. Revenue

- 41 Fees Earned
- 42 Rent Revenue

5. Expenses

- 51 Wages Expense
- 52 Rent Expense
- 53 Depreciation Expense
- 54 Utilities Expense
- 55 Supplies Expense
- 56 Insurance Expense
- 59 Miscellaneous Expense





Source Documents

- **Initially, all transactions must be identified taking the information on the source documents.**
- **source document**
 - **A paper prepared as the evidence that a transaction occurred.**
 - **It includes invoices, receipts, cheque stubs, and memorandums.**

Analyzing Transactions

- When analyzing transactions, we need to identify:
 - The accounts affected
 - The nature of the accounts
 - How the accounts are affected
- **Once the effect of the transactions are analyzed, the rule of debit and credit will be applied for recording,**

Recording Transactions

- Initially, all transactions are recorded in the **General Journal**.
- Each transaction always affects at least two different accounts.
 - One account has a debit effect.
 - The second account has a credit effect.
- This methodology was named “double entry” accounting by whom?

What Is a General Journal?

- The book in which a person enters the original record of a business transaction
 - Commonly referred to as a book of original entry
- **Chronological listing of all** the business transactions for the company
 - Each listing records the debits and credits associated with that business transaction
- **A book or a location on a hard drive** where all business transactions are listed

General Journal Page

GENERAL JOURNAL

Page:

[illegible]

Illustration

The date of the transaction is entered in the date **column**.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2002 Sept. 1	Cash M. Doucet, Capital Invested cash in business.		15,000	15,000	
1	Equipment Cash Purchased equipment for cash.		7,000	7,000	

Melkamsewu, Attorney-at-Law, is a sole proprietorship business owned and operated by **Ato Melkamu**. On July 1, 2009, **Melkamsewu, Attorney-at-Law**, has the following assets and liabilities: cash, \$1,000; accounts receivable, \$3,200; supplies, \$850; land, \$10,000; accounts payable, \$1,530. Office space and office equipment are currently being rented, pending the construction of an office complex on land purchased last year. Business transactions during July are summarized as follows:

July 2. Received cash from clients for services, \$3,928.

July 5. Paid creditors on account, \$1,055.

July 12. Received cash from **Ato Melkamu** as an additional investment, \$3,700.

July 15. Paid office rent for the month, \$1,200.

July 20. Charged clients for legal services on account, \$2,025.

July 23. Purchased supplies on account, \$245.

July 25. Received cash from clients on account, \$3,000.

July 27. Received invoice for paralegal services from Legal Aid Inc. for July (to be paid on August 10), \$1,635.

July 29. Paid the following: wages expense, \$850; answering service expense, \$250; utilities expense, \$325; and miscellaneous expense, \$75.

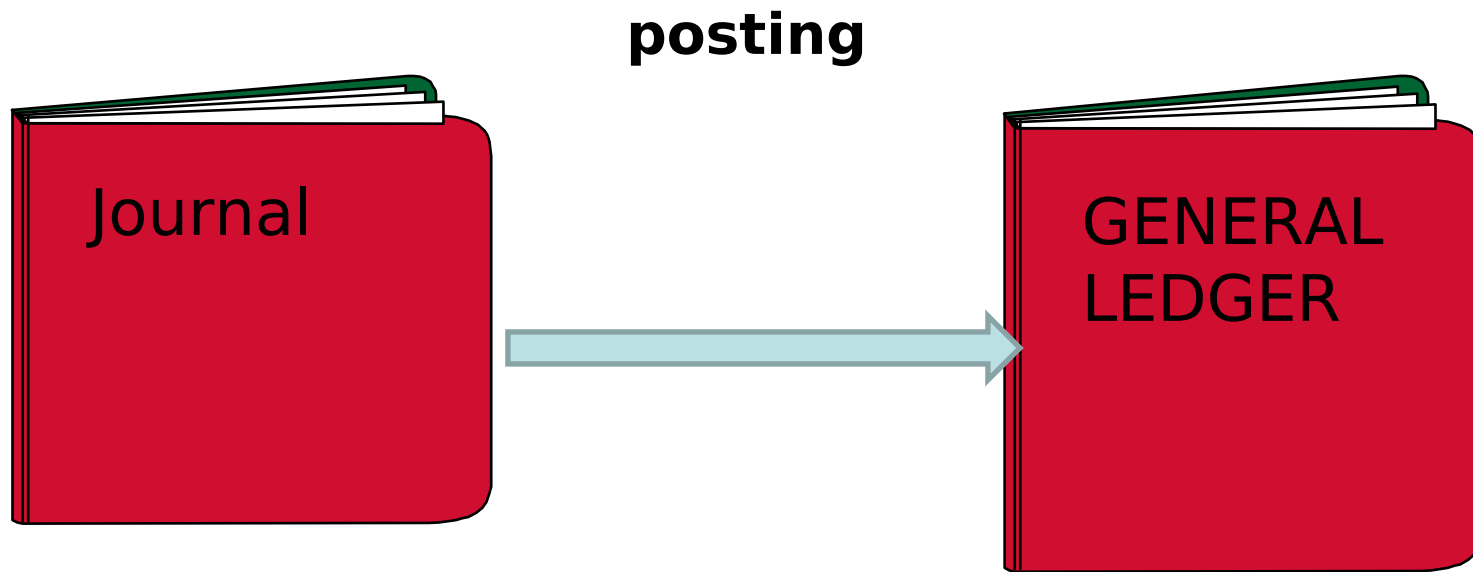
July 30. Determined that the cost of supplies on hand was \$980; therefore, the cost of supplies used during the month was \$115.

July 30. **Ato Melkamu** withdrew \$1,000 in cash from the business for personal use.

Date	Description	Pos t ref.	Debit	Credit
July 2.				
July 5				
July 12				
July 15				
July 20				

Posting to THE LEDGER Accounts

- The entire **group of accounts** maintained by a company is referred to collectively as the **ledger**.
- A **general ledger** contains all the assets, liabilities, and owner's equity accounts.
- Posting: is the process of transferring figures from the journal to the ledger accounts



Four-Step Posting Process

- 1. Transfer transaction date to account's date column**
- 2. Transfer the debit/credit amount and calculate the new balance**
- 3. Write journal page number in posting reference column of ledger as a cross-reference**
- 4. Go back to journal and write account number in posting reference column of journal as a cross-reference**

ILLUSTRATION

POSTING A JOURNAL ENTRY

General Journal				
Date	Account Title and Explanation	Ref	Debit	Credit
2002				
01-Sep	Cash	101	15,000	
	M. Doucet, Capital	301		15,000
	Invested cash in business.			

General Ledger					
Cash					
Date	Account Title and Explanation	Ref	Debit	Credit	Balance
2002					
01-Sep		J 1	15,000		15,000

In the ledger, enter in the appropriate columns of the account(s) debited the **date**, **journal page**, and **debit amount** shown in the journal and the account number to which the journal was posted.

ILLUSTRATION

POSTING A JOURNAL ENTRY

General Journal				
Date	Account Title and Explanation	Ref	Debit	Credit
2002				
01-Sep	Cash	101	15,000	
	M. Doucet, Capital	301		15,000
	Invested cash in business.			

General Ledger					
M. Doucet, Capital					
Date	Account Title and Explanation	Ref	Debit	Credit	Balance
2002					
1-Sep		J 1		15,000	15,000

In the ledger, enter in the appropriate columns of the account(s) credited the **date**, **journal page**, and **credit amount** shown in the journal and the account number to which the journal was posted

Trial Balance

THE TRIAL BALANCE

- A **trial balance** is a list of accounts and their balances at a given time.
- The primary purpose of a trial balance is to prove the **mathematical equality of debits and credits** after posting.
- A trial balance also uncovers errors in journalizing and posting.
- The procedures for preparing a trial balance consist of
 1. listing the account titles and their balances,
 2. totaling the debit and credit columns, and
 3. proving the equality of the two columns.

Trial balance: Sample

EMM

Trial Balance
Dec 31, 2004

Account title	Debit	Credit
Cash	143,534	
Account Receivables	11,500	
Supplies	20500	
Prepaid Insurance	24,000	
Prepaid rent	8000	
Vat receivable	5070	
Office Equipment	17,000	
Machinery	100,000	
Account Payables		11550
VAT payable		10,950
Withholding payable		76
Employee income tax paya-		5,770
Pension contr. Payable		1,883
Notes payable		40,000
Contributed capital		224,500
Retained earnings		0
Service Revenue		73,000
Salary Expense	30,800	
Advertizing expenses	1800	
Utilities Expense	5500	
Bank charges	25	
	367,729	367,729

LIMITATIONS OF A TRIAL BALANCE

- **A trial balance does not prove that all transactions have been recorded or that the ledger is correct.**
- **Numerous errors may exist even though the trial balance columns agree.**
- **The trial balance may balance even when**
 - 1. a transaction is not journalized,**
 - 2. a correct journal entry is not posted,**
 - 3. a journal entry is posted twice,**
 - 4. incorrect accounts are used in journalizing or posting,**
 - 5. offsetting errors are made in recording the amount of the transaction.**

- **Errors may occur in posting debits and credits from the journal to the ledger.**
- **One way to detect such errors is by preparing a trial balance.**
- **The steps in preparing a trial balance are as follows:**

Step 1: List the name of the company, the title of the trial balance, and the date the trial balance is prepared.

Step 2: List the accounts from the ledger and enter their debit or credit balance in the Debit or Credit column of the trial balance.

Step 3: Total the Debit and Credit columns of the trial balance.

Step 4: Verify that the total of the Debit column equals the total of the Credit column.

Errors Affecting the Trial Balance

- If the trial balance totals are not equal, an error has occurred.
- In this case, the error must be found and corrected.
- A method useful in discovering errors is as follows:
 1. If the difference between the Debit and Credit column totals is 10, 100, or 1,000, an error in addition may have occurred.
 - In this case, re-add the trial balance column totals.
- If the error still exists, re-compute the account balances.

2. If the difference between the Debit and Credit column totals can be evenly divisible by 2, the error may be due to the entering of a debit balance as a credit balance, or vice versa.

- In **this case, review the trial balance for account balances** of one-half the difference that may have been entered in the wrong column. For example, if the Debit column total is \$20,640 and the Credit column total is \$20,236, the difference of \$404 (\$20,640 - \$20,236) may be due to a credit account balance of \$202 that was entered as a debit account balance.

3. If the difference between the Debit and Credit column totals is evenly divisible by 9, trace the account balances back to the ledger to see if an account balance was incorrectly copied from the ledger.

Two common types of copying errors are transpositions and slides.

A **transposition error** occurs when the order of the digits is copied incorrectly, such as writing \$542 as \$452 or \$524.

In a **slide (slide error)**, the entire number is copied incorrectly one or more spaces to the right or the left, such

Cont'd..

- 4. **If the difference between the Debit and Credit column totals is not evenly divisible by 2 or 9,** review the ledger to see if an account balance in the amount of the error has been omitted from the trial balance.
- If the error is not discovered, **review the journal postings** to see if a posting of a debit or credit may have been omitted.
- 5. **If an error is not discovered by the** preceding steps, the accounting process must be retraced, beginning with the last journal entry.

Cont'd...

- The **trial balance does not** provide complete proof of the accuracy of the ledger.
- It indicates only that the **debits and the credits are equal**.
- This proof is **of value**, however, because errors often affect the equality of debits and credits.

Errors Not Affecting the Trial Balance

- **An error may occur that does not cause the trial balance totals to be unequal.**
 - Such an error may be discovered when preparing the trial balance or may be indicated by an unusual account balance.
 - ***For example,*** a credit balance in the supplies account indicates an error has occurred.
 - This is because a business cannot have “negative” supplies. When such errors are discovered, they should be corrected.
 - If the error has already been journalized and posted to the ledger, a **correcting journal entry** is normally prepared.

Exercises

- Page 84= **EX 2-18: Errors in trial balance**
- **Page 90= PR 2-6A: Corrected trial balance**

Adjusting Entries

Update
account
balances

Prior to
preparing
financial
statements



Financial Statements

ACCOUNTING RECORDS,
called ***financial
statements***, provide
summarized
information to the
owner.



Financial Statements

- **Income statement**
 - A summary of the revenue and expenses *for a specific period of time.*
- **Statement of owner's equity**
 - A summary of the changes in the owner's equity that have occurred *during a specific period of time.*
- **Balance sheet**
 - A list of the assets, liabilities, and owner's equity *as of a specific date.*
- **Statement of cash flows**
 - A summary of the cash receipts and disbursements *for a specific period of time.* ⚡

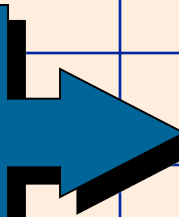
NetSolutions

Income Statement

For the Month Ended November 30,

	2005						
Fees earned						\$7	500
Operating expenses:						00	
Wages expense			\$2	125			
Rent expense			00	800	00		
Supplies expense				800	00		
Utilities expense				450	00		
Miscellaneous expense				275	00		
Total operating expenses						1	135
Net income						\$3	050 00

To the
statement of
owner's
equity




NetSolutions

Statement of Owner's Equity

For the Month Ended November 30,

Mr. Abebe, capital, November 1, 2005					\$			
Investment				\$25 000 00	0			
Net income				3 050 00				
				\$28 050 00				
Less withdrawals				2 000 00				
Increase in owner's equity						26 050 00		
Mr. Abebe, capital, November 30, 2005						\$26 050		

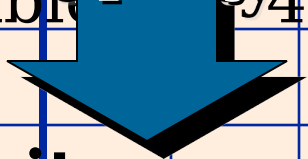
From the
income
statement

To the
balance
sheet



**NetSolutions
Balance Sheet
November 30, 2005**

From the
statement of
owner's
equity



Assets							
Cash	\$	5	900	00	Accounts Payable		5400
Supplies			550	00	Owner's Equity		
Land		20	000	00	Mr. Abebe, cap.	26	050
					Total liabilities and		
Total assets	\$	26	450	00	owner's equity	\$26	450

This balance sheet
presented using the
account form



When the balance sheet displays the liabilities and owner's equity below the assets, the ***report form*** is being used.



Statement of Cash

Flows

Steps in preparing cash flow is first to identify transaction that affects the following three cash flow activities.

1. Cash Flows from Operating Activities—

This section reports a summary of cash receipts and cash payments from

2. Cash Flows from Investing Activities—This section reports the cash transactions for the acquisition and sale of relatively permanent assets or Fixed Assets.

3. Cash Flows from Financing Activities—This section reports the cash transactions related to cash investments by the owner, borrowings, and cash withdrawals by

Summary of the above all transactions that affects cash flow statements are

<u>Transaction Activity</u>	<u>Amount</u>	<u>Cash</u>	<u>Flow</u>
a. \$25,000	Financing	(Investment by Mr. Abebe)	
b. 20,000	Investing	(Purchase of land)	
d. 7,500	Operating	(Fees earned)	
e. 3,650	Operating	(Payment of expenses)	

NetSolutions

Statement of Cash Flows

For the Month Ended November 30,

2005

Cash flows from operating activities:

Cash received from customers\$ 7 500 00

Deduct cash payments for expenses

and payments to creditors 4 600 00

Net cash flow from operating activities

2 900 00

Cash flows from investing activities:

Cash payment for acquisition of land (20 000 00

Cash flows from financing activities:

Cash received as owner's investment\$25 000 00

Deduct cash withdrawal by owner2 000 00

Net cash flow from financing activities

23 000 00

Should match Cash on the balance sheet

Net cash flow and Nov 30, 2005 cash balance

Home-Take Illustration

Income Statement

Ethio Metal Fabrication
Income Statement
For The Year Ended December 31, 2004

Sales Revenue		73000
Salary Expense	33,300	
Advertizing expenses	1800	
Utilities Expense	5500	
Bank charges	25	
Supplies Expense	12000	
Insurance Expense	1000	
Rent expense	2000	
Depreciation Expense	2050	
Total expenses		(57,675)
Net income		<u>15325</u>

Every amount on this income statement was taken from the Income Statement column of the work sheet.



Statement of Owner's Equity

Ethio Metal Fabrication

Statement of retained earnings

For the Year Ended December 31, 2004

Retained Earnings December 1, 2004.....		0
Add: Net Income (Net Loss).....	15325	
Less: dividend paid.....	<u>(0)</u>	
Net Increase In Capital		<u>15325</u>
Retained Earnings December 31, 2004.....		<u><u>Br 15325</u></u>



Balance sheet

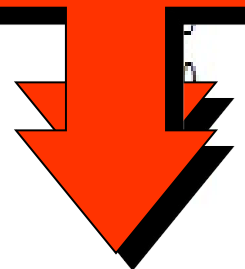
Ethio Motor Maintenance

Balance Sheet

December 31, 2004

Assets		Liability and Owner's Equity	
Cash	143,534	Account Payables	
Account Receivables	11,500	VAT payable	
Supplies	8,500	Withholding payable	
Prepaid Insurance	23,000	Employee income tax payable	
Prepaid rent	6,000	Pension contr. Payable	
Vat receivable	5,070	Salaries Payable	
Office Equipment	17,000	Notes payable	
Accum. Depm -Equip	(400)	Total liab.	
Machinery	100,000	Retained earning	<u>15,325</u>
Accum Depm. Mach	(1,650)	Contributed capital	<u>224,500</u>
Total Assets	312,554	Total liab. and OE	<u>312,554</u>

From the
Statement of
Owner's
Equity



Adjusting and Closing Entries

Adjusting entries are recorded in the journal at the end of the accounting period.

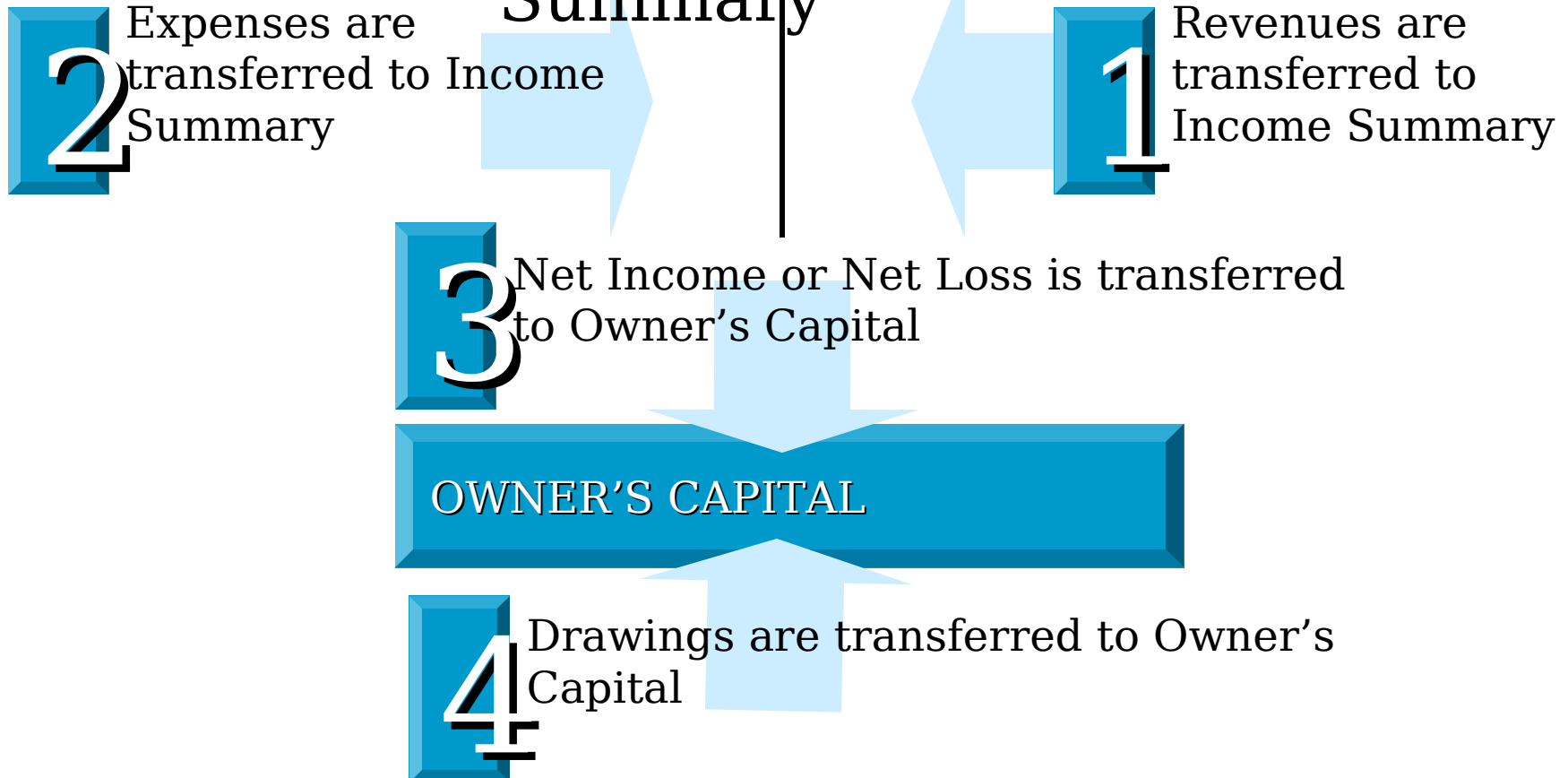


Adjusting entries for EMF

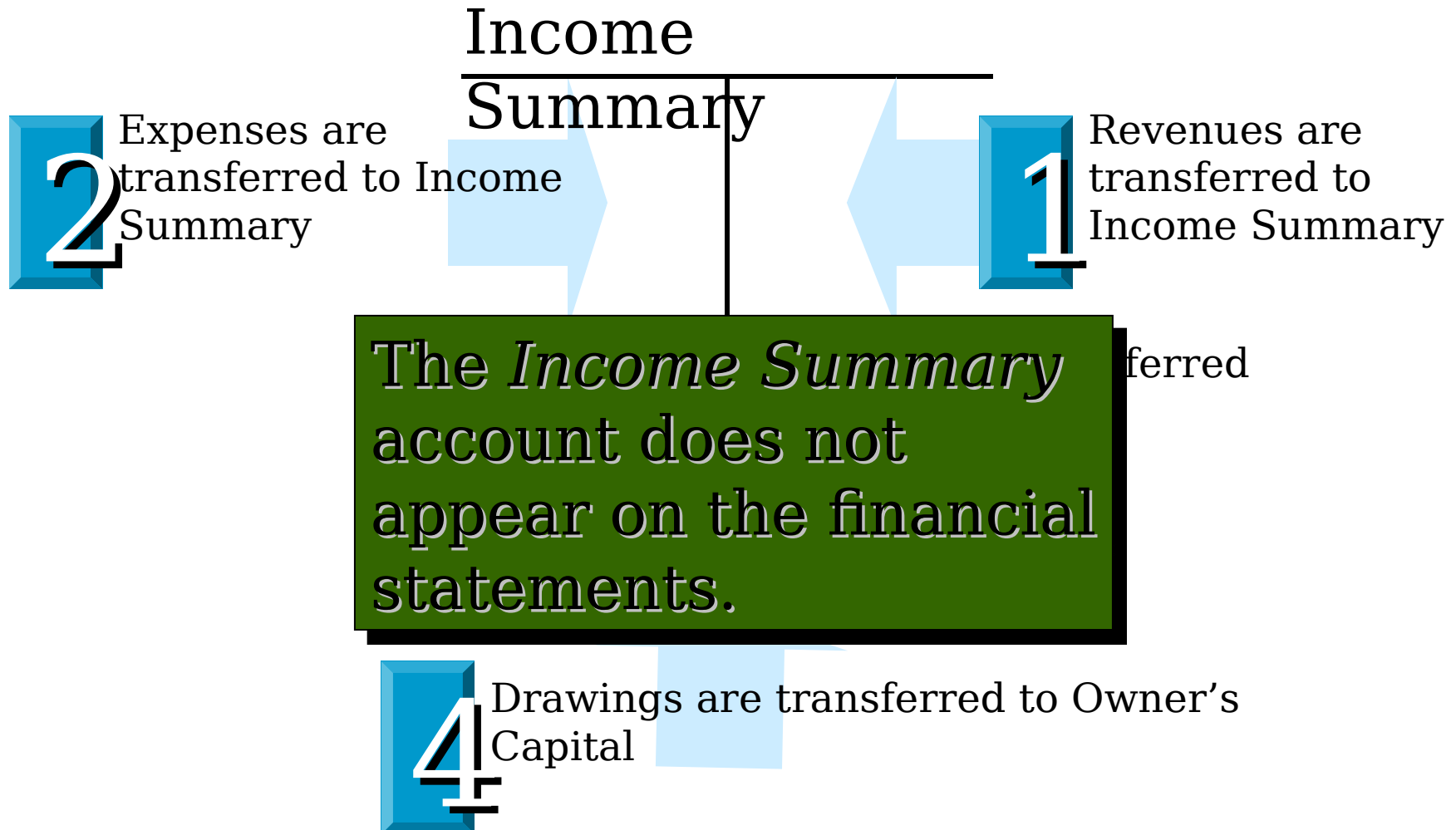
General Journal/ Journal Voucher				Page
Date	Description	P/R	Debit	Credit
	Adjusting Entries			
<u>Dece 31</u>	Supplies Expense		12,00.00	
	Supplies			12,000.00
31	Insurance Expense		1000.00	
	Prepaid Insurance			1000.00
31	Rent expense		2000.00	
	Rent Income			2000.00
31	Salary Expense		2500.00	
	Salary Payable			2500.00
31	Depreciation Expense		2050.00	
	Accumulated Depreciation - Equip			400.00
	Accumulated Depreciation - <u>Machi</u>			1650

The Closing Process

Income Summary



Adjusting and Closing Entries



The Closing Process

Wages Expense

Bal.

33,300

Rent Expense

Bal. 2000

Depreciation Expense

Bal. 2050

Utilities Expense

Bal. 5500

Supplies Expense

Bal. 12000

Insurance Expense

Bal. 1000

Bank charges

Bal. 25

Income Summary

Sales

Bal. 73000

Retained earnings

-

Note: The balances shown are adjusted balances before closing. The following sequence demonstrates the closing process.



The Closing Process

Wages Expense

Bal.

33,300

Rent Expense

Bal. 2000

Depreciation Expense

Bal. 2050

Utilities Expense

Bal. 5500

Supplies Expense

Bal.

12,000

Insurance Expense

Bal. 1000

Bank charges

Bal. 25

Income Summary

16,960

Fees Earned

16,840

Bal.

16,840

Retained earnings

Step 1

Debit each revenue account for the amount of its balance, and credit *Income Summary* for the total

The Closing Process

<u>Wages Expense</u>		
Bal.		33,300
33,300		
<u>Rent Expense</u>		
Bal. 2000		2000
<u>Depreciation Expense</u>		
Bal. 2050		2050
<u>Utilities Expense</u>		
Bal. 5500		5500
<u>Supplies Expense</u>		
Bal.		12,040
12,000		
<u>Insurance Expense</u>		
Bal. 1000		1000
<u>Bank charges</u>		
Bal. 25		25

<u>Income Summary</u>		
	57,775	73000

<u>Retained earnings</u>		

Step 2

Debit *Income Summary* for the total expenses and credit each expense account for its balance.

The Closing Process

Income Summary	
57,775	73000
15,325	

Retained Earnings	
	Bal. 0
	15325

Step 3

Debit *Income Summary* for the amount of its balance (in this case, the net income) and credit

After the closing entries are posted,
all of the temporary accounts have
zero balances.



EMF

Post closing Trail Balance As of December 31,2004

Account Title	Debit	Credit
Cash	143,534	
Account Receivables	11,500	
Supplies	8,500	
Prepaid Insurance	23,000	
Prepaid rent	6,000	
Vat receivable	5,070	
Office Equipment	17,000	
Accum. Depm- Equip		400
Machinery	100,000	
Accum. Depm- Machinery		1,650
Account Payables		11,550
Salaries payable		2,500
VAT payable		10,950
Withholding payable		76
Employee income tax paya.		5,770
Pension contr. Payable		1,883
Notes payable		40,000
Contributed capital		224,500
Retained earnings		15,775
	<u>314,604</u>	<u>314,604</u>

Chapter

2

The End