UNIT 4

BUSINESS RECORDS KEEPING AND FINANCIAL REPORTS 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 including the role played by financial statements. The basic financial statements, Income Statement, Capital Statement and Balance Sheet will be discussed, as well.

4.1 What is Accounting?

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.

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.*

A person who earns a living by undertaking activity of accounting is called *accountant.*

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.
- 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)

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.

to facilitate comparability of financial statements of different periods and different organizations.

b. *Cost Accounting*: is 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:* 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 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 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 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. 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 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.

Accounting 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.

The size and complexity of the business unit increased, the accounting problems involved in the issuance of financial statements became more complex.

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 accounting 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.

4.3. The Beginning 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.

Is 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.

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.

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.

a. Current Assets or Working Capital: is Assets used to support the day-to – day operations of a company are. 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.

*b. Fixed Asse*ts 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)

….....2.000.00

Equals the amount of the owner’s (Ato Teshome’s)

capital..... 70.000.00

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

1, the equity of the creditors and

2, the equity of the owners.

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	Loan (liabilities)
Cash .....5,000.00 Inventories .....6,000.00 Accounts Receivables.....4,000.00 Total Assets.....15,000.00	Loan from commercial Bank of Ethiopia ….....6,000.00 Ato Teshome Capital ..... 9,000.00 Total liab & capital.....15, 000.00

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

4.3.5 Body of the Balance Sheet

It 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

Assets (1) What is owned	Liabilities (2) What is owe Capital (3) What the business is worth

Left hand side (Debit) Right hand side (Credit)

Steps in preparing a balance sheet

1. Write the heading on three lines;
2. Prepare the assets section on the left-hand side
3. Prepare the liabilities section on the right-hand side
4. Prepare the capital section on the right-hand side
5. Determine if the balance sheet is “in balance” and complete its preparation

Haregewoin Aboye Beauty Salon

Balance Sheet

December 31, 2001

Assets	**Liabilities**
Cash..... 650.00	Ato Teshome Tesfaye Co.
Operating Supplies 250.00	….....150.00
Beauty Salon Equipment	Commercial Bankof Ethiopia
…..... 3600.00	….....850.00
Office Furniture	TotalLiabilities.....1000.00
…..... 500.00	**Capital**
	Haregewoin Aboye, capital
Total assets 5000.00	…..... 4000.00
	Total liab and cap
	….....
	5000.00

4.4 Recording the Opening Entry

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 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

1. Special journal. A journal that is used to record only one type of entry.

2. General journal. is used to record entries that cannot be recorded in special journals.

4.4.2.1. The General Journal

Is 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. The two-column general journal, shown below, is used by the Haregowin Aboye Beauty Salon to record its beginning balance sheet.

General Journal Page No.___

Date	Account Title	Post Ref.	Debit	Credit

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 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 the credit column.

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.

Steps in Recording the Opening Entry

Step 1: Date of entry: Step 3: Credit part of the entry:

Step 2: Debit part of the entry: Step 4: Source of the entry:

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 Operating supplies Beauty salon equipment Office Furniture		650.00 250.00 3600.00 500.00	

		Ato Teshome Tesfaye Co.			150.00
		Commercial Bank of Eth			850.00
		W/ro Haregowin Aboye			4000.00
		Dec.1 balance sheet			

4.5 Posting the Opening Entry

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. 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

The part of the chart of accounts of Haregewoin Aboye Beaty Salon needed for this unit is shown blow.

Haregewoin Aboye Beauty Salone

Chart of Accounts

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

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 numbers 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.

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. 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
201		Cash		650.00	
0	1	Operating supplies		250	
Dec.		Beauty salon equipment		3600	
		Office Furniture		500	
		Ato Teshome Tesfaye Co.			
		Commercial Bank of Eth.			150
		W/o Haregowin Aboye Capital			850
		Dec.1 balance sheet			4000

Account: Cash

Account no. 11

date	Item	Post Ref.	dabit	date	item	Post Ref.	credit
2010 dec. 1	Balance		650.00				

Step 1: Write the amount of the cash debit,

Step 2: Write the date of the journal entry,

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

General Journal

Page 1 …….....

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

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.

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.

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:

General Journal Page 1

Date		Account Title	Post Ref.	Debit	Credit
2010		Cash	11	650.00	
Dec.	1	Operating supplies	12	50.00	
		Beauty salon equipment	13	3600.00	
		Office Furniture	14	500.00	
		Ato Teshome Tesfaye Co.	21		150.00
		Commercial Bank of Eth.	22		850.00
		W/o haregowin Aboye	31		4000.00
		Capital			

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

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.

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.

How will they change? Will the account increase or decrease?

Do they get a Debit or Credit ? It is a method to help your thoughts process without the formality of general journal entries.

4.7. Income and Expense Accounts

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.

A decrease in proprietorship that results from the operation of the business is called an expense. All expense transaction causes a decrease in proprietorship. A business may have a variety of expenses. For example, most Beauty Salons pay for telephone, water, electricity 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.

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 steps in analyzing expense transaction.

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.

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

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. 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

Step 5: Extend the income and expense items into the Income Statement section.

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

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

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

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	13	3600.00				3600.00	

Equipment	14	500.00				500.00	
Office Furniture	21		150.00				150.00
Ato Teshome Tesfaye	22		850.00				850.00
Com.	31		5092.0				5092.00
Commercial Bank of	41		0		1318.50		
Ethiopia	51	18.00	1318.5	18.00			
W/o Haregewoin	52	73.50	0	73.50			
Aboye Cap.	53	31.50		31.50			
Sales	54	35.00		35.00			
Advertising Expense	55	68.50		68.50		7184.00	
Fuel Expense		7410.50		226.50	1318.50		6092.00
Miscellaneous Expense				1092.00			1092.00
Rent Expense			7410.5				
Utilities Expense			0				
Total							
Net Income							
				1318.50	1318.50	7184.00	7184.00

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

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

1. Heading of the Income Statement

2. Income Section of an Income Statement

3. Expense section of an income statement

4. Net Income

5 Preparing the Income Statement

Five steps are followed in preparing the income statement:

1. Prepare the heading

2. Prepare the revenue section.

3. Prepare the expense section.

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

5. Rule the Income Statement.

Haregewoin Aboye Beauty Salon

Income Statement

For month ended December 31, 2010

Revenue		1318.50
Sales	18.00	
Expenses		
Advertising Expense	73.50	
Fuel Expenses	31.50	
Miscellaneous Expenses	35.00	
Rent Expenses	68.50____	
Utilities Expenses		
Total Expenses		226.50_
Net Income		1092.0_

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 Bal-ance sheet columns. The heading of the work sheet contains the name of the busi-ness 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

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

4.9.4. The capital statement

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

Haregewoin Aboye Beauty Salon

Capital Statement

For Month Ended December 31, 2010

Haregewoin Aboye Capital, December 1,2010	4000.00	
Plus :Additional Capital 1,000.00	1,000.00	
Total		5000.00
Net Income for December, 2001	1092.00	
Less :Withdrawals for December, 2001	1000.00	
Net Increase in Capital		92.00
Haregewoin Aboye, Capital, December 31, 2001		5,092.

4.10 The 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 expensesBr110 Urgent merchandise. Br 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.