Accounting
for Basic Bookkeeping
2nd Edition

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FOREWORD

Say the word, “accountant,” and you’re likely to get visions of men and women hunched over their desks or their computers, much like Ebenezer Scrooge’s clerk Bob Cratchit, going over records, determining where every last cent, centime, centavo, or sen went to. Say the word, “accounting,” and you may likely think of a subject where tedium and boredom occur side by side with the kind of incomprehensible jargon that only an elite few can understand.

Granted, such thoughts might be somewhat true, but accounting is far more than tedium and being an unknowable magical art. Accounting underlies everything that we do in our modern-day world, yet can easily be understood and used in our every day, financial lives.

This courseware aims to dispel the notion of accounting as being difficult and complex. Students become familiar with the basics and elements of accounting in an easy-to-understand way, by presenting day-to-day activities wherein accounting is used. In this way, the student’s understanding of the technical aspects of accounting, as a simple but necessary business tool, is developed.

The first volume of this courseware establishes the basics of accounting and introduces some of its essential elements, and also raises the student’s awareness of the wide range of job opportunities available to accountants, as accounting is used in all industries worldwide. The second volume of this courseware delves into accounting as a means to organize one’s personal, household, and business finances, with the intention of developing a mindset to keep track of funds and to be able to plan financially for future goals such as savings.

Jaime L Caro

Jaime D. L. Caro, Ph.D.
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ABOUT THE AUTHORS

CIELITO S. CANTORIA, CPA graduated from the Central Colleges of the Philippines in October, 1980 with a degree in Bachelor of Science in Business Administration, Major in Accounting. She took the licensure examination for Certified Public Accountant (CPA) and passed the Board in June 1981.

The author's more than 20 years of accounting experience started during her college days when she financed her way through college and review school, working as a general clerk in a construction company. Her accounting career took off in August 1981, after she landed a job as a Junior Auditor of one of the top universal banks in the Philippines. She subsequently advanced to higher positions by becoming a Senior Auditor, a Branch Accountant, and a Branch Assistant Manager.

In 1989, she went into full-time practice of her accounting profession in partnership with her husband, who is also a CPA and co-author of this book. As a husband-and-wife team, they handle accounting of different types of small- to medium-scale businesses, such as garments manufacturing, trucking, import-export trading, educational institutions, security services, retail outlets, pawnshop operations and real estate development.

The author is currently a Senior Writer of a New York-based online digital magazine that covers a variety of topics in the fields of business, science, and technology. The online publisher ranks her as among the top 10% of its pool of international writers, earning her milestone recognitions as the writer of the "Spotlight Article of the Month" in April 2010 and as a recipient of the company's 2010 annual "Beacon Award."

LEONARDO P. CANTORIA, JR., CPA is a graduate of the University of the East with a degree of Bachelor of Science in Business Administration (BSBA) Major in Accounting. It took him only three years to earn his BSBA degree, which permitted him to attend various post-graduate seminars in leading universities and prestigious associations. In 1984, he became a Certified Public Accountant.

He rose from the ranks by starting out as a bookkeeper in one of the country's top universal banks where he was subsequently promoted as internal auditor. In 1990, he sought career advancements with other banks and went on to become Branch Manager and later Audit Head, where he gained his first formal writing experience by creating the bank's manual for cash, clearing operations, and credit policies. By the year 2000, he became the Accounting Manager of a top financing company where he was later promoted as Managing Director of its Hong Kong subsidiary.

In 2008, he decided to devote his full time to the flourishing accounting service business partnership he had formed with his wife, who is also a CPA and co-author of this book. This career move likewise afforded him the opportunity to venture into the academe by teaching accounting, finance, and taxation subjects in one of the country's leading business schools.

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Jaime D. L. Caro, Ph.D. has more than 20 years of experience in education and research in the areas of Computer Science, Information Technology, and Mathematics. He received the degrees of Bachelor of Science major in Mathematics (cum laude) in 1986, Master of Science in Mathematics in 1994, and Doctor of Philosophy in Mathematics in 1996, all from the University of the Philippines, Diliman. He spent a year as a post doctorate research fellow at the University of Oxford from 1997 to 1998. He is presently Assistant Vice President for Development of the University of the Philippines, Program Director of the UP Information Technology Training Center (UP ITTC), and a professor of Computer Science in UP Diliman. He is an honorary member of the Philippine Society of Information Technology Education (PSITE), President of the Computing Society of the Philippines (CSP), and a member of the Technical Panel on Information Technology Education of the Commission on Higher Education (CHED). Dr. Caro is a recognized expert on Complexity Theory, Combinatorial Network Theory, Online Communities, and e-Learning.

Armando R. Codera, Jr., MBA has been in the IT industry for over 20 years, particularly in software development, project management, product development, and business management. He completed both his Bachelor of Science in Computer Science and Masters in Business Administration at the University of the Philippines in Diliman. His professional career spans both the government and private sectors, including having served as Head of Systems Development under the Presidential Management Staff in 1989, as IT Director of SmithKline Beecham in 1998, and as E-business Director of Glaxo SmithKline Philippines in 2001. He is currently the Sales and Marketing Director of TechFactors Inc., as well as President of Headstart Business Solutions, an IT company providing technology solutions and consulting services to companies and institutions to enhance customer interfaces.

CONTENTS

BOOK INTRODUCTION

This courseware aims to dispel the notion that accounting is a difficult and complex subject matter to comprehend. The course initially involves ordinary and common practices in one's day-to-day activities so that, in this way, the student can more easily visualize and apply basic concepts, and thus enhance his or her accounting foundation. This also makes it easier for the student to figure out the technical aspects of accounting as simple but necessary business tools.

LEARNING GOALS

By the end of this courseware, learners are expected to:

1. apply the concepts and fundamentals of accounting as a tool for organizing and managing personal finances and in carrying out similar non-entrepreneurial tasks;

2. maintain accounting records to determine profits gained from simple income-earning activities;

3. keep accounting books to record assets, liabilities and capital for business purposes; and

4. comply with organizational policies and basic income tax requirements.

CHAPTER 01

Basic Accounting Concepts

Origins of Accounting

(Prehistoric Times of Bohemia, Moravia and Slovakia, National Museum in Prague / Wikimedia CCA-SA Unported)

Many believe that accounting evolved from the concept of "possession." As mankind learned to amass food, objects and territorial claims, it became important to determine just how much had been collected and owned.

Evidence of one of the first tally systems has been linked to the jawbone of a wolf found in the Cro-Magnon cave that was discovered in Czechoslovakia in 1937. Research revealed that the said jawbone had fifty-five slashes carved into it and that the slashes were presented in groups of five.

In a separate archaeological find in Africa, a piece of animal bone was discovered which contained notches expressed in groups of 11, 13, 17 and 19, which represent numbers that cannot be distributed equally. It was apparent that making a permanent record of "how many" was of great relevance and significance even at that early period.

As more artifacts were discovered, researchers became more convinced that, even during prehistoric times, man became conscious of recording and monitoring his possessions became more and more obvious.

When the Stone Age became the Bronze Age, and when the Bronze Age later transitioned into the Iron Age, metal possessions apparently became more valuable than the previous earthenware belongings. Tokens of varying forms and sizes have been found, and are surmised to have been used to denote value, a significant development that heralded an improvement in trading methods.

The Earliest Forms of Accounting

The beginnings of ancient human civilizations oftentimes involved war and conflict, which turned tribes into nations when these conquered other tribes, and nations to empires by vanquishing other nations. The idea of acquiring possessions had evolved into the concept of amassing wealth, which allowed those who had more to gain control or power over those who had less.

It was in the ancient lands of Mesopotamia, Babylonia and Egypt that the earliest forms of accounting were introduced. As mankind evolved from being hunters to being farmers, certain complexities necessitated the development of a system for managing wealth and possessions.


(Defensive Walls Zutphen mure / Wikimedia under public Domain)

Invaders and conquerors oftentimes turned their captives into slaves, whom they had to account for because they were traded and distributed. Subjects were likewise required to pay taxes to their overlords or rulers if they wanted to reside within the city walls and thus benefit from the protection that a walled city provided. Agricultural crops had to be counted and recorded to make sure that the people were paying the correct amount of taxes.

The earliest known accounting records have been traced to the ancient biblical walled city of Jericho, the oldest known continuously inhabited city on Earth. Anthropologists and archaeologists have found stone markers and envelopes which apparently served as documents that resembled a balance sheet. Each document was specific to a certain individual, along with specific entries for agricultural inventories and number of tokens.

(Globular envelope with a cluster of accounting tokens – Wikimedia – CCA-SA 2.5 Generic)

In the cities of Sumer and Mesopotamia, bookkeeping records were unearthed in the form of clay tablets, which bore indentations to mark the number of precious metals and goods that were traded. The clay, which was impressed while wet and which would later be left under the sun to dry and harden, would serve as permanent records. Moreover, the "abax," a device invented as an improvement over the tokens that were being used as markers in Sumeria, is said to be the original form of the abacus.

(The British Museum, Room 55 - Cuneiform Collection)

In Egypt, papyrus paper became popular for administrative and record-keeping purposes. This allowed the development of an auditing system, since the papyrus records provided clear documentation of any irregularities among the Pharaoh's administrators.

The Greeks came up with a more sophisticated method of trading by introducing the concepts of money, accounting and banking. This was later adopted by the Roman Empire as it developed as a center of civilization during the Classical Period of European history.

The Renaissance and the Birth of Modern Accounting

It was during the Renaissance in the 14th century, well after the fall of the Roman Empire, that Italian scholars, led by Frater Luca Bartolomes Pacioli, developed the foundations of modern accounting. However, his works were not published until much later, when accounting, as a scholarly discipline, was taken up as a separate subject matter.

In his book, *Summa de Arithmetica, Geometria, Proportioni et Proportionalita (Everything About Arithmetic, Geometry and Proportion*), the bookkeeping system was included among the guidelines for mathematical knowledge and applications.

Pacioli's guidelines included three important books, namely: (1) the daybook, (2) the journal and (3) the ledger.

- The first book, the daybook, contained the chronological order of recording all business transactions, and provided columns for various monetary units.

(Portrait of Fra Luca Pacioli / Wikimedia under public domain)

- The second book, which was the journal, contained explanations of the transactions that were recorded in the daybook but were written in narrative form.
- The last, which was the ledger, had entries posted on the left page and on the right page, both of which referred to a single account (cash, goods, etc.).
- Pacioli's cycle of recording and monitoring ended with a trial balance.

The Renaissance man's final bookkeeping instruction was to make sure that the total of the ledger accounts on the left and right pages should be the same, otherwise, an error or several errors were made in recording the entries to the ledger. Thus, due diligence and intelligence were to be applied in seeking and correcting such errors.

Elements that Brought about the Concept of Accounting

In order to arrive at a definition of accounting, let us first review the elements that brought about the concept of accounting:

Possession – The need to own food, objects, tools or property to ensure adequate provisions for one's means for daily subsistence.
Value – A concept that recognizes that every object has a different worth or significance.
Territory – This denotes the limits or the boundaries within which an individual can impose his right over his possession.
Token – The device or tool which is acceptable as unit of measure for the value of an object, and which a willing trader will accept as a means of exchange.
Taxes – The payment required by the ruler from the people in exchange for the benefits of living in the latter's territory under full protection.
Barter – The simple exchange of goods.
Trading – The exchange of goods for tokens or money.
Arithmetic – The system of summing up or subtracting the numbers that were recorded in order to arrive at a summary of one's trading activities.
Journalizing – The act of making a written record of the trading activity or of the tax payments.
Obligation – A duty or act which the residents of a territory are required to pay or perform in order to receive a benefit or to enjoy a privilege.

These were the elements of the earliest known transactions, which required a proper system of recording, known as bookkeeping.

However, the recording of business transactions will only have full significance if the summary could be interpreted. After the Renaissance, the Age of Industrialization brought forth more scientific methods aimed at measuring productivity and efficiency.

Bookkeeping provided the milestone records by which the productivity of a business industry could be measured. Interpretations required a broader range of knowledge, since there were other values to consider for analysis, such as the length of time and the proportion and the propriety of elements to be included. These requirements gave birth to the concept of accounting as a separate discipline.

Accounting, therefore, is defined as the systematic and organized method of identifying, recording, classifying and summarizing various financial details into financial reports, which will be analyzed and interpreted as basis for making economic decisions.

Bookkeeping on the other hand, is more concerned with the recording phase of accounting.

Basic Accounting Rules

Modern day learning techniques emphasize the "apples-to-apples" concept. In accounting, this denotes that records maintained should all be for the same period of coverage, and should be calculated using the same components, as well as categorized based on the same rules of classifications.

Adherence to this discipline required the establishment of rules, now commonly known as the "generally accepted accounting principles." These serve as guidelines to meet a specific set of standards for both internal and external purposes. In this way, the financial reports that serve as financial summary of business operations can withstand all forms of scrutiny, tests of accuracy and comparisons. These basic accounting rules are as follows:

Business Entity or the Entity Principle – This denotes the segregation of objects and property owned for business purposes from those used for personal or non-profit activities.

Example: A family car and its related expenses should not be included as part of the business possessions.

Assumption of Monetary Value – This refers to the establishment of the unit of currency to be used for recognizing the transactions. This should be in accordance with the economy in which the business operates. As an example, the Philippine economy makes use of the "peso" as the unit of currency. Hence, local business entities that engage in importing and exporting goods and commodities will have to record related transactions in the peso equivalent.

Assumption of Time Period – This principle requires uniformity of the accounting period in which business transactions are recognized. This is in view of the two types of recognized accounting periods, the calendar and the fiscal periods. Ordinarily, businesses observe a 12-month accounting period, commencing from January and ending on December of the same year. Thus, if a business has adopted the calendar period, it follows that only the business transactions that were completed from January to December of the present year shall be included for recording, summarizing and interpreting purposes. A more comprehensive explanation about accounting periods will be discussed in a future lesson.

Cost Recognition Principle – A reference to cost denotes the value of money that was paid as a means to acquire goods and pay for services. To maintain uniformity, cost should be recorded at its original price or at its historical cost plus the incidental expenses that were paid relative to the goods or items acquired.

Example: A piece of land bought five years ago at a purchase price of two hundred thousand pesos was recorded in the business books for the same amount. Under the cost recognition principle, this amount shall remain as the value of the property in the business books, regardless of the present market value of the property, which is now pegged at one million pesos.

Income Recognition Principle – This refers to the recognition of income derived from the selling of goods or rendering of services in exchange for cash or a promise to pay. Goods sold on account are recognized and recorded within the same period that the goods or services were transferred, and in accordance with the payment arrangement mutually agreed upon by the seller and the buyer.

Example: Businessman Juan sells household appliances on installment arrangements. At the end of the year 2015, some borrowers still had unpaid balances amounting to fifteen thousand pesos. The borrowers were able to complete their payment only in March, 2016. Based on the principle of income recognition, the unpaid amount of fifteen thousand as of 2015 is still part of the revenue for the said year.

Matching Principle – This principle requires that only those costs that were used to produce income for a particular accounting period will be recognized as operating expenses. Costs that will benefit the business beyond the present accounting period shall be recorded as the cost of ownership as a prepaid expense.

Example: A dump truck bought at a purchase price of five hundred thousand pesos has an estimated useful life of five years. This amount will not be recorded as expense but as the acquisition cost of the equipment. Matching principle will be observed by distributing the PhP 500k over the truck's 5-year useful life by way of depreciation expenses. That way, the truck's annual depreciation cost will match the income produced by the dump truck for each year of service.

Materiality – A reference to materiality pertains to decisions regarding the inclusion, disclosure or the treatment of a particular amount by determining its significance or insignificance relative to the operation or productivity of a business.

Example: An employee was unable to account for a five-peso shortage for a particular day's total transaction. After exerting all efforts to locate the error, the shortage was temporarily recorded as a sundry expense. A month later, the same employee incurred a shortage of five hundred pesos and again, the error could not be traced. Due to the materiality of the amount, the shortage was recorded as a receivable amount from the employee and will be deducted accordingly from his next salary.

Conservatism – This principle is observed by exercising a certain degree of caution in determining the option to consider if presented with two or more possible choices. The principle of conservatism dictates that the option to take is the one in which the business will not expect greater benefits.

Example: A farmer estimates that his agricultural land is capable of producing five hundred thousand pesos worth of agricultural crops for the season. However, in mapping out his future plans, the farmer will adhere to the principle of conservatism by estimating that only 60% or only three hundred thousand worth of agricultural crops will be successful.

Consistency – This refers to constancy, maintaining uniformity or using the same methodologies, bases, and measures in recording, presenting and interpreting the financial information of the business.

Example: Consistency principle is observed in calculating annual depreciation expenses, since there are other methods that may be allowed for special purposes. As a rule, if a straight-line method was used to compute previous depreciation expenses, then the same method shall be used consistently in all accounting periods and for all capital assets.

Going Concern – The business shall always operate under the assumption that all its projections, plans of actions and operational objectives are geared toward the growth and continuity of the business.

Example: A unit of equipment that has been fully depreciated is not zeroed-out as a business possession, as far as its operational efficiency is concerned. At the very least, it is booked at its scrap value to show that it is still being used as part of the business operation. Maintaining the equipment at its scrap value provides a basis of the price for which the fully depreciated equipment can be sold. As a going concern, the business entity intends to sell the fully depreciated asset to lessen the cost of a suitable replacement in light of its intention to operate continuously and profitably.

Accounting in Business and Industry

Let us recall from the origins of accounting the fundamental aspects that gave rise to the accounting discipline. These factors shed light on how accounting evolved into becoming a significant tool for businesses and various industries.

1. An organized and accurate record of possessions provides the owner with a basis for distinguishing the objects, tools and goods used for personal activities from those that are utilized for trading or business purposes.
2. Clear and accurate sets of documentation describe the benefits and costs, derived from and incurred for business operations. These can serve as additional proof of compliance with the tax requirements of the community in which a business owner resides or trades.
3. A well-maintained set of records containing details of how money flows in and out of the business helps the owner analyze any change, be it an increase or a decrease, in his financial condition.
4. By having a clear understanding of how money and other devices were utilized, a business owner can institute the necessary improvements or corrective measures to ensure that business possessions are constantly put to productive or fruitful use.
5. Accurate and reliable records furnish baselines on which future business plans or targeted goals can be developed and formulated.
6. A sound accounting system provides a safeguard against improper use or misappropriation of business possessions.
7. A complete set of properly documented accounting records serves as a fair gauge of measuring not only the performance of the business but also of the workforce employed to carry out day-to-day transactions.

Accounting Occupations and Professions

Given the significance of accounting to businesses and different industries, individuals with knowledge and proficiency in basic bookkeeping methods have a wide range of job opportunities available.

Such job titles as accounting clerk, accounting technician or bookkeeper are entry-level positions on which one can build an accountancy career. These are often offered to college interns, working students or fresh college graduates and are quite useful as for a way to acquire hands-on experience. Most of the time, they are tasked to perform the following functions:

Accounting Clerks

The type of work assigned to accounting clerks depends on the size and nature of a business organization. Large companies have job titles like Accounting Clerk (General), Accounting Clerk (Accounts Receivable), Accounting Clerk (Accounts Payable), Accounting Clerk (Purchasing), and similar specialized handling of accounts. However, acquiring a broad range of experience from these functions tends to be limited if a clerk stays stagnant in this job. Accounting functions are often limited to the handling of documents and entries pertaining to a single account.

Bookkeepers

Bookkeepers usually have a wider range of responsibilities inasmuch as the work assigned to them includes balancing of the daily transactions and preparing a summary form that resembles a trial balance. Work may be shared with another bookkeeper in charge of reviewing transaction summaries in a computerized accounting setup. Functions also include posting of entries in the general ledger books and reconciling account balances against the subsidiary ledgers handled by the accounting clerks.

The Certified Public Accountant

Graduates of Bachelor of Science in Accountancy should aim to pass the professional board examination administered by the Philippine Regulatory Commission (PRC). Passing the board will earn an accountancy graduate the title of Certified Public Accountant (CPA), which will open more avenues for higher-paying career opportunities.

CPAs who come from entry-level occupations can start at supervisory positions and can rise through the ranks to the positions of Assistant Managers, Managers, Assistant Vice-Presidents, Vice Presidents (Controller), and up to Senior Vice President/Chief Financial Officer (SVP-CFO). They may be assigned to different accounting departments like Accounting, Budget, Credit and Collection, Systems Analysis, Finance and Banking, and Internal Audit just to name a few.

Functions or job positions include budget analyst, systems analyst, credit processor, credit reviewer, financial analyst, and internal auditor.

As a CPA, an accounting professional can also work independently as a public accountant for different small to medium scale businesses. Startup businesses usually hire a freelance CPA to set up and maintain their accounting books as an alternative to hiring a bookkeeper and an accountant. Business owners seek well-rounded CPAs to act as financial consultants for project feasibility studies, or as business analysts for the development and integration of software for a computerized business system.

A CPA who pursues further education by successfully completing a Master's Degree in Business Administration or Master of Science in Accountancy can find work as an accounting professor or reviewer for the CPA Board Exam.

comprehension check

Basic Accounting Concepts

Accounting for Basic Bookkeeping

Name: ______________________________

Section: ______________ Date: ______________

I. Write T in the box if the statement is True, F if false. Underline the True/False portion that makes the statement false.

1. Prehistoric men improvised a tally system by carving on the cave walls.
2. To amass wealth means to distribute different possessions.
3. The exchange of goods for money is called barter.
4. Bookkeeping was introduced during the Renaissance Era as part of a mathematical concept.
5. Taxes in the olden days referred to the concept of “worth” or significance of a possession.
6. The principle of using a standard time period means using a 12-month cycle.
7. Cost should include the difference between the present value of money and that of the original cost.
8. Accounting requires giving equal importance to all peso value regardless if the amount is insignificant.
9. It is improper for a business owner to use the business funds to pay for household expenses.
10. A Certified Public Accountant also gains a valid license to formally teach accounting subjects in educational institutions.

II. In today’s present condition, apply the concept of ownership and obligation by classifying each item accordingly.

Example: A pair of shoes = Possession

Possession/Obligation

1. A piece of jewelry
2. A family car
3. Savings account deposit
4. Paid the monthly installment due for the month
5. Purchased an LCD TV
6. Settlement of tuition fees before the periodic test
7. Trade-in value of an old cellphone
8. Winnings from lottery
9. Received a piece of property as inheritance
10. Bought a sack of rice

III. Choose the correct answer. Underline the accounting principle being observed in the statement.

1. The business owner makes annual sales projections.
   (Consistency, Going Concern, Conservatism)

2. Value of all stock merchandise are recorded based on acquisition cost.
   (Conservatism, Income Recognition, Cost Recognition)

3. The constant use of the straight line method for calculating depreciation expenses.
   (Cost recognition, Conservatism, Consistency)

4. Omitting the centavo amounts or rounding off the amounts to the nearest peso value in financial statement reports.
   (Going Concern, Revenue Recognition, Materiality)

5. Cash received from customers before cut-off time are recorded as Income from Sales on the same day.
   (Conservatism, Materiality, Income Recognition)

6. The business owner buys only a minimal quantity of goods to sell in anticipation of the upcoming rainy season.
   (Cost Recognition, Going Concern, Conservatism)

7. Unsold goods are excluded from the Cost of Goods Sold during the year.
   (Materiality, Going Concern, Matching)

8. The peso equivalent of imported goods bought from duty-free shops is used as basis for recording purposes.
   (Assumption of Monetary Value, Conservatism, Materiality)

9. The school's accounting period starts from June to March, to coincide with the school year.
   (Assumption of Monetary Value, Assumption of Time Period, Going Concern)

10. The owner deposited twenty thousand pesos in a separate account, because the money will be used as the working capital of the business.
    (Assumption of Monetary Value, Materiality, Economic Identity)

Different Industries and Specialized Accounting Fields

Financial Accounting as Services Rendered by Accounting Firms or by Private Practitioners – Financial accounting services pertain to the review and evaluation of a business entity's financial reports for the benefit of external users. Part of their service is the issuance of an audit certification or "auditor's report," which states whether the organization records its business transactions and reports the results of its business operations in a manner consistent with and in accordance with generally accepted accounting principles. If otherwise, the certifying accountant will issue a qualified auditor's report, stating therein the violations or non-conforming practices compared to the acceptable standards.

Managerial Accounting – This field of specialization stands in contrast to the areas delved into in financial accounting. Managerial accountants make use of financial reports for internal purposes particularly for management's planning and decision making purposes.

Managerial accountants present financial reports in varying statement formats to show comparisons against previous years' reports. Analysis ratios are utilized to determine rates and proportions of increases and/or decreases as well as to provide measurements of efficiency in various aspects of operation.

Financial certification is a crucial requirement among external users since a great part of their decision-making process depends on the financial statements submitted by a business entity.

Cost Accounting in Manufacturing Industries – Largely concerned with the calculation and analysis of production costs as a means for profit maximization.

Financial Accounting for Financial Institutions – Involves mapping out financial strategies in managing fund sources and their usage in investment institutions such as banks, investments and securities firms, and insurance companies. A popular example of financial analysis use is the management of investment portfolios comprising shares of stocks, debenture bonds, treasury bills, money market placements, trust and mutual funds.

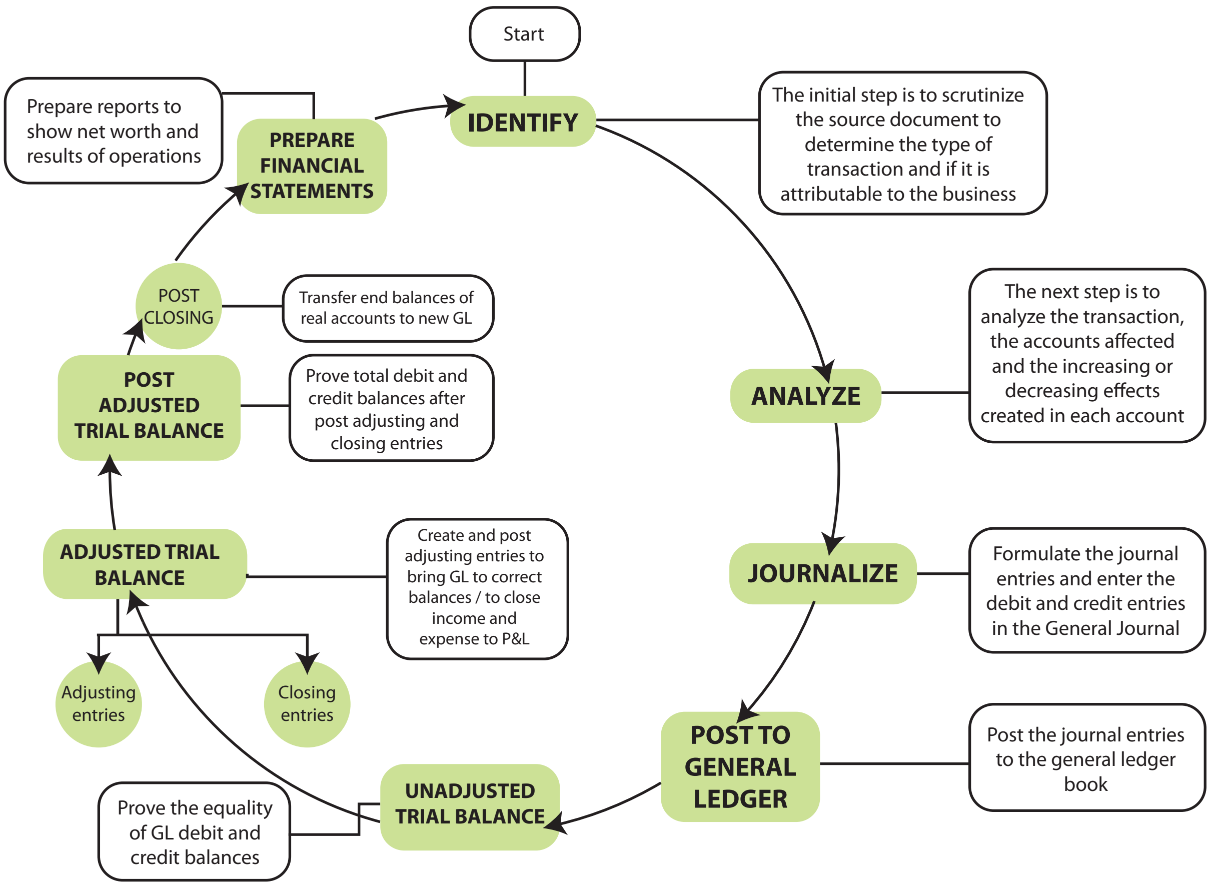
Fund Accounting for Government Offices and Units – Accountants here are basically concerned with monitoring and reporting fund usage, all of which should be in accordance with the approved annual budget for each government unit or department. This is to ensure that the taxpayer's money is properly utilized.

Fund Accounting for Non-Profit Organizations – Non-profit organizations are institutions that essentially receive funds in the form of grants or charitable contributions to handle a philanthropic or special community project. The accountant's main concern is to monitor and report all funds received, and to ensure that all fund usage is within the authorized limits and for the authorized purposes.

Forensic Accounting for Independent Accounting Firms – The role of the accountant in this case is to act as a forensic investigator in charge of gathering accounting evidence that will be used and exhibited in court. They also provide explanations and expert testimony in the courts of law. This is to ensure the successful prosecution of unscrupulous individuals being tried for white collar crimes or for stealing money by way of accounting manipulation.

CHAPTER 02

The Accounting Cycle



The accounting cycle represents the entire set of accounting steps performed during a particular accounting period. The first part of the cycle is performed repetitively on a daily basis during the entire accounting period. The second part is generally performed at the end of every financial reporting period, which may be on a monthly, quarterly or semi-annual basis as required by the business owner or by corporate policy and in accordance with the quarterly and annual tax tax returns mandated by the Bureau of Internal Revenue (BIR). The post closing procedure of transferring the end balances to the new general ledger (GL) is normally performed at the end of the year.

The entire process was formerly regarded as monotonous and tedious but developments in methodologies and advancements in computer technology have made the steps easier and faster to perform. Nevertheless, it would be advantageous to have at least a basic understanding of how these steps transpire in an established accounting system.

To best explain the topic, let's follow the accounting cycle by using a cash register receipt for a PhP 500 worth of office supplies as our starting point. Almost everyone is familiar with the cash register receipt produced by a retailer's business machine every time a transaction is completed. The receipt is a form of "source document," which means that this is what the accounting entry will be based upon.

Step 1. Identify – What kind of transaction do we have?

We will discuss this from the point of view of a customer who has purchased some office supplies on behalf of a business entity. Hence, the receipt represents a purchase of asset in the form of supplies, using cash as the medium of payment.

Step 2. Analyze – What accounts will be affected by this transaction and how will they be affected?

- The accounts affected are "Office Supplies on Hand" and "Cash on Hand," which are both assets in nature.
- The transaction therefore increases the available offices supplies by as much as PhP 500. The activity likewise reduces the entity's available cash by the same amount.

Step 3. Prepare Journal Entry/Entries – Here, a set of accounting entries will be formulated, by using the data gathered from the transaction analysis. To facilitate the discussion for this step, the accounting entry for this particular transaction is briefly described as a recording function that involves the use of:

- a debit (Dr.) entry to increase a possession or asset; and
- a credit (Cr.) entry to reduce or to decrease the value of an asset.

The symbols Dr. and Cr. denote debit and credit respectively. The accounting entries will be journalized in the general journal book, as follows:

Dr. Office Supplies on Hand	PhP 500	
Cr. Cash on Hand		PhP 500

Explanation: To record the purchase of two (2) reams of bond paper.

The concepts of debit and credit will be discussed in full in the next lesson.

Step 4. Post the entries to the general ledger (GL) – See the following simulated general ledger page and study the effects of the posted journal entries:

Office Supplies on Hand

Date	Explanation	Debit	Credit	Balance
	Beg. Balance			1,500
Sept. 01	Purchased 2 reams of bond paper -OR#1223344	500		2,000

Cash on Hand

Date	Explanation	Debit	Credit	Balance
	Beg. Balance			18,630
Sept. 01	Purchased 2 reams of bond paper -OR#1223344		500	18,130

Step 5. Make a Trial Balance – All general ledger (GL) account balances similar to those presented above shall be summarized in an accounting tool called "trial balance." This is to ensure that all debit and credit balances are equal.

Trial Balance

Date	Account Title	Debit	Credit

Step 6. Prepare for Adjusting of Entries – This part of the accounting cycle is complex in nature and requires a deeper understanding of the accounting principles pertaining to: (1) Cost Recognition, (2) Revenue Recognition and (3) Matching Principle. Adherence to these principles requires adjusting entries to bring the book balances nearer to the real financial conditions of the business, which will likewise be discussed in full in a separate lesson.

Preparing pre- and post-closing entries involves the process of zeroing-out the balances of selected accounts, by forwarding them to the Profit and Loss account. Post closing also entails transferring the end balances to the new general ledger book, since the business is about to enter a new accounting period.

Step 7. Prepare Adjusted Trial Balance – The cycle then continues to the process of proving the equality of the debit and credit balances of the general ledger, after the adjusting and closing entries are posted. This is a necessary procedure before proceeding to the final step, which is the financial statements preparation.

Step 8. Prepare Financial Statements – From the Adjusted Trial Balance sheet, the accountant will then prepare the financial statements such as the Statement of Comprehensive Income (popularly known as the Income Statement), Statement of Financial Position (popularly known as the Balance Sheet), Statement of Changes in Owner's Equity, and the Statement of Cash Flows.

Step 9. Prepare Post-Closing Entries – This step pertains to the closing of the nominal accounts such as the Income Accounts, Expense Accounts, and the Owner's Drawing Account.

Step 10. Prepare Post-Closing Trial Balance – This refers to the trial balance being prepared after the closing entries are made and recorded in the general ledger.

The Accounting Period

The principle of "Assumption of Time Period" requires the establishment of a specific time frame to observe, in which the accounting cycle will be completed. As previously mentioned, a 12-month period commencing in January and ending in December of the current year is a commonly assumed time frame. This is also known as the **"calendar year."**

In contrast is the "fiscal year," which is a period that starts and ends on months different from January and December, respectively. This type of accounting period is commonly observed by schools, recreational areas or summer resorts. A fiscal year is a 12-month period, in which accounting for operations commence and end according to the months that are most beneficial and appropriate for the business.

As an example, the accounting period of educational institutions typically starts on June and ends on May, as these months coincide with the time frame of a school year.

However, in view of the monthly, quarterly or semi-annual financial reporting requirements imposed by owners, management, regulatory bodies or other institutions, the major procedural steps of an accounting cycle are usually completed on a monthly or quarterly basis.

Generally, the **accounting period** is defined as the time frame assumed by a business entity as its period of recording the transactions related to business operations, which could either be a calendar or a fiscal year. It is also the time frame in which an accounting cycle is partially completed in order to furnish the required financial statement reports.

Chart of Accounts

The chart of accounts is a list of all the account titles being used by a business entity for the purpose of classifying its transactions. The general ledger accounts are referenced against the said list and may include only those that were affected by an entity's activities during a particular accounting period.

Each account is assigned with specific numeric codes which are used as reference numbers for accounting entries. Although most small businesses are not too keen in utilizing numeric codes, the latter is quite significant for large companies with multiple branches or subsidiaries. Doing so ensures uniformity or consistency of account titles being used by the entire organization. Study the excerpt of a sample chart of accounts on the right:

	CHART OF ACCOUNTS
	ASSETS
	Current Assets
100	Cash on Hand
101	Cash in Bank
102	Petty Cash Fund
103	Accounts Receivable - Trade
104	Merchandise Inventory
105	Office Supplies on Hand
106	Other Assets - Prepaid Expenses
107	Other Assets - Advance Rent/Deposit
	Non-Current or Fixed Assets
201	Furniture, Fixture & Equipment
202	Machineries & Equipment
203	Transportation Equipment
	LIABILITIES
	Current Liabilities
500	Withholding Tax Payable
501	SSS/Medicare/PhilHealth/Pag-Ibig EC Payable
502	VAT/Percentage Tax Payable
503	Accounts Payable - Trade
	Non-Current or Long - Term Liabilities
600	Loans or Notes Payable
601	Car-Financing
	CAPITAL
700	Owner's Capital
701	Owner's Capital Drawings

Basic Account Titles

Let us delve further into the fundamental aspect of "Account Titles" inasmuch as the accounting processes deal mainly with accounts. The titles should briefly describe the nature of a particular transaction under which it is classified.

There are three types of account titles, namely:

- Assets
- Liabilities
- Capital

Each of these categories denotes the nature or circumstance of a transaction, and will be debited or credited accordingly, the purpose of which is to put into effect an increase or decrease in its balance. It is quite important that transactions are recorded using the correct account titles, because these clarify the information contained in the information in financial reports.

To illustrate, let us recall the origins of accounting and the need to have an organized system for keeping track of one's possessions, obligations and values. At this point, we will convert these three factors into their equivalent account titles and, from here on, become familiar with their uses and of the source documents they come from.

FACTOR 1: POSSESSIONS

These are basically **assets** in the accounting perspective. The following are the most common accounting titles used to denote business possessions or assets, as listed in the Chart of Accounts:

Cash on Hand – Money that has not yet been deposited in a depository bank, and are usually placed in a cash safe or vault while inside the business premises.

Source document/s: Cash register tapes, Official Receipts issued, cash transfer slips and cashier's daily cash report

Cash in Bank – Money that has been physically transferred to a depository bank to ensure better protection against theft and misuse.

Source document/s: Deposit slip, Bank Advice or Bank Debit/Credit Memo, Withdrawal Slip, Check issued and monthly bank statements

Petty Cash Fund – This refers to money that is maintained as a small fund, and used for minor and frequently incurred expenses. The fund is kept under lock and key by using a cash box or cash drawer and handled for safekeeping and disbursement by a designated petty cash custodian.

Source document: Memorandum stating the amount of fund to be maintained and designating the petty cash custodian, petty cash vouchers, and checks issued for the fund set-up and fund replenishments.

Merchandise Inventory – These are goods kept as stock inventory and are intended to be sold by a business entity. All merchandise inventory stocks are recorded at purchase costs plus the incidental expenses related to their purchase. The business entity gains profit from selling the goods held as inventory by trading it at a selling price that is more than the original cost or purchase price.

Source document: Purchase Orders, Delivery Receipt, Official Receipt, Sales Invoice, Stock Requisition or Withdrawal Slip and Inventory List

Accounts Receivable – Trade – The amount of goods purchased by a customer on account or credit terms. This asset is tangible only by virtue of its source document, in contrast to other current assets that possess physical substance. Hence, this account is carefully monitored and evaluated by way of subsidiary ledgers, source documents and direct confirmation with customers.

Source document: Promissory Note, IOUs, and Credit Agreement

Office Supplies on Hand – Also called Supplies on Hand, since some businesses may have other types of requirements for daily operations. Some examples of office supplies are bond paper, business stationery, unissued official receipts, cash register tapes, diskettes, CDs, pens, pencils, stapler and its staple wires, paper clips, fasteners, folders, etc.

Examples of businesses with other requirements include bakeries, beauty parlors, barber shops, car-wash establishments, etc.

Source documents: Purchase Order, Delivery Receipt, Official Receipt, Sales Invoice, Stock Requisition or Withdrawal Slip and Supplies Inventory List.

Other Assets – Prepaid Expenses – There are certain business expenditures that require advance payments but are not treated as outright expenses. Expenses such as insurance premiums, interest on loans, rental payments and the like are initially recorded as Prepaid Expenses. These are subsequently recorded as expenses in accordance with the month or duration in which they are deemed as having been incurred.

Other Assets – Advance Rent/Deposit – These are paid to business entities that require a specific amount of payment considered as deposit before a facility, utility or service will be rendered. Entities that commonly require such deposits are electric companies, water supply providers, communication service installers and landlords or lessors of real properties.

Source documents: Official Receipts, Terms and Conditions, Contracts or Agreements.

FACTOR 2: OBLIGATIONS

These are liabilities in accounting context, in the sense that the business entity has an obligation to satisfy payment of a certain amount of money on a specified due date, with interests and penalty charges being added to the amount due if payment is done after the due date. The following are examples of liabilities commonly found in an entity's chart of accounts:

Withholding Tax Payable – These are the taxes due to the BIR, representing taxes deducted from salaries of employees and income of contractors hired by the business entity.

Source documents: Payroll Worksheet, BIR Remittance Forms, Contractual Agreements, Check Payments and validated Bank Confirmation Receipts

SSS/Medicare/PhilHealth/Pag-Ibig Payable – Similar to the taxes withheld from employees' salaries, these are the other mandatory deductions made against said salaries. The purpose of these deductions is to set up government-managed healthcare, pension and housing funds for future use of the employee extended by way of emergency loans, housing loans, hospital bill reimbursements and retirement funds. Employers are required to contribute additional funds to the individual account of every regular employee.

Source documents: Payroll Worksheet, SSS/PhilHealth/Pag-Ibig Remittance Forms and validated Bank Confirmation Receipts

VAT or Percentage Tax Payable – Value-Added Tax (VAT) are taxes imposed on both buyers and sellers in connection with the purchase of goods or services. The method of calculating the tax payable is quite complex; hence, tax topics and concerns are taken up in higher levels of accounting subjects.

Percentage Tax on the other hand is easier to comprehend but tends to be more costly on the part of the trader. Nevertheless, this topic is briefly discussed in a later lesson.

Source documents: Official Receipts, BIR Tax Forms, validated Bank Confirmation Receipts

Accounts Payable – Trade – This title is also known as trade credit in the business sense. The account is used for transactions pertaining to goods bought as stock inventory, in which actual payment is deferred at some future date but only for a short period, e.g., 10 days, 15 days or 30 days. This is done to give the proprietor a chance to sell some of the goods and raise some money to pay for the credit purchase.

Source documents: Sales Invoice, Purchase Order, Official Receipt, Check Payments, and Credit Agreement

Loans or Notes Payable – The account title used for transactions pertaining to money borrowed from banks or financing companies, which are considered as long-term if the period covered lasts for more than a year.

Source documents: Promissory Notes, Bank Credit Advices, Debit Memos, Credit Agreements, Disclosure Statements and Official Receipts for loan payments

Car Financing – Loans that are typically granted by banks or financing institutions through the assistance of car dealers as the latter's way of securing payment for cars purchased by customers. Business entities usually avail this type of credit in purchasing service utility vehicles or as part of employee benefits.

Source documents: Similar to those required in Loans Payable but with the inclusion of Deed of Sale, Formal approval of authorized signatories, car registration papers, insurance policies, etc.

FACTOR 3: VALUES

Another term for value is "worth," which in the accounting framework pertains to the Owner's Capital. Part of the accounting concept is to determine the worth or value of the business. It answers the question: "How much money has the owner invested in his or her business?"

Recording and monitoring all the assets and liabilities of the business provides the means for determining the owner's net capital contribution or the business's net worth. This is determined by using the formula:

Net Worth or Net Capital = Assets – Liabilities

Account titles for monitoring the Owner's Net Capital or Net Worth of the business, are the following:

(Name of Owner), Capital – The account title to denote the owner's total capital contributions is best described by using the owner's name. As a business owner, he is referred to as a single proprietor. This stands in contrast to the corporate organizations where there are multiple owners, called incorporators, and stockholders or investors.

(Name of Owner), Capital Drawings – This account title is used to separate the personal expenses of the single proprietor, in case the owner made use of business funds. As a rule, the business owner should not use business funds to pay for personal expenditures, a procedure that adheres to the accounting principle of "Economic Identity." However, in cases where such transactions happen, the usual remedy is to use the account Capital Drawings as a means to keep personal expenses separate from the business.

Net Income or Loss – This represents the net effect of all the income and expense accounts after being summarized in the Profit and Loss summary. The latter is an account title utilized as part of the post-closing procedure of the accounting cycle. Income and expense accounts are temporary in nature and fall under the Capital accounts classification.

If the Profit and Loss account balance shows a Net Income, then the owner's capital will increase. In contrast, therefore, a Net Loss would mean a decrease in the capital account.

Common Accounting Terminologies

To provide a better understanding of the above explanations and other accounting rationalizations, familiarization with some of the common terminologies is recommended. Study the definitions below:

Account balance – The latest or last amount reflected in the "Balance" column of the general ledger account.
Beneficial – A condition that is most favorable or advantageous. In accounting, the concept of benefit denotes higher income, lesser costs or a more stable business condition.
Business Entity – A reference to entity denotes a "being" that is legally recognized as different from an individual or a persona. Henceforth, a business entity denotes a form of being that is different from its owner/s.
Chronological Order – This is a method of recording transactions or filing of documents according to the proper order of dates in which transactions occur.
Contribution – A gift or assistance or payment that is added to a common fund, which is intended for a special purpose and is oftentimes distributed as a form of benefit.

Corporation/Company – A company or a corporation is a form of business entity in which a group of individuals known as incorporators will contribute money and/or property to be used as capital resources. A company is registered with the Securities and Exchange Commission in order to establish a separate but legal identity. This means that any liability assumed by a company is only for the company's account and will not encroach on the personal assets of its incorporators, stockholders and investors.

Credit Purchase – This pertains to the act of buying merchandise or goods in exchange for a promise to pay in accordance with the terms and conditions of the seller. It is only granted at the discretion or approval of a designated authority.

Deduction – A reference to deduction in accounting terminology pertains to a specific amount that is subtracted from income (i.e., salaries, commissions, collection. etc.), usually by virtue of tax laws, methodologies or as governed by an agreement. Examples of deductions are withholding taxes, advance interests, deposit requirements, and the like.

Depository Bank – A banking institution referred to as a depository bank indicates that it manages and maintains the bank deposit of a person or business entity, in relation to the latter's Cash in Bank account.

Financial Condition – This refers to the current ability of a person or an entity to meet immediate obligations and expenses in the ordinary course of a business or its existence. A financial condition described as "healthy" denotes that a person or business entity has more than enough to meet maturing obligations and means of subsistence. A poor financial condition tends to require a person or an entity to borrow funds as a means to keep pace with its upcoming commitments and necessities.

Fixed Asset – This refers to a non-consumable physical asset that could diminish in value due to natural wear and tear and may be movable or immovable. It has an estimated useful life, in which it will bring future years' benefits by being utilized as a means to generate profit.

General Ledger – This is the main book of accounts in which accounting entries are posted and summarized according to account title classification.

Incorporators – These are individuals who provide the seed capital to set up a corporate organization. Under Philippine law, there should at least be five (5) incorporators, each of whom should own at least one share of the total authorized capital stocks.

Industry/Industries – This refers to any form of commercial or economic activity participated in by an entity, either to manufacture or sell goods or to provide services, whether for profit or non-profit purposes.

Investor – An investor may be an individual or a business entity that contributes money in another business entity's business activities, for the purpose of earning a share in the latter's income. Stockholders or holders of debenture bonds are examples of investors.

Long-term – A period or duration of a term that exceeds one year.

Net or Net of – The use of the words "net" or "net of," in the accounting sense, means that deductions have been made against an income or a particular value. An amount reported at its net value denotes that there are no more liabilities or attributes to eliminate, which renders the net amount free and available for use. Examples of amounts reported at net value includes net income, net loss, net sales, and fees, salaries or commissions that are net of withholding tax

On Account – Another term used to denote buying on credit, in which the amount of goods purchased will be added to the buyer's accounts receivable balance in the seller's books.

Profit – This refers to the difference between the actual cost of goods sold or manufactured and the selling price at which it was bought by customers.

Resources – In accounting terminology, resources refer to the assets of the business entity, which comprise cash, merchandise, receivables, supplies, fixed assets and all other possessions, which the business can use or harness for profit generation purposes.

Selling Price – The amount at which goods are offered for sale as a source of profit.

Short-term – A period or duration of a term that is one year or less.

Single Proprietor – This refers to a person or individual who sets aside some of his personal assets to put up a business enterprise. He or she is also referred to as an entrepreneur and assumes the status of a self-employed individual.

Stock – This accounting term denotes goods or merchandise kept or maintained as supply of goods to be sold. However, it is recorded in the books as Merchandise Inventory since its composition is based on an inventory list of available merchandise.

Shares of Stocks – An investment instrument offered by a company to the public, for a stipulated price, in return for a share of ownership and entitlement to a share in the company's earnings. A company may offer two types of stocks: common or preferred. Both types should be authorized by the Securities and Exchange Commission (SEC) in order to have value.

Stockholder or Shareholder– A person or entity that acquires partial ownership of a corporation by buying into the latter's authorized shares of stocks.

Transaction – A business activity related in part or in whole to the purpose and nature of the industry for which the business operates. Some examples of transactions include sales, purchase of goods, payment of accounts payable, collection of a receivable, borrowing from a bank, remittance of taxes withheld and all other activities related to the business operations.

Yield – A reference to yield in accounting means that a benefit in the form of income was produced as either a result of a business activity or was derived from an investment.

Withhold/Withheld – The act of deducting a specific amount of money from an income due to a person or entity, as a form of compliance with tax laws, or with an agreement or a policy. Amounts withheld are subsequently remitted to a government unit, returned to the owner of the income or applied as payment, which all depend on the nature of the transaction.

Zero-out – In accounting methodologies, it is a procedure performed for the purpose of eliminating a temporary account from the current general ledger book by creating an entry or entries that will produce a zero balance. If a temporary account has a debit balance, a credit entry will be entered; hence it follows that a temporary account with a credit balance will be zeroed-out by a debit entry. Zeroing-out a temporary account is different from creating a zero-effect in the course of posting entries for regular transactions.

The Three Elements of Accounting

From the previous explanations about account titles, recall that the main elements of accounting are the entity's (1) assets, (2) liabilities, and (3) capital.

The income and expense accounts are noted separately since they are temporary accounts used to determine if the owner's capital investment increased by a resulting Net Income or decreased by a resulting Net Loss.

comprehension check

Name: ______________________________

Section: ______________ Date: ______________

I. Arrange the following accounting tasks in the order by which they should appear as procedural steps of the accounting cycle. Assign the numbers 2 - 8 to denote the proper order; the first one, number one (1), has been done for you.

______ 1. Create accounting entries to debit Cash and credit Sales.

______ 2. Check the equality of the total debit and credit balances after posting the adjusting entry.

______ 3. Prepare the Balance Sheet and the Income Statement.

1 4. The cashier's summary of cash collection representing the goods sold for the day.

______ 5. Make adjustments to the income and expense accounts in preparation for the year-end closing of the ledger book.

______ 6. Determine if the cashier's cash collection report will have an increasing effect on the Cash on Hand account and the Sales account.

______ 7. Post the debit to Cash and credit to Sales on the general ledger.

______ 8. Check the equality of the general ledger's total debit and credit, after posting the transactions for the day.

II. Identify the fundamental accounting concept described by the statement. Write the answer on the space provided.

______ 1. A 12-month period which commences and ends on the months that are considered as applicable or beneficial for the business.

______ 2. The official list of account titles used by a business entity to ensure uniformity and consistency.

______ 3. An accounting tool used to prove the equality between the total debits and total credits of the general ledger.

______ 4. This set of procedures is performed every year-end of the accounting period in order to bring the general ledger balances as closely and as accurately as possible to the actual financial condition of a business.

______ 5. This represents the entire set of accounting steps performed during a particular accounting period.

______ 6. The step performed after the transaction has been analyzed.

_______7. This accounting item provides the basis for a transaction and its accounting entries.

_______8. This value is determined by the formula “Asset - Liabilities.”

_______9. A temporary general ledger account in which the income and expense accounts are summarized.

_______10. The result of the year’s business operation that will create an increasing effect on the Owner’s Capital.

III. Identify if the item is an asset, a liability or a capital account

__________ 1. Petty Cash Fund for PhP 5,000
__________ 2. Account with supplier; balance of PhP 2,000 due on Sept. 30, 2016
__________ 3. Customer’s account with a balance of PhP 2,000 due on Sept. 30, 2016
__________ 4. Money borrowed from a bank; payable in two years; PhP 100,000
__________ 5. Checking account maintained at WestBank; current balance PhP 10,000
__________ 6. Payment of company car financing loan at Signet Motors - PhP 112,000.
__________ 7. PhP 20,000 transferred from cash register machine to cash safe.
__________ 8. 100 pieces of CD stocks; unit cost is PhP 5.00; selling price is PhP 12.00
__________ 9. PhP 75,000 personal money deposited under the business name
__________ 10. Net Loss of PhP 3,110 realized in 2015.

IV. Underline the correct accounting terminology.

1. (Contribution, Deduction) is a specific amount subtracted from an income.

2. (Fixed Asset, Current Asset), a non-consumable resource depreciated over its estimated life.

3. A period of coverage from July 01, 2016 to July 01,2021 is a (short-term, long-term) plan.

4. An (investor, incorporator) contributes to the initial capital of a corporation.

5. A business (industry, entity) refers to a “being” that is separate from its owner/s.

6. (Resources, Profits) refer to the assets of the business.

7. A (single proprietor, investor) sets aside personal assets to put up his own business.

8. (Net of, On account) denotes that the purchase was made on credit.

9. (Profit, Benefit) is the difference between the actual cost of goods sold and the selling price.

10. (Transaction, Account balance) refers to the latest figures reflected in the balance column.

Assets represent the resources of the business and are carried in the general ledger book for as long as the business is on-going, unless they are sold or disposed. Basically, the assets of the business originates as personal possessions of its owners, but were segregated when it was put up as capital funds of the business.

Capital represents the part of the assets that is owned by the business owner/s. For the sake of simplicity, capital here refers to a business owned by a single proprietor. The account title, therefore, should be aptly described by stating the owner's name.

To state the relationship between asset and capital, it can be expressed through the mathematical equation:

Assets = Capital

However**, the liability** accounts have to be considered before fully accepting this equation as a representative of the accounting concept. Consider the following:

- Some assets may have been purchased or acquired by way of credit or made use of borrowed funds. This means that part of the business assets are not yet wholly owned and may yet be taken away by creditors or lenders.
- There are also the unpaid liabilities which the business is scheduled to pay on their due dates. This denotes that part of the cash, booked as asset, is already good as spent because it will be used to pay for the entity's upcoming liabilities.

In view of these premises, the accounting equation Asset=Capital has to be modified in order to state a more accurate mathematical equation. The composition of Asset as resources, therefore, could also be stated as partly made up of Liabilities, and not only Capital.

The equation will now be stated as:

Assets = Liabilities + Capital

This is now the basic accounting equation we have to observe when balancing the book of accounts. The left portion of the equation represents the debit side of the accounting concept, while the right portion is the corresponding credit side. The normal balance of an asset, therefore, is the debit side, while the normal balance of the liabilities and capital is the credit side.

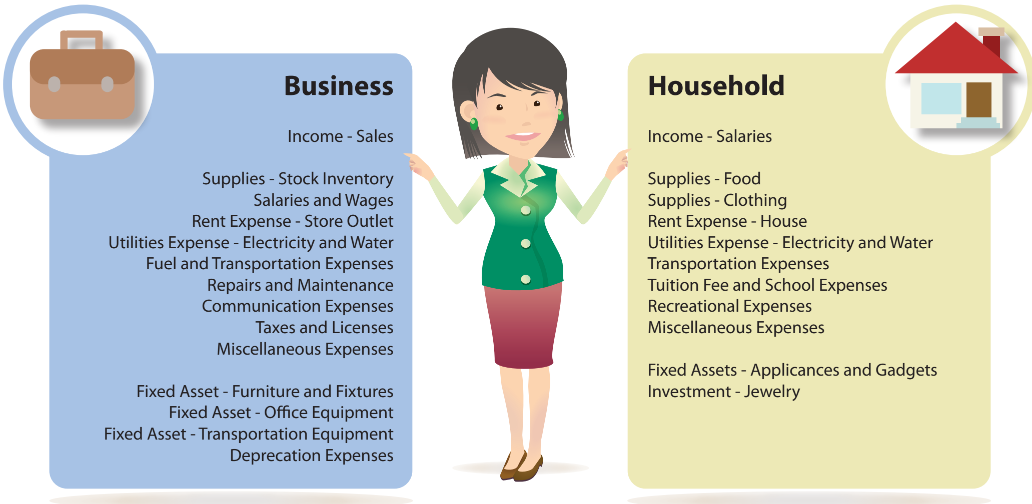
These are important things to remember when creating accounting entries, which will be discussed in the next chapter: Application of Accounting Concept and Methodologies.

CHAPTER 03

Applying Accounting Concepts

Why Accounting Is Important

Emphasis has been made about the separation of personal possessions from the business assets, since this is one of the most basic principles or rules to observe. It would be difficult to determine just how much the proprietor has put into the business and how much one has gained or lost from it, if personal and business funds are co-mingled.



A household unit can be likened to a business, in which the keeper of the household income should also aim to realize a positive net effect after deducting all expenses, so that the net worth of the household will also increase. In this case however, the goal is to realize savings instead of income. Technically, the excess of household income over the household expenses is calculated in the same way as that of the net income of a business.

In managing household finances, it is important for a family unit to monitor its monthly expenses by taking into consideration the salaries that comprise the source of household funds. Unlike income from business, salaries tend to be fixed and constant, and are thus easier to budget as a means to achieve a particular savings goal.

In order to acquire familiarity with the accounting fundamentals, we will adopt what we have learned and are about to learn, to account for both personal and business finances. However, students should first familiarize themselves with the methodologies observed in accounting for transactions, whether for personal or business concerns.

Books of Accounts

Accounting is a process that mainly involves a lot of recording and monitoring, after which we can fulfill the related functions of summarizing and interpreting to see how well a business is doing. All businesses are also legally required to maintain books of accounts for records purposes.

These books of accounts enable a business entity to show a comprehensive record of all transactions that support the income tax return filed for the year. In the event that an examiner or assessor of the Bureau of Internal Revenue (BIR) finds a need to verify the details of the income reported, the entity's books of accounts will be the basis for the BIR examiner's evaluations.

Different business industries use different kinds of transaction books to facilitate the recording of their operational transactions. These books are also referred to as "special books of accounts" and should also be duly registered with the BIR.

General Journal

This is where the accounting entries are recorded in chronological order, to provide the details of every relevant transaction.

GENERAL JOURNAL				
DATE	JOURNAL ENTRIES	REF	DEBIT	CREDIT

There are instances in which a single type of business activity is made up of multiple transactions transpiring in a single day. The most common example is selling, in which all sales are ordinarily sold on cash basis or COD (Cash on Delivery). Some businesses allow selling on account on a case to case basis.

Repetitive recording of like transactions can be avoided by using transaction books, for purposes of summarizing transactions of the same nature. Examples of such books are the Sales Book, Cash Receipts Book, Check Disbursements Book, and Petty Cash Book.

Initially, similar transactions are posted accordingly and will be summarized by extracting the total amount affecting each account. The totals will then be the basis for the General Journal accounting entries.

General Ledger

All Journal entries are posted in this book. This is often referred to as the "Book of Accounts" since it contains the compilation of accounts being used to monitor the balances of the assets, liabilities, capital, income, and expenses of the business entity.

GENERAL LEDGER						
					BALANCE	
DATE	EXPLANATION	RFF.	DEBIT	CREDIT	DEBIT	CREDIT

Cash Receipts Book (CRB)

This book is often used in a manual system of accounting, in which multiple cash receipt transactions during the day are listed individually. They are recorded according to the numerical sequence of the receipts issued to acknowledge the amount of cash received.

The entries for the day will then be summarized in order to extract the total amount of cash received and to identify the accounts that were affected by the cash receipts transactions. The same totals will be used to formulate the accounting entries that will be included in the General Journal (GJ).

CASH RECEIPTS BOOK								
				DEBIT		CREDIT		SUNDRY ACCOUNT
Date	Received From	OR No.	Description	Cash	Sales Discnt	Cash Sales	Accts Rcvble	

The Sales Book

Small business retailers who operate without the use of computerized business machines maintain a sales book for monitoring the goods sold or the services rendered during the day. Listing of the entries in this book is usually assigned to the sales or store clerks, as a means for monitoring the sales clerks' sales performance and for monitoring the items sold, as well as providing an additional reference for monitoring the total cash receipts derived from sales transactions.

SALES BOOK							
Date	SI #	Customer	Description	Terms	Sales Cr	A/R Dr	Cash Sales Dr

The Check Disbursements Book (CDB)

This book is the counterpart of the Cash Receipts Book in a manual accounting system. The expenses recorded in this book are those which involve check payments as a means to monitor cash-in-bank disbursements. Payments are recorded not only in chronological order but also with each check's numerical sequence being noted. The general journal accounting entries will be based on the total amount covered by the checks issued for the day, with the particular expenses being properly allocated when they occur.

CHECK DISBURSEMENTS BOOK														
Date	Payee	Check No	Amount	Description	Accts. Pyble	WITz- Pyble	SSS- Pyble	VAT-Pyble	Loans Pyble	Purchases	Utilities	Salaries	Fxd Assets	Others

Petty Cash Book (PCB)

This book is maintained to monitor the Petty Cash Fund, in line with the fund's use for defraying minor and recurring business expenses. The purpose of this fund is to avoid the misuse of cash that is on hand.

The PCB contains a record of all petty cash disbursements, which provide details of the expenses incurred and paid from the petty cash fund. The fund balance is monitored to determine if and when fund replenishment is needed. General journal entries will only be recorded when the petty cash fund is replenished, with the expense totals recorded and used as basis for fund replenishment.

PETTY CASH BOOK										
							D E B I T			PCF
Date	Payee	PCV No.	Amount	Description	Ofc. Supp.	Transpo.	Repairs	Misc.	Others	Balance

The Check Register

This book is used to control the issuances of checks. An important piece of information furnished by this book is the date at which the amounts in the checks were deducted against a business entity's deposit account. The information contained in this book is vital for bank reconciliation procedures, and may not necessarily be included as basis for accounting entries.

CHECK REGISTER						
Date	**Check No.**	**Amount**	**Payee**	**Bank**	**Date Due**	**Remarks**

Subsidiary Ledgers

Subsidiary ledgers provide a system of accounting for individual accounts which comprise a particular GL account. Let us use, as an example, the Accounts Receivable – Trade, which represents the total items sold to customers on credit. Proper accounting procedures require that each customer be provided with his or her own ledger as a means to monitor payments received and to keep track of each customer's correct balance.

It is important that, at any given date, the total derived from summing up the individual balances of these subsidiary ledgers would be the same as the balance reflected in the Accounts Receivable –Trade. Other examples of transactions that make use of subsidiary ledgers are: Furniture, Fixtures and Equipment, Accounts Payable – Trade and Office Supplies on Hand.

Customer's Subsidiary Ledger: (NAME)					**Acct. # __________**	
Date	**Description**	**CA No.**	**Debit**	**OR No.**	**Credit**	**Balance**

In recording and monitoring one's personal/household finances, the likeliest transaction books to use are the Cash Receipts, Check or Cash Disbursement, Petty Cash Fund, Check Register, and Subsidiary Ledgers.

Single-Entry Vs. Double-Entry Bookkeeping System

In order to explain the difference between the single-entry and the double-entry bookkeeping system, we need to recall the basic accounting equation:

Assets = Liabilities + Capital

A single-entry system denotes that there is only one accounting entry made to record a particular transaction. A cash sales transaction, as an example, is recorded by a debit entry to the cash account. The system works under the presumption that all debit entries made to the cash account represent money received from sales transactions.

The drawback to this accounting system is the difficulty of monitoring the correct amount of income to be credited with the capital account at the end of the period. The cash account balance is affected by different debit and credit transactions, thus presenting some difficulty in reconciling the entries attributable to sales transactions.

A double-entry system makes use of two or more accounting entries to properly reflect all accounts that were affected by a transaction. Let us again make use of cash sales as examples to show the difference between single-entry and double-entry system.

The double-entry method creates one entry to show the increase in cash balance and another entry to show the increase in sales. This stands in contrast to the single-entry method, in which there is only one entry to record the increase in cash balance, with the assumption that the said increase is attributable to sales.

Nonetheless, there are certain accounting concepts that require only a single-entry, for the simple reason that there is only one account affected.

Journalizing the Debit and Credit Entries

Journalizing, or journalization, is the act of recording an accounting entry created after identifying and analyzing the transaction. Basically, all transaction entries are recorded in the General Journal (GJ); thus, all entries appearing in the General Ledger (GL) can be referenced against the GJ.

Determining the Debit and Credit Entries

In determining when to debit or credit a particular account, it is important to recall several accounting concepts taken up in the previous chapter:

Recall that the second step in the accounting cycle is analyzing if the transaction is attributable to the business, and then determining the increasing or decreasing effect to the accounts affected.

Based on the fundamental accounting equation, the following are the normal balances of the following accounting elements:

- Assets = Debit
- Liabilities = Credit
- Capital = Credit

1. To increase an asset account, a debit entry will be used. Conversely, if the transaction will cause the balance of an asset account to decrease, a credit entry will be used.
2. To increase a liability and a capital account, a credit entry will be used. Conversely, a debit entry will have a decreasing effect on a liability or a capital account.
3. Transactions pertaining to income and expenses will cause the capital account to increase or decrease, depending on the type of transaction. To illustrate by way of mathematical equation, the fundamental accounting equation can be expanded to:

Assets = Liabilities + (Owner's Capital + Income – Expenses – Capital Drawings)

Therefore, the normal balance of an income account is on the credit side.

Income = Credit

Expenses are deducted to arrive at the net income amount. Capital drawings, on the other hand, are also deductions against the owner's capital. Since the normal balance of the capital account is on the credit side, a debit entry is used to reduce capital. Based on the premise that expense accounts are deductions against income, the normal balance of an expense account is therefore on the debit side. The same holds true for Capital Drawings.

Expenses = Debit
Capital Drawings = Debit

Pro-forma Accounting Entries

The following are called pro-forma journal entries and are formulated based on the column headings of the different transaction books: Sales Book (SB), Cash Receipts Book (CRB), Check Disbursement Book (CDB), or Petty Cash Book (PCB).

As a rule, accounting entries are recorded directly into the General Journal. The bookkeeper prepares accounting tickets, which state the accounting entries, the explanation and the source document plus the reference number. Entries which were extracted from the different transactions books are included during the preparation of accounting tickets.

Cash Receipts Book (CRB)

CASH RECEIPTS BOOK

				DEBIT		CREDIT	
Date	Received from	OR No.	Description	Cash	Sales Discnt	Sales	Accts Rcvble

1. Dr. Cash on Hand PhP xxx
   Cr. Sales PhP xxx

Explanation: To record cash sales.

2. Dr. Cash on Hand PhP xxx
   Cr. Accounts Receivable PhP xxx

Explanation: To record collection of receivable without prompt-payment discount.

3. Dr. Cash on Hand PhP xxx
   Dr. Sales Discount xxx
   Cr. Accounts Receivable PhP xxx

Explanation: To record collection of receivable with prompt-payment discount.

Note: These entries can be converted into a compound entry as shown below:

Dr. Cash on Hand PhP xxx
Dr. Sales Discount PhP xxx
Cr. Sales PhP xxx
Cr. Accounts Receivable PhP xxx

Explanation: To record total cash collections derived from Sales and Accounts Receivables as per CRB.

Check Disbursements Book (CDB)

CHECK DISBURSEMENTS BOOK													
				D E B I T									
Date	Check No	Amount	Description	Accts. Pyble	WITz- Pyble	SSS- Pyble	VAT-Pyble	Loans Pyble	Purchases	Utilities	Salaries	Fxd Assets	Others

1. Dr. Accounts Payable-Trade PhP xxx
   Cr. Cash in Bank PhP xxx

Explanation: To record payment to (Name of Supplier) OR# _____.

2. Dr. Withholding Tax Payable PhP xxx
   Cr. Cash in Bank PhP xxx

Explanation: To record payment of August Withholding Tax/Bank Receipt No. _____.

3. Dr. SSS/Medicare/PhilHealth/Pag-Ibig Payable PhP xxx
   Cr. Cash in Bank PhP xxx

Explanation: To record payment of August SSS/Medicare/PhilHealth/Pag-Ibig Payable /Bank Receipt No. _____.

4. Dr. VAT Tax Payable PhP xxx
   Cr. Cash in Bank PhP xxx

Explanation: To record payment of August VAT Payable /Bank Receipt No. _____.

5. Dr. Loans Payable PhP xxx
   Cr. Cash in Bank PhP xxx

Explanation: To record payment of August loan amortization /Bank Receipt No. _____.

6.	Dr. Purchases	PhP xxx	
	Cr. Cash in Bank		PhP xxx

Explanation: To record payment of goods purchased/OR No. _____.

7.	Dr. Utilities Expense	PhP xxx	
	Cr. Cash in Bank		PhP xxx

Explanation: To record payment of Meralco -August Bill/SOA No. _____.

8.	Dr. Salaries and Wages	PhP xxx	
	Cr. Cash in Bank		PhP xxx

Explanation: To record check issued to fund Aug. 16-31 Payroll.

9.	Dr. Furniture and Fixtures	PhP xxx	
	Cr. Cash in Bank		PhP xxx

Explanation: To record the purchase of one unit computer desk, OR No. _____.

Note: All these entries can be converted into a compound entry, since the amounts will be based on the total CDB transactions for the day.

Dr. Accounts Payable-Trade	PhP xxx	
Dr. Withholding Tax Payable	xxx	
Dr. SSS/Medicare/PhilHealth/Pag-Ibig Payable	xxx	
Dr. VAT Tax Payable	xxx	
Dr. Loans Payable	xxx	
Dr. Purchases	xxx	
Dr. Utilities Expense	xxx	
Dr. Salaries and Wages	xxx	
Dr. Furniture and Fixtures	xxx	
Cr. Cash in Bank		PhP xxx

Explanations: To record total cash in bank disbursements for the day as per CDB.

Petty Cash Book (PCB)

PETTY CASH BOOK										
					D E B I T					PCF
Date	Payee	PCV No.	Amount	Description	Ofc. Supp.	Transpo.	Repairs	Misc.	Others	Balance

Dr. Office Supplies	PhP xxx	
Dr. Transportation Expenses	xxx	
Dr. Repairs and Maintenance	xxx	
Dr. Miscellaneous Expenses	xxx	
Cr. Cash in Bank		PhP xxx

Explanation: To record petty cash replenishment as per PCB.

- **Examples of Journal Entries for Non-Multiple Transactions:**

1. Deposit of cash on hand to depository bank:

Dr. Cash in Bank	PhP xxx	
Cr. Cash on Hand		PhP xxx

Explanation: To record deposit made to SA/CA _____ (Name of Bank).

2. Purchase of goods and fixed asset on credit:

Dr. Purchases	PhP xxx	
Dr. Furniture, Fixtures and Equipment	xxx	
Cr. Accounts Payable –Trade		PhP xxx

Explanation – To record purchase of (specify items) and (specify furniture, fixture or equipment) from (Supplier's Name) as per OR No. ______.

3. Received proceeds of funds borrowed from bank:

Dr. Cash in Bank	PhP xxx	
Cr. Loans Payable		PhP xxx

Explanation: To record proceeds of funds borrowed from (Bank's Name) as per PN No. _____.

4. Payment of business owner's personal expenses (car registration fees, insurance expenses, etc.):

Dr. J. Dela Cruz, Capital Drawings	PhP xxx	
Cr. Cash in Bank		PhP xxx

Explanation: To record car registration fees and insurance expense of owner-J. Dela Cruz as per OR #. ____.

T-Accounts and the Trial Balance

T-Accounts are T-shaped sketches that simulate the debit and credit section of the General Journal. This accounting tool is useful when evaluating the accuracy of the debit and credit entries that will affect the general ledger accounts. It is often described as an accounting "scratch paper" and is used in conjunction with the trial balance.

As an example, the pro-forma compound entries that follow are assigned with amounts as a means to illustrate how the the T-accounts are used. Study and trace the T-account posting by referencing the journal entry numbers.

Journal Entry 1- Cash Receipts Book (CRB)

Dr. Cash on Hand	PhP 9,750
Dr. Sales Discount	250

Cr. Sales		PhP 7,000
Cr. Accounts Receivable		3,000

Explanation: To record total cash collections derived from Sales and Accounts Receivables as per CRB.

Journal Entry 2 - Check Disbursement Book (CDB)

Dr. Accounts Payable-Trade	PhP 5,000	
Dr. Withholding Tax Payable	2,000	
Dr. SSS/Medicare/PhilHealth/Pag-Ibig Payable	3,200	
Dr. VAT Tax Payable	2,850	
Dr. Loans Payable	3,500	
Dr. Purchases	3,000	
Dr. Utilities Expense	4,750	
Dr. Salaries and Wages	12,500	
Dr. Furniture and Fixtures	6,500	
Cr. Cash in Bank		PhP 43,300

Explanation: To record total cash in bank disbursements for the day as per CDB.

Journal Entry 3 - Petty Cash Book (PCB)

Dr. Office Supplies	PhP 210	
Dr. Transportation Expenses	150	
Dr. Repairs and Maintenance	75	
Dr. Miscellaneous Expenses	35	
Cr. Cash in Bank		PhP 470

Explanation: To record petty cash replenishment as per PCB.

Journal Entry 4 - Non-Multiple Transaction

Dr. Cash in Bank	PhP 20,000	
Cr. Cash on Hand		PhP 20,000

Explanation: To record deposit made to SA/CA _____ (Name of Bank).

Journal Entry 5 - Non-Multiple Transaction

Dr. Purchases	PhP 6,000	
Dr. Furniture, Fixtures and Equipment	10,000	
Cr. Accounts Payable –Trade		PhP 16,000

Explanation: To record purchase of (specify items) and (specify furniture, fixture or equipment) from (Supplier's Name) as per OR No. ______.

Journal Entry 6 - Non-Multiple Transaction

Dr. Cash in Bank	PhP 50,000	
Cr. Loans Payable		PhP 50,000

Explanation: To record proceeds of funds borrowed from (Bank's Name) as per PN No. _____.

Journal Entry 7 - Non-Multiple Transaction

Dr. J. Dela Cruz Capital, Drawings	PhP 4,800	
Cr. Cash in Bank		PhP 4,800

Explanation: To record car registration fees and insurance expense of owner J. Dela Cruz as per OR #. ____.

T - A C C O U N T S

	Cash on Hand			Cash in Bank			Accounts Receivable - Trade			Furniture, Fixtures & Equipment	
JE-1	9,750		JE-2		43,300	JE-1		3,000	JE-2	6,500	
JE-4		20,000	JE-3		470				JE-5	10,000	
			JE-4	20,000							
			JE-6	50,000							
			JE-7		4,800						
	9,750	20,000		70,000	48,570			3,000		16,500	

	Office Supplies			Withholding Tax Payable			SSS/Med/PH/Pag-ibig Payab			VAT Payable	
JE-3	210		JE-2	2,000		JE-2	3,200		JE-2	2,850	
	210			2,000			3,200			2,850	

	Accounts Payable - Trade			Loans Payable			Purchases			Utilities Expenses	
JE-2	5,000		JE-2	3,500		JE-2	3,000		JE-2	4,750	
JE-5		16,000	JE-6		50,000	JE-5	6,000				
	5,000	16,000		3,500	50,000		9,000			4,750	

	Salaries and Wages			Transportation Expenses			Repairs & Maintenance			Miscellaneous Expenses	
JE-2	12,500		JE-3	150		JE-3	75		JE-3	35	
	12,500			150			75			35	

	Sales			Sales Discount			J. Dela Cruz, Capital Drawings	
JE-1		7,000	JE-1	250		JE-7	4,800	
		7,000		250			4,800	

The objective in creating T-accounts is to summarize all accounts affected by multiple journal entries for trial balance purposes. It would, of course, be best to check the correctness of all entries before these are actually posted to the GL.

Take note of how each T-account posting was marked with the journal entry number from which the entries were derived. In the event that the trial balance results in an imbalance between total debit and credit entries, errors in posting can be traced via the journal entry numbers.

In this way, the books of accounts can be maintained as error-free as possible to avoid any doubt being cast over the integrity of the GL.

Applying Accounting Concepts

Name: ______________________________

Section: ______________ Date: ______________

I. Determine if each of the following GL accounts is a Debit or a Credit by writing either Debit or Credit on the space provided.

_________ 1. Withholding Tax Payable
_________ 2. Rent Expense
_________ 3. Owner's Capital
_________ 4. Office Supplies on Hand
_________ 5. VAT Payable
_________ 6. Taxes, Licenses, and Registration Expenses
_________ 7. Purchases - Cost of Goods
_________ 8. Merchandise Inventory
_________ 9. Interest Income on savings deposit account
_________ 10. Accounts Payable -Trade
_________ 11. Capital Drawing
_________ 12. Petty Cash Fund
_________ 13. Accounts Receivable- Trade
_________ 14. Sales
_________ 15. Income from Rent
_________ 16. Utilities Expense
_________ 17. 5-Year Note Payable
_________ 18. Cash in Bank
_________ 19. Office Furniture and Fixtures
_________ 20. Miscellaneous Income

II. Identify whether the individual transaction is a multiple or non-multiple transaction event for a single day. Write M for a multiple transaction event and NM for a non-multiple transaction event.

_________ 1. Major repair of transport equipment
_________ 2. Messenger's transportation expenses
_________ 3. Semi-Monthly Payroll
_________ 4. Payment of rent
_________ 5. Photocopying Expenses
_________ 6. Over-the-counter Sales
_________ 7. Cash withdrawn by owner
_________ 8. Purchase of one (1) unit laser printer
_________ 9. A/R Collector's total cash receipts for the day
_________ 10. Payment of latest water bill

III. Study the following individual transactions and identify the particular transaction book used for its initial recording. Choose between SB, CRB, CDB or PCB. If the transaction does not occur in multiples in a single day write GJ for General Journal.

______1. Paid the electrician PhP150 as cost of labor and materials for repairing the main fuse box

______2. Purchased three sacks of flour from supplier Gotez, worth PhP 3,000. Term: 15 days

______3. Received customer Jebob's full payment of PhP 750 for items bought under Credit Agreement No. 54

______4. To record the amount of PhP 225 tax withheld from employee's salary, which was excluded from the payroll but supported by Accounting Ticket No. 72, dated September 03

______5. Bank reconciliation revealed a PhP 575 debit memo for the cost of checkbooks ordered, not yet recorded in the books of accounts

______6. Customer bought 50 boxes of all-natural soap; the PhP 2,000 cash sales was facilitated by Sales Clerk Noemi, one of the top selling sales clerk of the outlet

______7. Check issued to Meralco for PhP 2,000 & paid on Sept. 03

______8. Fifty bottles of perfume, selling at PhP 250 each were sold on account to customer Vayuda

______9. A customer paid PhP 3,000 as full-payment for account balance

______10. A check was issued for the salaries of five employees. Each employee was entitled to a net salary of PhP 4,350 each

IV. Assuming that transactions 1 to 10 above are journalized individually, create the accounting entries that will be recorded in the General Journal. Include the explanations for the entries.

1.

Explanation:

2.

Explanation:

comprehension check

Name: ____________________

Section: ____________________ Date: ____________________

3.

Explanation:

4.

Explanation:

5.

Explanation:

6.

Explanation:

7.

Explanation:

8.

Explanation:

9.

Explanation:

10.

Explanation:

V. Create T-accounts for the given transactions described in items 1 to 10 above. Use a separate columnar sheet to show how the accounting entries created in Exercise II is presented by way of T-accounts.

VI. Check if the accounting entries are equal in terms of total debits and total credits. Show the equality by transposing the T-accounts into a trial balance, on a separate columnar sheet.

Using the Trial Balance

The trial balance is an accounting tool generally used for balancing the GL debit and credit balances. Nevertheless, its use is not limited for this purpose alone. Take note that, in the T-Accounts presented above, multiple entries can affect a single GL account, from which posting errors may arise unless one keeps track of how it will affect all GL account postings.

Hence, the trial balance can also be used to balance the total debit and credit entries that were initially posted in individual T-accounts. Once these debit and credit entries have been proven as equal, the T-accounts and the Trial Balance can now serve as guides when actually posting the transaction in the general ledger. Doing so minimizes the possibility of creating posting errors.

Study the following trial balance in which each of the T-account totals are presented according to the sum of their debits and credits.

Trial Balance

Date	Account Title	Debit	Credit
Sept. 06,2016	Cash on Hand	9,750	20,000
	Cash in Bank	70,000	48,570
	Accounts Receivable		3,000
	Furniture, Fixtures and Equipment	16,500	
	Office Supplies	210	
	Withholding Tax Payable	2,000	
	SSS/MC, PH & Pag-ibig Payable	3,200	
	VAT Payable	2,850	
	Accounts Payable	5,000	16,000
	Loans Payable	3,500	50,000
	Purchases	9,000	
	Utilities Expense	4,750	
	Salaries and Wages	12,500	
	Transportation Expenses	150	
	Repairs & Maintenance	75	
	Miscellaneous Expenses	35	
	Sales		7,000
	Sales Discount	250	
	J. Dela Cruz, Capital Drawings	4,800	
	Totals	**144,570**	**144,570**

Posting the Journal Entries to the General Ledger

After proving the equality between the totals of the journal debit and credit entries, each journal entry will then be entered in its corresponding GL account. The following are examples of how the journal entries are recorded in the general ledger. Here, take note of how entries were posted in the same manner by which they were posted in the T-accounts:

GENERAL LEDGER

CASH ON HAND

DATE		EXPLANATION	REF	DEBIT	CREDIT	BALANCE DEBIT	BALANCE CREDIT
		Balance				15,500	
September	6	Total cash collections as per CRB	JE-1	9,750		25,250	
		Cash deposit to SA/CA _____ (Name of Bank).	JE-4		20,000	5,250	

GENERAL LEDGER

CASH IN BANK

DATE		EXPLANATION	REF	DEBIT	CREDIT	BALANCE DEBIT	BALANCE CREDIT
September	6	Balance				75,000	
		Total check disbursement as per CDB	JE-2		43,300	31,700	
		Petty cash replenishment as per PCB	JE-3		470	31,230	
		Deposit made to SA/CA _____ (Name of Bank).	JE-4	20,000		51,230	
		Funds borrowed from (Bank's Name)	JE-6	50,000		101,230	
		Car reg. fees & insurance of J. Dela Cruz	JE-7		4,800	96,430	

It is after all journal entries have been posted that the trial balance will be used to prove the equality between the GL debit and credit balances produced by the accounting entries.

CHAPTER 04

Understanding Business Transactions

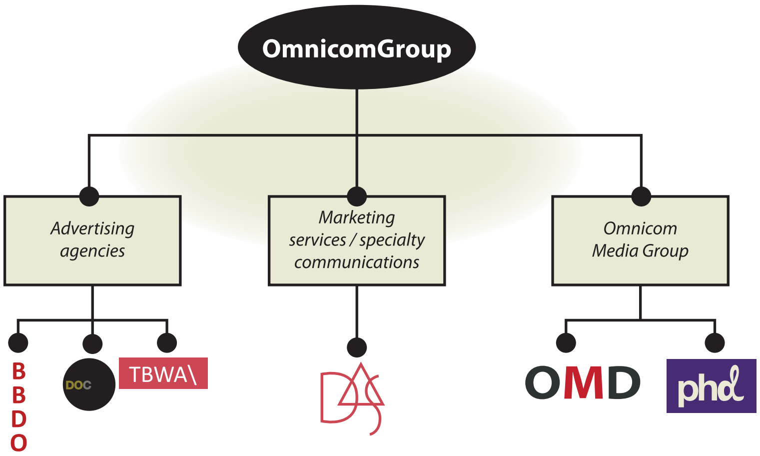
Types of Businesses and Related Transactions

Learning about the different types of business industries can help one analyze the kind of transactions encountered in accounting for both personal and business finances. Bookkeepers and accountants deal with the same types of business transactions, i.e., sales, payment of salaries, utilities, transportation, fuel and lubricants, rent, contributions to employee benefits, etc., regardless of company.

The main difference lies in the nature of the business activity that a company is involved in, from which profits or income are realized; thus, the term industry. These are classified into three major categories: (1) Service, (2) Manufacturing, and (3) Merchandising or Retailing.

Service Industries

Businesses classified under this category are engaged in providing services as a means to generate income. A service may come in the form of labor or performance of an action or a series of actions. They also pertain to letting, leasing or provision of facilities to accommodate a customer.



(Image Source: Omnicon.01 at Wikimedia CCA-SA 3.0 Unported)

Some examples include the professional services of accountants, doctors, lawyers, engineers, architects, teachers, haircutters, entertainers, therapists, recruitment agencies, and the like. Other types of service industries are those that render services through the use of computer automation, or provision of facilities, equipment, and administration of public funds. Entities that render such services include government and non-government offices or NGOs, IT technologists, software developers, hotels, spas, fitness gyms, banks, advertising agencies, job agencies, and the like.

Sources and Uses of Fund or Income

Entrepreneurs and business entities of service industries collect income in the form of fees, while capital funds are mostly invested in fixed assets, buildings, real property, equipment, tools, computers, and IT technology. Purchases of goods are minimal and are usually recorded as supplies inventory although, in some cases, some goods are bought for retail purposes, such as computers for an accounting firm, for example, but these are not part of the main line of business.

Conditions

Services may be contracted as a means to maintain exclusivity, benefiting both the service provider and the service user. In such cases, advance payments may be required by the contractor and subsequent payments may be based on a schedule of dates of payments or on percentages of completion.

However, there are also work-for-hire service providers, who are commissioned to perform work on a specific task. Inasmuch as the supplies, materials, equipment, and facilities are provided by the hirers, the relationship between the hirer and the service providers is likened to that of an employer-employee relationship and not as a business partnership.

With this in mind, daily operational transactions therefore do not come in the form of multiple occurrences; thus, accounting entries are often journalized directly in the general journal.

Manufacturing Industries

These are the producers of different consumer goods and specialty products, which consumers buy from different commercial establishments or retail outlets.

Sources and Uses of Fund or Income

Capital investments are typically utilized in acquiring or fabricating machinery and equipment used for the manufacture of goods. Production output is brought to the market through distributors or wholesalers who act as middlemen between the manufacturing company and retailers. In this way, goods are sold in bulk, which allows for the quick conversion of finished goods into sales.

(Image: Seagate Wuxi China Factory Tour by Robert Scoble Wikimedia Commons CCA 2.0 Generic)

Moreover, accounting for manufacturing industries is more complex because it requires a thorough analysis of production costs, as these costs serve as basis for determining the selling price. Cost accountants have to take into account direct labor, direct materials and manufacturing overhead costs plus any other company expenses indirectly related to production. Various inventories are maintained, in which goods held and available are classified as raw materials, work-in-process, and finished goods for purposes of proper cost monitoring.

Conditions

Since manufacturers purchase raw materials in bulk as a means to lessen the cost, most purchases are bought on account or on credit terms. The same condition is true when selling the finished goods to distributors or wholesalers; hence, it is common for manufacturing companies to deal heavily in accounts payable and accounts receivable transactions, but not necessarily in multiple occurrences.

Merchandising or Retailing Industry

These are businesses that venture largely into buying goods or products as distributors, wholesalers or retailers. Their business activities are mainly concerned with the buying and selling of goods to small traders and consumers at marked-up prices.

(Image courtesy of Wikimedia Commons CCA-SA 3.0 Unported)

Sources and Uses of Fund or Income

The capital funds are mostly invested in the purchase of goods maintained as merchandise inventory.

As mentioned earlier, distributors and wholesalers purchase their goods on credit but they may not always extend the same privilege to their retailer-customers. Since buying in bulk requires large amounts, they need to sell goods on cash basis in order to meet their obligations as these become due.

Retailers, on the other hand, sell goods on a per piece basis, which makes the process of converting goods into cash a slower process. It is for this reason that selling minimally-priced items on credit is generally discouraged among retailers.

Conditions

Distributors and wholesalers fall under this category inasmuch as they practically buy goods directly from the manufacturers. As much as possible, they maintain their selling prices at levels that will allow retailers to gain profit from the latter's own trading activities. Retailers on the other hand, freely mark up their selling prices in consideration of the overhead costs they incur.

Some retailers maintain outlets in department stores and other commercial establishments, where overhead costs like rent expense and cost of utilities, are higher. In contrast, public market and home-based retailers have fewer overhead costs; hence they can afford to sell at relatively lower prices that enable them to stay competitive as well as lucrative.

Purchasing, Merchandise Inventory, Cost of Goods Sold

Purchasing in accounting is often related to the buying either of goods to sell or of fixed assets that will be used to generate income. Generally, such purchases require large amounts of cash outlay; thus, acquisitions are done by way of credit facilities.

Purchasing activities are supported by business documents in the form of purchase requisitions, purchase orders, delivery receipts, sales invoices, and the supplier's official receipt.

Accounting for Goods Purchased

Goods or merchandise stock are initially recorded under the Purchases account as an expense item. They may be bought on cash on delivery (COD) basis or on credit terms.

The only journal entries posted to the Purchases account are those related to procurement activities. In the event that a purchased item has to be returned to the supplier, any adjustments in the value of the purchased goods are taken up in a separate account called Purchase Returns and Discounts.

Keep it in mind that the only credit entry required by this account is the pre-closing adjusting entry at year's end. Since the books are about to be closed for the year, the balance of the GL-Purchase account will be transferred to the Cost of Goods Sold account.

To better explain the accounting method for this transaction, let us use as example a retailer, who purchases goods on COD basis from supplier Golden-I and on credit from supplier Kan-Bar. On September 06, 2016, the retailer bought an assortment of merchandise from Kan-Bar, worth PhP 15,550 (Non-VAT). The bookkeeper prepared the following journal entries for this particular transaction:

Dr. Purchases	PhP 15,550	
Cr. Accounts Payable		PhP 15,550

Explanation: To record the purchase of goods from Kan-Bar under Purchase Order No. 15-11.

The bookkeeper will then post this journal entry on the GL-Purchases, as illustrated by the example below.

Year: 2016		GENERAL LEDGER					
		PURCHASES					
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
January	15	Purchased 2 boxes of ABX from Golden-I	JE-7	900		900	
March	15	Purchased 2 boxes of LKY from Golden-I	JE-54	800		1,700	
April	15	Purchased various items from Kan-Bar	JE-75	10,430		12,130	
June	15	Purchased various items from Kan-Bar	JE-94	8,260		20,390	
July	15	Purchased 2 boxes of PLIJ from Golden-I	JE-115	560		20,950	
September	15	Purchased various items from Kan-Bar	JE-154	15,550		36,500	

Accounting for Returned Items

To further continue the explanation on this topic, we will continue with the same set of examples:

Supposing that, on the same day that the PhP 15,550 purchase from Kan-Bar was delivered, the retailer rejected several defective items worth PhP 265. The rejected items were noted on the delivery receipt and returned to the supplier using a separate Return Slip duly acknowledged by a Kan-Bar representative.

When recording returned items, the following should be kept in mind:

1. No adjustments on the previously posted Purchase entry will be made, although best practices recommend putting a notation about the returned item, next to the entry.

2. The retailer will defer with the recognition of the transaction, awaiting Kan-Bar's sales invoice, which should state information similar to the following:

Purchase of various items on September 06, 2016 per DR 515	PhP 15,550
Less: Returned Items as per Return Slip No. 61	265
Net Amount Due on this Billing Statement	PhP 15,285

Once the retailer-buyer is satisfied that the return has been properly acknowledged by the supplier, the purchase will be recorded accordingly via this entry:

Dr. Purchase Returns and Discount	PhP 265	
Cr. Accounts Payable-Trade		Php 265

Explanation: To record the defective items rejected and returned to supplier.

Through these entries the Accounts Payable-Trade was reduced to PhP15,285, and returned item worth PhP265 was recognized.

3. Upon payment of the billed amount, the bookkeeper will create the following journal entries:

JE No. 77

Dr. Accounts Payable-Trade PhP 15,285

Cr. Cash in Bank PhP 15,285

Explanation: To record payment of Kan-Bar Billing Statement No. 545 (Purchase Amount PhP 15,550 less returned items of PhP 265).

Accounting for Incidental Expenses Related to a Purchase Transaction

All expenses, such as delivery fees and handling charges, costs of installation and all other expenses incidental to the purchase of goods should be added to the cost of purchase.

Accounting for Merchandise Inventory

Stock inventory is recorded at purchase cost, including all other related expenses incurred in connection with the purchase transaction. As goods are released or issued from the stockroom, due care should be applied in assigning the unit cost for items with fluctuating prices.

At the end of a particular accounting period, a physical inventory will be conducted to determine the remaining goods unsold. Each product shall be listed according to their assigned item codes along with the purchase cost per unit and the number of items physically counted. In determining the amount of unit cost to be assigned for items with varying prices, one should follow the "First-in, First-Out" rule or FIFO.

What is FIFO?

Under this rule, the basic assumption is that the old stocks are the first to be issued or released; the unit cost of goods released will be based on previous year's prices until the items are consumed. Any remaining stocks physically counted as on hand at year-end, shall be based on the latest applicable purchase cost.

Take a look at an excerpt of an inventory list below, which shows the total amount of inventory counted as still unsold:

MERCHANDISE INVENTORY LIST

Date of inventory:

Item Code	Brand	Size	Color	Lot Size	Unit Cost	Quantity/Lot	Php Amount
123	ABX	S	Natural	50/box	450	2	900
124	TNR	L	White	100/box	900	1	900
125	GOI	S	Black	50/box	550	3	1650
126	LKY	S	Blue	50/box	400	2	800
127	EJT	L	Brown	100/box	875	2	1750
128	PLIJ	Reg.	Asstd.	10kl/bag	280	1	280
129	SMBT	Reg.	White	10kl/bag	300	2	600
130	GRUP	Family	Asstd.	30kl/bag	750	1	750
TOTAL	--------------------------End of List--------------------------					14	7630

A set of correlated pre-closing adjusting entries will be created, to record the actual value of the merchandise inventory that is still on hand and unsold as of year-end based on this list.

AJE 10

Dr. Cost of Goods Sold PhP 5,480
Cr. Merchandise Inventory PhP 5,480

Explanation: To transfer the Merchandise Inventory balance to Cost of Goods Sold.

AJE 11

Dr. Merchandise Inventory PhP 7,630
Cr. Cost of Goods Sold PhP 7,630

Explanation: To record the amount of merchandise inventory physically counted and actually on hand at year-end.

Assuming that the Merchandise Inventory account has a beginning balance of PhP 5,480, the items comprising this amount will be considered as the first of the items to have been sold during the year. Thus, a pre-closing adjusting entry will be created to denote that this particular inventory became part of the cost of goods sold for the year.

View the GL-Merchandise Inventory account example, and study the effects of the two adjusting entries:

GENERAL LEDGER							
		MERCHANDISE INVENTORY					
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
January	1	Beginning balance				5,480	
December	31	Year-end adjusting entry for cost recognition.	AJE-10		5,480	-	
December	31	Value of mdse. inventory actually on hand	AJE-11	7,630		7,630	

Accounting for Cost of Goods Sold (COGS)

All GL-accounts related to goods purchased during the year, shall be transferred to the Cost of Goods Sold account upon closing of books. Beginning and ending balances of the merchandise inventory account are also components of the Cost of Goods Sold as discussed in the previous section, Accounting for Merchandise Inventory.

We will continue with our business case example and use as basis the GL-Purchase previously presented, and we'll work on the assumption that the September 06, 2016, transaction is the last entry.

Year: 2016		GENERAL LEDGER					
						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
January	15	Purchased 2 boxes of ABX from Golden-I	JE-7	900		900	
March	10	Purchased 2 boxes of LKY from Golden-I	JE-54	800		1,700	
April	20	Purchased various items from Kan-Bar	JE-75	10,430		12, 130	
June	27	Purchased various items from Kan-Bar	JE-94	8,260		20,390	
July	2	Purchased 2 boxes of PLU from Golden-I	JE-115	560		20,950	Note: Returned items PhP 265
September	6	Purchased various items from Kan-Bar	JE-154	15,550		36,500	

The GL-Purchases account end balance of PhP 36,500 will be the amount used for the adjusting entries:

AJE 12

Dr. Cost of Goods Sold	PhP 36,500	
Cr. Purchases		PhP 36,500

Explanation: To transfer the Purchases account balance to COGS.

AJE 13

Dr. Purchase Returns and Discounts	PhP 265	
Cr. Cost of Goods Sold		PhP 265

Explanation: To transfer the Purchase Returns and Discounts balance to COGS.

Let us now find out the effects of these year-end adjusting entries in the Cost of Goods Sold, Purchases, and Purchase Returns and Discounts, by viewing the sample GL accounts below:

Year: 2016 — GENERAL LEDGER

DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
December	31	Merchandise Inventory beginning		5,480		5,480	
		Merchandise Inventory ending	AJE-11		7,630	(2,150)	
		Purchases	AJE-12	36,500		34,350	
		Purchase Returns and Discounts	AJE-13		265	34,085	

Year: 2016 — GENERAL LEDGER

DATE		EXPLANATION	REF	DEBIT	CREDIT	BALANCE DEBIT	BALANCE CREDIT
January	15	Purchased 2 boxes of ABX from Golden-I	JE-7	900		900	
March	10	Purchased 2 boxes of LKY from Golden-I	JE-54	800		1,700	
April	20	Purchased various items from Kan-Bar	JE-75	10,430		12, 130	
June	27	Purchased various items from Kan-Bar	JE-94	8,260		20,390	
July	2	Purchased 2 boxes of PLU from Golden-I	JE-115	560		20,950	Note: Returned items PhP 265
September	6	Purchased various items from Kan-Bar	JE-154	15,550		36,500	
December	31	Transferred the balance to COGS	AJE-12		36,500		

Year: 2016 — GENERAL LEDGER

DATE		EXPLANATION	REF	DEBIT	CREDIT	BALANCE DEBIT	BALANCE CREDIT
October		Returned Item - Return Slip No. 61	JE-77		265		265
December		Transferred the balance to COGS	AJE-13	265			-

The accuracy of the cost of goods sold (COGS) balance can be checked by stating the accounting entries into a balance sheet statement form:

Cost of Goods Sold:		
Merchandise Inventory, Beg.	PhP	5,480
Add: Purchases		36,500
Less: Purchase Returns and Discounts		(265)
Total Goods Available for Sale	**PhP**	**41,715**
Less: Merchandise Inventory, End.		(7,630)
Cost of Goods Sold:	**PhP**	**34,085**

Borrowing, Loans Payable, Prepaid Interest Expenses

Borrowing in the accounting sense means obtaining money from external sources, such as banks and lending institutions. This transaction is usually substantial in amount and is typically supported by a promissory note. It is more commonly known by the term "loan," thus denoting an interest bearing transaction.

Banks usually grant loans only to their eligible depositors, in which the funds borrowed can be easily transferred to the depositor's account. Similarly, loan payments can also be deducted from the depositor's account balance, but with proper authorization coming from the borrower-depositor.

Accounting for Loans Payable

Once a loan is approved for release by the bank, the funds will be added to the depositor's bank balance. However, one should understand that the bank usually deducts bank charges and advance interest payments from the amount released. Deductions made for advance interests are termed as "discounted."

Study this example:

The owner of our example retail business was able to obtain a fifty-thousand-peso loan from his depository bank. The term on the loan is for one year and payable in 12 monthly installments at an interest rate of 12% p.a. It was released on September 05, 2016 and the amount transferred to proprietor's bank account was net of the interest due for one year.

The bookkeeper created journal entries based on the following information stated in the bank's credit advice:

Principal Amount	PhP 50,000
Less: Front-end Processing Fees	500
Less: One-year Interest Discounted	6,000
Net Proceeds	PhP 43,500
	==========

JE-9

Dr. Cash in Bank	PhP 43,500	
Dr. Prepaid Interest	6,000	
Dr. Bank Charges	500	
Cr. Loans Payable		PhP 50,000

Explanation: To record proceeds of loan granted by WestBank per Credit Advice No. 87.

Accounting for Prepaid Interest

The interest paid in advance was recorded as an asset account, since the amount is technically still not an expense; expense recognition takes place at month-end. These topics will be discussed in full in Lessons 7 and 8.

Accounting for Loan Payments

Beginning October 05 of the current year through September 05 of the succeeding year, monthly loan payments of PhP 4,166.67 will be deducted from the cash in back account, as authorized by the business owner. The monthly journal entries are therefore as follows:

JE-34

Dr. Loans Payable PhP 4,166.67

Cr. Cash in Bank PhP 4,166.67

Explanation: To record the first monthly installment on WestBank loan as per bank Debit Advice No. 112.

View the sample GL-Loans Payable for these transactions:

Year: 2016		GENERAL LEDGER					
						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
September	5	1-yr Loan granted by WestBank	JE-9		50,000		50,000
October	5	First monthly installment	JE-34	4,166.67			45,833.33

Lending, Notes Receivable, Unearned Interest Discount

Lending is a form of service industry activity which businesses like banks, pawnshops and credit card companies extend to customers. It is the exact opposite of borrowing and therefore requires a different set of journal entries.

In order to provide examples of journal entries for lending transactions, for this topic we will make use of a pawnshop's lending activities. The entries are expected to occur in multiple occasions for a single day's transaction since loaning out of money is the main activity of a pawnshop business.

To facilitate their recording, a "Loans Extended Book" is being used to summarize all amounts loaned out for the day. Bear in mind that transaction books may vary in titles but they basically have the same purpose—that of summarizing numerous transactions of similar nature to avoid creating repetitive journal entries.

Accounting for Loans Receivable

The Loans Extended Book (LEB) shows how much has been paid out as loans for the day and how much cash was actually disbursed to customers. The interest and service charges are discounted, thus reducing the amount of cash actually received by the customers. The LEB's summary totals furnish the amounts for the journal entries pertaining to the lending transactions for the day.

LOANS EXTENDED BOOK

Date		Pawn Ticket #	Description of Pledged Item	Appraised Value	% Interest, Mo.	Loan Amount	Interest (3 mos.)	S.C.	Cash Disbursed
September	6	123	24-k gold necklace	12,000	3.50%	9,600	1,008	5.00	8,587.00
		124	18-k gold necklace	7,500	5.00%	6,000	900	5.00	5,095.00
		125	1 set gold ring & pendant diamond	6,000	5.00%	4,800	720	4.80	4,075.20
		126	1 Rolex watch 18-k white gold	6,000	5.00%	4,800	720	4.80	4,075.20
		127	1 Samsung Cellphone 83410W	4,000	5.00%	3,200	480	3.20	2,176.80
		128	1 Sony Playstation 3	10,000	3.50%	8,000	840	5.00	7,155.00
		129	1 X-box 360	10,000	3.50%	8,000	840	5.00	7,155.00
			Total			44,400	5,508	32.80	38,859.20

Disclaimer: The values and rates provided above are only hypothetical and donot represent the standard and legal requirements for pawnshop operations. They only serve as value examples for the accounting transaction and its journal entries.

comprehension check

Understanding Business Transactions

Accounting for Basic Bookkeeping

4

Name: ______________________________

Section: ______________ Date: ______________

I. Identify the type of business industry (Retail, Service, or Manufacturing) based on the business transaction described in each statement.

Example: Purchased 50 sacks of rice to replenish stock inventory. ___Retail___

_________ 1. Received PhP 200 as membership fee for gym facilities
_________ 2. Released 20 boxes of bath soap from stockroom, to replenish store shelves
_________ 3. Collected monthly rent on leased commercial space
_________ 4. Purchased 10 bales of spun cotton requisitioned by production department
_________ 5. Submitted the floor plan for the proposed building
_________ 6. Delivered 12 dozen T-shirts to MAK Distributing Co.
_________ 7. Paid PhP 14,750 to garment sewers assigned at Plant B
_________ 8. Billed the customer for installation of POS systems program
_________ 9. Sold various grocery items totalling PhP 365
_________ 10. Paid interest on time deposit placement

II. Choose the applicable set of journal entries for the following transactions. Write the corresponding letter of your answer on the space provided.

1. Purchased raw materials; terms 30 days/2% PhP 15,000
   a. Dr. Cost of Raw Materials - PhP 15,000 / Cr. Accounts Payable - PhP 15,000
   b. Dr. Purchases - Raw Materials PhP 15,000 / Cr. Cash - PhP 15,000
   c. Dr. Purchases - Raw Materials - PhP 15,000 / Cr. Accounts Payable -Trade PhP 15,000

2. Received PhP 5,500 as mo. installment payment for an LCD TV
   a. Dr. Accounts Receivable - Trade PhP 5,500 / Cash PhP 5,500
   b. Dr. Cash PhP 5,500 / Accounts Receivable - Trade PhP 5,500
   c. None of the above

3. Paid Billing Statement for items worth PhP 7,300 received under DR No. 564
   a. Dr. Merchandise Inventory - PhP 7,500 / Cr. Accounts Payable - PhP 7,500
   b. Dr. Accounts Payable - Trade - PhP 7,500 / Cr. Cash in Bank PhP 7,500
   Cr. Cash in Bank PhP 7,300
   c. None of the above

4. Issued check for PhP 3,460 to pay for last month's electric bill
   a. Dr. Power,Light and Water - PhP 3,640 / Cr. Cash in Bank PhP 3,640
   b. Dr. Power, Light and Water - PhP 3,640 / Cr. Accounts Payable PhP 3,640
   c. Dr. Power, Light and Water - PhP 3,460 / Cr. Cash in Bank PhP 3,460
5. Pre-closing adjusting entries for Merchandise Inventory Beg. PhP 4,855
   a. Dr. Purchases PhP 4,855 / Cr. Merchandise Inventory PhP 4,855
   b. Dr. Merchandise Inventory, PhP 4,855 / Cr. Cost of Goods Sold
   c. Dr. Cost of Goods Sold - PhP 4,855 / Cr. Merchandise Inventory - PhP 4,855
6. Proceeds of loan received in full PhP 75,000
   a. Dr. Loans Payable PhP 75,000 / Cr. Cash in Bank PhP 75,000
   b. Dr. Cash in Bank PhP 7,500 / Cr. Loans Payable PhP 7,500
   c. None of the above
7. Received loan payment from borrower: Pawn Ticket # 114 PhP 1,800
   a. Dr. Loans Receivable - PhP 1,800 / Cr. Cash on Hand PhP 1,800
   b. Dr. Cash on Hand - PhP 1,800 / Cr. Loans Receivable PhP 1,800
   c. Dr. Cash on Hand - PhP 1,800 / Cr. Loans Payable - PhP 1,800
8. Total cash sales for the day PhP 6,115 based on cash receipts book
   a. Dr. Sales - PhP 6,115 / Cr. Cash - PhP 6,115
   b. Dr. Cash on Hand - PhP 6,115 / Cr. Cash in Bank- PhP 6,115
   c. Dr. Cash on Hand - PhP 6,115 / Cr. Sales - PhP 6,115
9. A total of PhP 785 in unearned interest discounts was recognized as income
   a. Dr. Unearned Interest Discount - PhP 785 / Cr. Interest Income - PhP 785
   b. Dr. Interest Income - PhP 785 / Unearned Interest Discount - PhP 785
   c. None of the above
10. Year-end physical inventory of goods still on hand amounted to PhP 5,185
   a. Dr. Merchandise Inventory, End. -PhP 5, 815 / Cr. Cost of Goods Sold - PhP 5,815
   b. Dr. Cost of Goods Sold - PhP 5,815 / Cr. Merchandise Inventory - PhP 5,815
   c. Dr. Merchandise Inventory, End. - PhP 5,185 / Cr. Cost of Goods Sold - PhP 5,185

JE- 32

Dr. Loans Receivable	PhP 44,400	
Cr. Cash on Hand		PhP 38,529.20
Cr. Unearned Interest Discount		5,508.00
Cr. Service Charge Income		32.80

Explanation: To record the total loans disbursed for the day.

Accounting for Unearned Income

The interest deducted or discounted from the loan represents three months advance interest payment. This means that, technically, it is still income unearned as of transaction date. After the three-month term, journal entries will be made to record the unearned income as actual income earned.

JE-57

Dr. Unearned Interest Discount	PhP 5,508	
Cr. Interest Income – Pledge Loans		PhP 5,508

Explanation: To record interest income earned from the September 06, 2016 pledge loans.

Accounting for Loans Payment

Similar to the Cash Receipts Book, a Loans Paid Book (LPB) is utilized for multiple transactions pertaining to all cash collections received. Aside from the principal amount, some customers are constrained to pay additional interest charges if they make payments beyond the due date. The journal entries for the total amount of loan and interest payments received on September 06, 2016 are in the following table.

LOANS PAID BOOK

Date		Pawn Ticket #	Name of Customer	Amount Paid	% of Interest	Interest	Total Paid
Sept.	6	78	C. Rosal	3,000	3.50%	9.50	3,009.50
		63	L. Abubakar	5,000	5.00%	5.70	5005.70
		82	M. delos Santos	1,200	3.50%	48.50	1,248.50
		74	J. Cadera	800	3.50%	3.60	803.60
		95	P. Santos	2,500	5.00%	16.50	2,516.50
			Total	12,500		83.80	12,583.80

JE-33

Dr. Cash on Hand	PhP 12,583.80	
Cr. Loans Receivable		PhP 12,500
Cr. Interest Income		83.80

Explanation: To record total loan and interest payments received for the day.

CHAPTER 05

A Bookkeeping Walk-Through for Personal Finances

Bookkeeping for Personal Assets

Most individuals hardly take the time to assess how much they have spent on personal effects or belongings. Their closets and cabinets are full of clothes, shoes, bags and other accessories without being fully aware of their total value. Electronic appliances, devices and gadgets have become so numerous that some households find it difficult to cope with the related costs, e.g., electricity, repairs, maintenance, supplies, add-ons, etc.

Personal assets include cash on hand and bank deposit accounts, which are the most liquid or readily usable to pay for goods and services. Another form of personal asset is jewelry, which could be used to acquire cash if pledged as collateral to a pawnshop loan. However, one should not forget that borrowing funds also increases one's expenses due to the interest and service charges being added to the debt or loaned amount.

In order to understand how a business gains from its operations, one should also understand the concept of "Return on Assets." The use of the word "return" denotes gaining something of value that will contribute to the growth or increase of one's resources. This way, an entity can be financially independent and capable of meeting not only its immediate requirements but also that of its future goals.

If one is to liken a household to a business entity, could the owners of the household expect a reasonable rate of return on the assets it acquired through the years? A household, just like a business, incurs expenses for its upkeep, and should also aim to control its expenditures or asset procurements in order to realize gains in the form of savings.

One way to clarify the situation is to account for all household assets and classify these according to their likeliest potentials to bring a reasonable amount of return. We will create accounting records, using the steps prescribed in the accounting cycle and other methods learned from earlier chapters.

We will call our entity as The Household Enterprise (THE) and hypothetically treat all its cash inflows and outflows as business transactions. Our task is to set up a formal set of accounting records, in conformity with the steps prescribed by the accounting cycle.

Step No. 1 Identify the transactions and determine ownership if they are all attributable to THE.

1. A two-storey house and lot bought in 2000; total of payments made on the property as of August 31, 2016 is PhP 515,000.
2. Additional costs incurred in improving the property PhP 185,000
3. A second-hand car bought in 2008: PhP 250,000
4. A personal computer worth PhP 28,000 purchased in 2010
5. A television set purchased for PhP 5,700 in 2009
6. A DVD-CD player – PhP 4,500 acquired in 2011
7. Refrigerator – PhP 12,000; bought in 2007
8. Gas Range – PhP 6,500; bought in 2005
9. An assortment of small kitchen and other household appliances and gadgets worth PhP 15,000.
10. Four units – electric fan worth PhP 3,200; purchased on different dates

11. Four units – cell phones worth PhP 30,000
12. An assortment of home furniture and fixtures totaling PhP 55,000; acquired from 2006 - 2012
13. An assortment of jewelry worth PhP 18,000.
14. Various pieces of clothing, shoes, bags, accessories, household linens, decors, books, magazines, CDs, utensils and miscellaneous implements with total market value estimated at PhP 85,000. These were accumulated from 2006 to 2015, including PhP 8,720 worth of items purchased from January to August, 2016.
15. Deposits paid to utility companies for the installation of an electric meter and a telephone landline – PhP 6,800.
16. Cash in Bank as of Dec. 31, 2015 – PhP 37,565.
17. Cash on Hand as of August. 31, 2015 – PhP 5,400.
18. THE's monthly income are derived from net salaries totaling PhP 62,000 per month.
19. Receipts for groceries and other household supplies purchased from January to August, 2016 amounted to PhP 124,872
20. Total amount of gasoline receipts from January to August, 2016 – PhP 104,560.
21. Total cost of repairs and maintenance incurred from January to August, 2016 – PhP 5,418.

Step No. 2 Analyze and classify items as capital assets if they bring benefits for more than a year and have resale or trade-in values in the event THE decides to discard or sell a particular item. Analyze and classify items as expense if considered as unrecoverable costs.

Step No. 3 Create journal entries to set up the accounts in the general ledger book.

JE-1

Dr. Building and Improvements	PhP 700,000	
Cr. THE, Capital		PhP 700,000

Explanation: To record total payments made on real property, including additional costs for improvements. Total amount paid representing ownership is PhP 515,000 plus improvements amounting to PhP 185,000.

JE-2

Dr. Transportation Equipment	PhP 250,000	
Cr. THE, Capital		PhP 250,000

Explanation: To take up the acquisition cost of the secondhand car purchased in 2008.

JE-3

Dr. Office Equipment – PC	PhP 28,000	
Cr. THE, Capital		PhP 28,000

Explanation: To take up the cost of one complete set of personal computer acquired in 2010.

JE-4

Dr. Furniture and Fixtures	PhP 131,900	
Cr. THE, Capital		PhP 131,900

Explanation: To take up, in the book of accounts, the acquisition cost of various furniture and fixtures.

• TV -	PhP	5,700
• DVD-CD player		4,500
• Refrigerator		12,000
• Gas Range		6,500
• Various household appliances and gadgets		15,000
• Four units – electric fan		3,200
• Four units – cell phones		30,000
• Assorted home furniture and fixtures		55,000
Total	PhP	131,900

JE- 5

Dr. Investments – Jewelry	PhP 18,000	
Cr. THE, Capital		PhP 18,000

Explanation: To take up the acquisition value of jewelry as investments.

JE-6

Dr. Other Assets – Deposit for Utility Accounts	PhP 6,800	
Cr. THE, Capital		PhP 6,800

Explanation: To record deposits paid to Meralco and PLDT.

JE-7

Dr. Cash in Bank	PhP 37,565	
Cr. THE, Capital		PhP 37,565

Explanation: To record balance of Cash in Bank as of December 31, 2015.

JE-8

Dr. Cash on Hand	PhP 5,400	
Cr. THE, Capital		PhP 5,400

Explanation: To record balance of cash on hand as of August 31, 2016.

JE- 9

Dr. Cash in Bank	PhP 496,000	
Cr. Income – Salaries		PhP 496,000

Explanation: To record income received from January to August, 2016.

JE-10

Dr. Cost of Living and Supplies Expenses	PhP 124,872	
Cr. Cash in Bank		PhP 124,872

Explanation: To record food and other supplies expenses from January to August, 2016.

JE- 11

Dr. Fuel, Oil and Lubricants	PhP 104,560	
Cr. Cash in Bank		PhP 104,560

Explanation: To record various receipts representing gasoline expenses from January to August, 2016.

JE -12

Dr. Repairs and Maintenance PhP 5,418

Cr. Cash in Bank PhP 5,418

Explanation: To record total costs of various repairs and maintenance from January to August, 2016.

JE-13

Dr. Clothing and Personal Accessories PhP 8,720

Cr. Cash in Bank PhP 8,720

Explanation: To record costs of clothing and other accessories from January to August, 2016.

Notation

Previous Year's Expenses – Various personal and household items worth PhP 76,280 (PhP 8,720 of the total expenses of PhP 85,000 were not included, since they were expenses incurred against previous years' income.

Step No. 4 Prepare T-Accounts

At this point, T-accounts will be utilized to summarize the multiple entries and to prepare for the trial balance. Study the T-accounts that follow and each of the journal entries that were posted.

	Cash in Bank			Cash on Hand			Accounts Receivable			Mortgage Loan Payable	
JE-7	37,565		JE-8	5,400							
JE-9	496,000										
JE-10		124,872									
JE-11		104,560									
JE-12		5,418									
JE-13		8,720									
	533,565	243,570									
				Building and Improvement			Transportation Equipment			Office Equipment	
			JE-1	700,000		JE-2	250,000		JE-3	28,000	
	Furniture & Fixtures			Investments - Jewelry			Other Assets Deposit/Utilities				
JE-4	131,900		JE-5	18,000		JE-6	6,800				
	THE, Capital			Income - Salaries			Cost of Living & Supplies			Fuel. Oil & Lube	
JE-1		700,000	JE-9		496,600	JE-10	124,872		JE-11	104,560	
JE-2		250,000									
JE-3		28,000									
JE-4		131,900									
JE-5		18,000									
JE-6		6,800		Repairs & Maintenance			Clothing/Personal Accessories			Interest Expenses	
JE-7		37,565	JE-12	5,418		JE-13	8,720				
JE-8		5,400									
		1,177.665									

Step No. 5 Prepare a trial balance to prove the equality of the debit and credit entries.

	The Household Enterprise **Trial Balance** Cut-Off Date : August 31, 2016		
Ref.	**Account Title**	**Debit**	**Credit**
GJ	Cash on Hand	5,400	
	Cash in Bank	533,565	234,570
	Accounts Receivable		
	Investment - Jewelry	18,000	
	Other Assets - Deposit for Utilities	6,800	
	Furniture & Fixtures	131,900	
	Office Equipment	28,000	
	Transportation Equipment	250,000	
	Building & Improvements	700,000	
	Mortgage Loan Payable		
	THE, Capital		1,177,665
	Income Salaries		496,000
	Cost of Living & Supplies	124,872	
	Fuel, Oil & Lubricant	104,560	
	Repairs & Maintenance	5,418	
	Clothing/Personal Accessories	8,720	
	Totals	**1,917,235**	**1,917,235**

Step No. 6 Post the journal entries to the General Ledger.

In as much as the debits and credits of the journal entries have been proven equal at this point, it would be best to post the entries to the general ledger. In case the trial balance produces a discrepancy between the debit and credit totals, posting errors are easier to detect if there are only a few entries to review.

Study the general ledger pages presented below:

		CASH IN BANK				BALANCE	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record balance of Cash in Bank as of 12/ 31, 2015	JE-7	37,565		37,565	
		To record income received form Jan. to Aug. 2016	JE-9	496,000		533,565	
		Food & supplies expenses fron Jan. to Aug.2016	JE-10		124,872	408,693	
		Various receipts gasoline expenses Jan. - Aug. 2016	JE-11		104,560	304,133	
		Various repairs & maintenance Jan. - Aug. 2016	JE-12		5,418	298,715	
		Clothing & accessories purchased Jan. - Aug. 2016	JE-13		8,720	289,995	

DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record balance of cash on hand as of 08/31/2016	JE-8	5,400		5,400	

DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To take-up the aquisition value jewelry as investments	JE-5	18,000		18,000	

DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record deposits paid to Meralco and PLDT	JE-6	6,800		6,800	

						BALANCE	
		FURNITURES & FIXTURES					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To take-up the aquisition cost of various furniture & fixtures	JE-4	131,900		131,900	

						BALANCE	
		OFFICE EQUIPMENT					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	Cost of one complete set of PC acquired 2010	JE-3	28,000		28,000	

						BALANCE	
		TRANSPORTATION EQUIPMENT					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	Acquisition cost of the secondhand car purchased in 2008	JE-2	250,000		250,000	

						BALANCE	
		BUILDING & IMPROVEMENT					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	Total payments made on real property, plus cost of improvements	JE-1	700,000		700,000	

						BALANCE	
		THE, CAPITAL					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	Total payments made on real property, plus improvements.	JE-1		700,000		700,000
		Acquisition cost of the secondhand car purchased in 2008	JE-2		250,000		950,000
		Cost of (1) complete set personal computer acquired in 2010	JE-3		28,000		978,000
		Cost of various furniture, fixtures	JE-4		131,900		1,109,900
		To take-up the acquisition value jewelry as investments.	JE-5		18,000		1,127,900
		To record deposits paid to Meralco and PLDT	JE-6		6,800		1,134,700
		To record balance of Cash in Bank as of December 31, 2015	JE-7		37,565		1,172,265
		To record balance of cash on hand as of August 31, 2016	JE-8		5,400		1,177,665

		INCOME - SALARIES					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record income received from January to August, 2016	JE-9		496,000		496,000

		COST OF LIVING & SUPPLIES EXPENSES					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record income received from January to August, 2016	JE-10	124,872		124,872	

		FUEL, OIL, & LUBRICANTS					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record income received from January to August, 2016	JE-11	104,560		104,560	

		REPAIRS & MAINTENANCE					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record income received from January to August, 2016	JE-12	5,418		5,418	

		CLOTHING & PERSONAL ACCESSORIES					
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record income received from January to August, 2016	JE-13	8,720		8,720	

Step No. 7 Prove the accuracy of the GL postings. Utilize the same trial balance, but provide a column for the net effect between the debit and credit entries. Check the accuracy of the individual GL account balance by comparing these against those reflected in the trial balance. All debit balances are in cream-colored highlights, while all credit balances are with blue highlights.

	The Household Enterprise			
	Trial Balance			
	Cut-Off Date : August 31, 2016			
Ref.	**Account Title**	**Debit**	**Credit**	**Balance**
GJ	Cash on Hand	5,400		5,400
	Cash in Bank	533,565	234,570	289,995
	Accounts Receivable			
	Investment - Jewelry	18,000		18,000
	Other Assets - Deposit for Utilities	6,800		6,800
	Furniture & Fixtures	131,900		131,900
	Office Equipment	28,000		28,000
	Transportation Equipment	250,000		250,000
	Building & Improvements	700,000		700,000
	Mortgage Loan Payable			
	THE, Capital		1,177,665	(1,177,665)
	Income Salaries		496,000	(496,000)
	Cost of Living & Supplies	124,872		124,872
	Fuel, Oil & Lubricant	104,560		104,560
	Repairs & Maintenance	5,418		5,418
	Clothing/Personal Accessories	8,720		8,720
	Power, Water & Communication			
	Tuition & Other Fees			
	Interest Expense			
	Total	**1,917,235**	**1,917,235**	

Bookkeeping for Personal Loans

After establishing THE's assets and capital, we have to determine how much of its capital is wholly owned or fully paid and if there are any financial burdens to consider. Determining the liabilities conforms to the basic accounting equation: Assets = Liabilities + Capital.

Again, the same set of procedures will be observed:

Step No. 1 Identify liability transactions and determine if they are for the account of THE.

1. The house and lot were bought under a 20-year home mortgage loan. It has an outstanding balance of PhP 335,000 as of December 31, 2015. The monthly installment payment due is PhP 6,750, of which PhP 5,000 is applied to the principal and PhP 1,750 represents interest charges.
2. Monthly school tuition fees totaling PhP 15,500 are due for payment every 10th of the month. A total amount of PhP 127,000 was paid in June, 2016, as down-payment for tuition, books, uniforms, and school supplies.
3. Monthly utilities of PhP 4,300 are payable every first week of the month.

Step No. 2 Analyze the type of liability and the accounts affected. Loans that extend for more than a year are classified as long term while those that cover periods of less than a year are classified as current liabilities. Establish payment made from January to August, 2016 and how much is still payable as of August 31, 2016. Some liabilities are due and payable on the following month and shall be recorded as expenses only on the date they were incurred or paid-out.

Step No. 3 Create journal entries in order to set up the accounts in the general ledger book.

JE-14

Dr. Building and Improvement	PhP 335,000	
Cr. Mortgage Loan Payable		PhP 335,000

Explanation: To record balance of outstanding mortgage loans payable.

JE-15

Dr. Mortgage Loan Payable	PhP 40,000	
Dr. Interest Expenses	PhP 14,000	
Cr. Cash in Bank		PhP 54,000

Explanation: To record loan payments from January to August, 2016 (PhP 6,750 x 8 months).

JE-16

Dr. Tuition Fees Paid	PhP 127,000	
Cr. Cash in Bank		PhP 127,000

Explanation: To record the down-payment paid for tuition, books and school supplies paid in June, 2016.

JE-17

Dr. Tuition Fees Paid	PhP 31,000	
Cr. Cash in Bank		PhP 31,000

Explanation: To record total tuition fee installments paid from July to August, 2016 (PhP 5,500 x 2 months).

JE-18

Dr. Power, Water and Communication	PhP 34,400	
Cr. Cash in Bank		PhP 34,400

Explanation: To take up utilities payments of Meralco, PLDT and MWSS billing statements from January to August, 2016 (PhP 4,300 x 8 months).

Step No. 4 Create T-accounts and post the journal entries. Study the T-accounts that follow and take note that the same set of T-accounts that were used for the asset entries, were utilized to allow for continuity of the Cash in Bank accounts.

	Cash in Bank			Building and Improvement			Mortgage Loan Payable				
JE-7	37,565		JE-1	700,000		JE-14		335,000			
JE-9	496,000		JE-14	335,000		JE-15	40,000				
JE-10		124,872		1,035,000							
JE-11		104,560									
JE-12		5,418									
JE-13		8,720									
	533,565	243,570									
JE-15		54,000									
JE-16		127,000		Interest Expenses			Tuition & Other Fees Paid			Power, Water, Communication	
JE-17		31,000	JE-15	14,000		JE-16	127,000		JE-18	34,400	
JE-18		34,400				JE-17	31,000				
	533,565	489,970					158,000				

Step No. 5 The same trial balance will be used to prove the accuracy of the debit and credit entries. The total produced will include those previously posted in the asset and capital accounts. Examine closely the new trial balance and the additional accounts. New debit and credit entries are highlighted using the same color codes.

	The Household Enterprise		
	Trial Balance		
	Cut-Off Date : August 31,2016		
Ref.	**Account Title**	**Debit**	**Credit**
GJ	Cash on Hand	5,400	
	Cash in Bank	533,565	489,970
	Accounts Receivable		
	Investment - Jewelry	18,000	
	Other Assets - Deposit for Utilities	6,800	
	Furniture & Fixtures	131,900	
	Office Equipment	28,000	
	Transportation Equipment	250,000	
	Building & Improvements	1,035,000	
	Mortgage Loan Payable	40,000	335,000
	THE, Capital		1,177,665
	Income Salaries		496,000
	Cost of Living & Supplies	124,872	
	Fuel, Oil & Lubricant	104,560	
	Repairs & Maintenance	5,418	
	Clothing/Personal Accessories	8,720	
	Power, Water & Communication	34,400	
	Tuition & Other Fee	158,000	
	Interest Expense	14,000	

Step No. 6 Post the journal entries in the GL accounts as shown below:

		THE, CAPITAL				**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	10	To record balance of Cash in Bank as of 12/31, 2015	JE-7	37,565		37,565	
		To record income received from Jan. to Aug. 2016	JE-9	496,000		533,565	
		Food & supplies expenses from Jan. to Aug. 2016	JE-10		124,872	408,693	
		Various receipts gasoline expenses Jan. - Aug. 2016	JE-11		104,560	304,133	
		Various repairs & maintenance Jan. - Aug. 2016	JE-12		5,418	298,715	
		Clothing & accessories purchased Jan. - Aug. 2016	JE-13		8,720	289,995	
		To record interest & loan payments from Jan. - Aug. 2016	JE-15		54,000	235,995	
		Down payment for tuition & school supplies paid in June 2016	JE-16		127,000	108,995	
		Total tuition fee installments paid from July to August, 2016	JE-17		31,000	77,995	
		Payment of Meralco, PLDT & MWSS billing from Jan. - Aug. 2016	JE-18		34,400	43,595	

BUILDING & IMPROVEMENT						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	Total payments made on real property, plus cost of improvement	JE-1	700,000		700,000	
		To record additional value of real property.	JE-14	335,000		1,035,000	

MORTGAGE LOANS PAYABLE						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	To record balance of outstanding mortgage loans payable	JE-14		335,000		335,000
		To record loan payments from January to August, 2016	JE-15	40,000			295,000

INTEREST EXPENSES						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	To record interest on loan payments from Jan. - Aug. 2016	JE-15	14,000		14,000	

TUITION FEES PAID						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	Down-payment for tuition & school supplies paid in June	JE-16	127,000		127,000	
		Total tuition fee installments paid from July to August, 2016	JE-17	31,000		158,000	

POWER, WATER, & COMMUNICATION						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	Payment of Meralco, PLDT & MWSS billing from Jan. - Aug. 2016	JE-16	34,400		34,400	

Step No. 7 Complete the trial balance by including the liability and expense accounts posted in this section. To ascertain the accuracy of the posted transactions, match the general ledger balance of the accounts affected against those appearing in the trial balance.

The Household Enterprise

Trial Balance

Cut-Off Date : August 31,2016

Ref.	Account Title	Debit	Credit	Balance
GJ	Cash on Hand	5,400		5,400
	Cash in Bank	533,565	234,570	289,995
	Accounts Receivable			-
	Investment - Jewelry	18,000		18,000
	Other Assets - Deposit for Utilities	6,800		6,800
	Furniture & Fixtures	131,900		131,900
	Office Equipment	28,000		28,000
	Transportation Equipment	250,000		250,000
	Building & Improvements	1,035,000		1,035,000
	Mortgage Loan Payable	40,000	335,000	(295,000)
	THE, Capital		1,177,665	(1,177,665)
	Income Salaries		496,000	(496,000)
	Cost of Living & Supplies	124,872		124,872
	Fuel, Oil & Lubricant	104,560		104,560
	Repairs & Maintenance	5,418		5,418
	Clothing/Personal Accessories	8,720		8,720
	Power, Water, & Communication	34,400		34,400
	Tuition & Other Fees	158,000		158,000
	Interest Expense	14,000		14,000
	Total	**2,498,635**	**2,498,635**	

Bookkeeping for Simple Lending Transactions

It is also important to find out if an entity is expecting funds coming from other sources as part of determining its most accurate financial state. In the case of THE, it was gathered that one of the owners was constrained to sell some of her jewelry on installment basis.

A total of PhP 40,000 worth of jewelry is yet to be collected because the buyer paid for less than the value of the jewelry. The buyer promised to pay the difference on November, 2016; hence, the uncollected amount shall be recognized in THE's general ledger books.

Step No. 1: Identify the transaction and determine if the receivable is for the account of THE.

Step No. 2: Analyze the accounts affected by the transaction and its applicable entries.

Step No. 3: Create the following journal entries:

JE-19

Dr. Accounts Receivable – Sale of Jewelry	PhP 40,000	
Cr. THE, Capital		PhP 40,000

Explanation: To take up the amount still receivable from buyer of jewelry.

Step No. 4 Post the journal entry directly in the general ledger. There is no need to create T-accounts, since there is only one set of journal entries to consider.

		ACCOUNTS RECEIVABLE - SALE OF JEWELRY				BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	Amount still receivable from buyer of jewelry	JE-19	40,000		40,000	

		THE, CAPITAL				BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	Amount still receivable from buyer of jewelry	JE-1		700,000		700,000
		Acquisition cost of the secondhand car purchased in 2008	JE-2		250,000		950,000
		Cost of (1) complete set of personal computer acquired in 2010	JE-3		28,000		978,000
		Cost of various furniture, fixtures	JE-4		131,900		1,109,000
		To take-up the acquisition jewelry as investments	JE-5		18,000		1,127,900
		To record deposits paid to Meralco and PLDT	JE-6		6,800		1,134,700
		To record balance of Cash in Bank as of December 31, 2015	JE-7		37,565		1,172,265
		To record balance of Cash on Hand as of August 31, 2016	JE-8		5,400		1,177,665
		Amount still receivable from buyer of jewelry	JE-19		40,000		1,217,665

Step No. 5 Adjust the trial balance to prove the equality of the new GL balances.

	The Household Enterprise			
	Trial Balance			
	Cut-Off Date : August 31,2016			
Ref.	**Account Title**	**Debit**	**Credit**	**Balance**
GJ	Cash on Hand	5,400		5,400
	Cash in Bank	533,565	489,970	43,595
	Accounts Receivable	40,000		40,000
	Investment - Jewelry	18,000		18,000
	Other Assets - Deposit for Utilities	6,800		6,800
	Furniture & Fixtures	131,900		131,900
	Office Equipment	28,000		28,000
	Transportation Equipment	250,000		250,000
	Building & Improvements	1,035,000		1,035,000
	Mortgage Loan Payable	40,000	335,000	(295,000)
	THE, Capital		1,217,665	(1,177,665)
	Income Salaries		496,000	(496,000)
	Cost of Living & Supplies	124,872		124,872
	Fuel, Oil & Lubricant	104,560		104,560
	Repairs & Maintenance	5,418		5,418
	Clothing/Personal Accessories	8,720		8,720
	Power, Water & Communication	34,400		34,400
	Tuition & Other Fees	158,000		158,000
	Interest Expense	14,000		14,000
	Total	**2,538,635**	**2,538,635**	

Bookkeeping for Cash in Bank

This section furnishes explanations about the Cash in Bank account and the matter of reconciling the balance reflected as per the bank statement and the balance as per the book of accounts. It is typical for these two balances to reflect different amounts on a specific date. Some transactions may have been taken up in an entity's books, but not reflected in the monthly bank statement, or vice versa.

In some cases, an entity may have deducted a particular amount from its cash in bank in relation to a check issued as payment, but said check has not yet been deducted at the bank's end. More importantly, errors in posting of entries are possible and one way to detect such errors is by reconciling the difference between the two records.

To illustrate, we will assume that the bank statement balance, as per the THE's August 31 ATM inquiry, was PhP 43,624, while Cash in Bank deposit, as per the GL books, shows a balance of PhP 43,624 as of August 31, 2016.

In as much as THE's deposit account does not involve the use of Automatic Transfer Arrangements and that all withdrawals are by way of ATM, the difference was easily accounted for. Net interest income which the bank's computer automatically adds to a savings deposit account had increased THE's bank deposit balance.

In a business environment, reconciliations are presented in a form of statement in order to clearly exhibit how the difference was accounted. On the next page is an example of how a bank reconciliation statement is prepared:

Balance per Books as of August 31, 2016		PhP 43,595
Balance per Bank Statement – Aug.31, 2016		43,624
Difference		(PhP 29)
Bank Transactions not appearing in THE's records:		
Interest Income	PhP 36.50	
Withholding Tax on Interest	(7.50)	
Net Amount	PhP 29	
Balance per Books as of August 31, 2016		PhP 43,595
Add: Net Interest		29
Adjusted Book Balance as of August 31, 2016		PhP 43,624
Balance per Bank Statement – Aug.31, 2016		PhP 43,624

A journal entry will then be created to bring the book balance to its adjusted amount.

JE-20

Dr. Cash in Bank	PhP 29	
Cr. Interest Income – SA deposit		PhP 29

Explanation: To record the net interest added by the bank on SA deposit.

Again, the entry will be posted in the general ledger book to put into effect the adjustment that was made. Take note of the last GL posting in the Cash in Bank account.

CASH IN BANK						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	To record balance of Cash in Bank as of 12/ 31, 2015	JE-7	37,565		37,565	
		To record income received from Jan. to Aug. 2016	JE-9	496,000		533,565	
		Food & supplies expenses from Jan. - Aug. 2016	JE-10		124,872	408,693	
		Various receipts gasoline expenses Jan. - Aug. 2016	JE-11		104,560	304,133	
		Various repairs & maintenance Jan. - Aug. 2016	JE-12		5,418	298,715	
		Clothing & accessories purchased Jan. - Aug. 2016	JE-13		8,720	289,995	
		To record interest & loan payments from Jan. - Aug. 2016	JE-15		54,000	235,995	
		Down payment for tuition & school supplies paid in June 2016	JE-16		127,000	108,995	
		Total tuition fee installments paid from July to August, 2016	JE-17		31,000	77,995	
		Payment of Meralco, PLDT & MWSS billing from Jan. - Aug. 2016	JE-18		34,400	43,595	
		Net interest (August) added by the bank on SA deposit	JE-20	29		43,624	

						BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	10	Net interest (August) added by the bank on SA deposit	JE-20		29		29

THE's trial balance can now be summarized into according to its GL balances to provide the household owners with a clearer picture of its resources and financial condition.

comprehension check

A Bookkeeping Walk-Through for Personal Finances

Accounting for Basic Bookkeeping

5

Name: ______________________________

Section: ______________ Date: ______________

I. Choose the correct answer and fill in the blank to complete the statement:

1. A household that controls its expenditures and asset procurements can expect to gain financial benefits in the form of
   a. Return on Assets
   b. Return on Investments
   c. savings

2. In identifying transactions, the bookkeeper should always determine if
   a. there is a reasonable rate of return on the asset.
   b. the transaction is attributable to the entity and its business.
   c. there is more than one journal entry to prepare.

3. Businesses should use their capital funds on resources that have the potential to bring financial growth. The concept referred to is
   a. Trade-in value
   b. Income
   c. Return on Assets

4. Loans or borrowing from external sources are considered as financial burdens because (of)
   a. the additional costs in the form of interest and service charges.
   b. they cannot be converted into cash.
   c. they will not bring benefits for more than a year.

5. This shows how the difference between cash in bank per book and per bank statement were accounted.
   a. trial balance
   b. T-account
   c. bank reconciliation statement.

6. A purchased item or expense that is expected to bring future years' benefits or that can be harnessed by the business for more than a year, is treated as a
   a. capital asset
   b. fixed asset
   c. none of the above

7. In accounting for business transactions, the first step is to
   a. identify those that are important to the business.
   b. identify those that have increasing or decreasing effects.
   c. identify those that are attributable to the business.

8. Segregating personal assets from business assets adheres to the principle of
   a. Materiality.
   b. Economic Identity.
   c. Going Concern.

9. The liabilities of a business entity represent the value of that are not wholly owned by the company.
   a. resources
   b. investments
   c. funds

10. This ordinarily creates a difference between savings account balance per book vs. balance per bank statement.
   a. Computer generated interests and withholding taxes
   b. Computer generated bank transfers
   c. Computer generated posting errors

II. Indicate if the account is to be debited or credited by putting an X mark under the appropriate column.

		DEBIT	CREDIT
Ex. Sales	Issued OR#123 for one unit cellphone sold.		X

Debit	Credit		Account Title	Transaction
		1	Cash on Hand	Installment paid by customer
		2	Furniture and Fixtures	Purchase of steel filing cabinets
		3	Salaries and Wages	Total amount of payroll for the week
		4	Cash in Bank	Payment of advance deposit for office unit
		5	Investment	Purchased shares of stocks
		6	Insurance Expense	Paid premium for one month
		7	Cash in Bank	Issued check for petty cash replenishment
		8	Cash on Hand	Received payment of subscription fees
		9	Taxes and Licenses	Paid annual business permits and fees
		10	Rental Income	Collected monthly rent from customers
		11	Other Assets	Paid Meralco for the electric meter deposit
		12	Capital	Net Income realized for the year
		13	Loans Payable	Payment deducted from bank deposit
		14	Accounts Payable	Sales Invoice payable within 10 days
		15	Loans Payable	Bank Memo for discounted loan proceeds

The Household Enterprise				
Trial Balance				
As of : August 31,2016				
Ref.	**Account Title**	**Debit**	**Credit**	**Balance**
GJ	Cash on Hand	5,400		5,400
	Cash in Bank	533,594	489,970	43,624
	Accounts Receivable	40,000		40,000
	Investment - Jewelry	18,000		18,000
	Other Assets - Deposit for Utilities	6,800		6,800
	Furniture & Fixtures	131,900		131,900
	Office Equipment	28,000		28,000
	Transportation Equipment	250,000		250,000
	Building & Improvements	1,035,000		1,035,000
	Mortgage Loan Payable	40,000	335,000	(295,000)
	THE, Capital		1,177,665	(1,177,665)
	Income Salaries		496,000	(496,000)
	Cost of Living & Supplies	124,872		124,872
	Fuel, Oil & Lubricant	104,560		104,560
	Repairs & Maintenance	5,418		5,418
	Clothing/Personal Accessories	8,720		8,720
	Power, Water & Communication	34,400		34,400
	Tuition & Other Fees	158,000		158,000
	Interest Expense	14,000		14,000
	Totals	**2,538,664**	**2,538,664**	

To better appreciate the information about THE's financial condition, the values appearing in the trial balance are being presented below in a statement form:

Statement of Personal Assets, Liabilities & Capital - THE	
C A S H	
Current Assets:	
Cash on Hand	5,400
Cash in Bank	43,624
Accounts Receivable	40,000
Investment in Jewelry	18,000
Other Assets - Deposit for Utilities	6,800
Total Current Assets:	**113,824**
Non-Current or Fixed Assets	
Furniture and Fixtures	131,900
Office Equipment	28,000
Tranportation Equipment	250,000
Building and Improvement	1,035,000
Total Non-Current Assets:	1,444,800
Total Assets:	**1,558,724**

LIABILITIES & CAPITAL	
Mortgage Loan Payable	295,000
Current Assets:	**295,000**
THE, Capital as of December 31, 2015	1,217,665
ADD: Income from Salaries Jan. to Aug. 2016	496,000
ADD: Income from Interest Aug.	29
LESS: Household Expenses from Jan. to Aug. 2016	
Cost of Living & Supplies	(124,872)
Fuel, Oil & Lubricant	(104,560)
Repairs & Maintenance	(5,418)
Clothing & Accessories	(8,720)
Power, Water & Communication Expenses	(34,400)
Tuition & Other Fees	(158,000)
Interest Expenses	(14,000)
Total THE, Capital as of Aug. 31, 2016	**1,263,724**
Total Liabilities & Capital	**1,558,724**

Total Assets of PhP 1,558,724 =Total Liabilities and Capital of PhP 1,558,724. This means that:

1. Part of the assets owned is not yet wholly owned, as represented by the mortgage loan payable of PhP 295,000.
2. THE's accumulated ownership or capital of PhP 1,217,665 is mainly invested in fixed assets.
3. Of the fixed assets owned by THE, only the real property represented by Building and Improvement for PhP 1,035,000 has the potential to bring some form of "Return on Assets." The rest were invested in fixed assets that are mostly fully depreciated as of 2015; hence the expected resale values are minimal.

CHAPTER 06

Entrepreneurship and Accounting

Accounting for Personal Finance Vs. Accounting for Business Enterprise

Entrepreneurship comes from the French word "entreprendre," which means to undertake or assume the role usually, of a business organizer and manager. A person regarded as an enterprising individual is deemed capable of organizing and managing a business by creatively using the available resources even with the challenges and risks involved.

In entrepreneurship, it is important to have the disciplines of organization and management, which are key factors to the financial success of a business. This is why accounting has always been an essential tool in any type of institution. It provides organized and accurate financial records on which to base plans and strategies for operational activities.

Accounting records provide ready references for determining how much has been gained or lost, and what sort of business strategy would be sensible to adopt or to change in order to improve the efficiency of business activities.

Without the proper accounting of all business resources, an entrepreneur would find it difficult to organize and manage operational activities to achieve financial goals. In the previous lesson's discussions on how to set up a formal record of one's personal finances, the Statement of Personal Assets, Liabilities and Capital showed that income earned by the household was mostly invested in fixed assets. This is because a household technically operates as a not-for-profit unit; hence, it is enough to just have an accounting for expenditures. In a business environment, this should not be the case; otherwise, there will not be enough funds for the smooth flow of operations if money is tied up in non-liquid assets. An efficient accounting system that presents such information in the form of financial reports can help entrepreneurs and business managers address fund management concerns.

Accounting Tools and Documents

Accounting tools and documents are used to systematically keep track of all transactions as they occur in the day-to-day operations of a business. The day-to-day task of accounting for business transactions involves repetitive and tedious procedures and processes, and many still have the notion that performing such tasks requires long hours of clerical work.

Special transaction books such as Cash Receipts, Sales, Petty Cash, as well as Cash and Check Disbursement Vouchers, subsidiary ledgers, and accounting schedules are some of the accounting tools being used. While part of these tools' purpose is to summarize transactions that are similar in nature, or to provide breakdowns on a per customer or per item basis, these also serve other uses. The Cash Receipts and Sales Books, for example, also keep track of the exchange of cash and goods between store clerks, cashiers and customers, as well as monitor the movements in stock inventory.

In light of present advancements in technology, the manual work involved can be made easier through the aid of computers. Here are some examples:

Microsoft Excel worksheets/spreadsheets – used to create pages similar to those found in columnar books. Excel has automated functions for extracting totals, thus sparing the bookkeeper from the laborious task of manually adding up a long list of financial values. Formulas for simple mathematical operations can be created in a specific cell to facilitate and ensure that calculations are accurate.

"Point of Sale" (POS) Business Machines – used by retailers and service industries together with POS systems, which enable a single operator to handle such accounting functions as recording, controlling and monitoring of sales transactions at the point of sale. A single barcode that goes through the POS processing system provides information about the sales transactions and the amount of payment received. The system also creates back-office transactions for monitoring the inventory of every item or product sold, or for preparing a billing statement.

Accounting software – when installed in a personal computer, these can perform analysis, recording, monitoring, summarizing and create reports once transactions are identified and encoded. This can also be an accounting system which is readily available in the market, customized or not.

Business Intelligence (BI) software – these are more sophisticated programs in which the accounting of transactions is integrated into every stage of business operations. These enable a computerized business system to record all types of data that are associated with every transaction that transpires.

Large-sized distributors and retailers can have their operations covered starting from the customers' placement of order to delivery and receipt, up to the final stages of collecting and receiving the customers' payment, all of which can be completed before the day ends. Transactional information gathered intelligently by the computer can be used to generate different reports that can be presented in different ways to provide the different types of data analyses needed by management.

Online tools and applications – also known as "cloud computing," which makes accounting software and other types of business applications available over the Internet. This is a possible cost-saving alternative, particularly for small- and medium-sized business organizations, to investing in more expensive software or proprietary programs to automate different types of business transactions. However, data security issues presently prevent these technological developments from gaining ground as reliable business tools.

The different accounting tools and documents available today make accounting work no longer as tedious as previously perceived. Yet accounting as a knowledge is still very important, since the financial reports being generated require human intelligence in analyzing data that are current and relevant to a particular business.

Single Proprietorship vs Partnership vs Corporations

There are different types of business entities in which accounting concepts vary in application. The most common types of business organization are sole proprietorship , partnership, and corporation.

Although this courseware focuses mostly on accounting for sole proprietorships, knowing the difference between these two types of business could help develop a better understanding of how a business enterprise is organized and managed.

Sole or Single Proprietorship

As the title suggests, ownership of the business solely belongs to a single individual. This gives him or her the right to control and run the business in whatever way he or she sees fit. It's a simple system of investing part of one's personal resources into a business venture for personal financial gains.

This is advantageous if the business will flourish as a lucrative source of income, since all economic benefits will add up as wealth for the proprietor. However, there is also the disadvantage of having the sole responsibility of shouldering the entire financial burden of the business. This is particularly true if business ventures fail to generate the expected returns.

When a business entity is unable to recover from its losses and reaches a point of depleting most of its resources, its lenders or creditors can make claims on the personal properties of the business owner of the sole proprietorship, regardless of whether or not such properties are recorded as part of the business assets.

Partnership

Partnership is an agreement between two or more individuals who who legally sign up to contribute money, property, or industry to a common fund with the goal of profiting among themselves as a business entity.

Corporations

A corporate organization is a legal entity created under the corporate laws of a country and registered with the Securities and Exchange Commission (SEC) of that country. It is founded by at least five individuals, referred to as "incorporators," who put in funds or assets as seed capital to start the business.

A corporation can raise additional capital funds by offering their shares of stocks to the public, but only up to the authorized number of shares approved by the SEC. Individuals or organizations that buy into its shares of stock are called investors and become part owners in proportion to their shareholdings.

Typically, corporate business operations are run by core groups of corporate officers and managers under the supervision and control of the corporation's Board of Directors. The latter acts as the overseer of the entire corporation's business undertakings, making sure that the capital funds are being utilized in the most profitable ways possible. This type of business organization distributes net profits through profit-sharing schemes and declaration of dividends. Funds used as payment of liabilities are limited to those coming from the company's resources, and any deficiency cannot be claimed against the personal assets or properties of the incorporators and investors. However, key officers and incorporators could become personally liable if they are found guilty of deliberately misleading the public and the investors by way of financial misrepresentation.

Such misrepresentation is usually aimed at hiding the financial losses of the company to prevent the stockholders from withdrawing their investments. In some cases, misrepresentation is done to mislead more investors into buying shares of stocks in a company that is no longer capable of generating profits or is unable to settle debts and other forms of financial obligations.

In the event that a company does become bankrupt, the personal assets of the incorporators and shareholders will not be affected. However, the creditors will have first priority over the funds generated from the liquidation of its assets, while the incorporators and shareholders can only recover their investments after all other claimants, including the employees, have been paid.

Maintaining reliable and accurate financial records and submitting related reports on time are critical factors in managing a company. Government regulatory requirements must be met by corporate organizations and closely monitored to protect investors. In fact, even a stockholder or Board member has the right to demand and examine the latest financial reports, and such demands should be satisfied within ten days of the submission of a written request by the stockholder or member.

Accounting for Capital Accounts in a Single Proprietorship

Accounting for capital between a single proprietorship and a corporation are quite different, mainly because they have different sources of capital funds. A person who decides to put up a business can simply segregate personal funds by maintaining a separate record of all assets to be used in operating the business. Segregation includes maintaining a separate deposit account to avoid the co-mingling of personal and business funds.

In contrast, accounting for corporate funds is more complex, since companies can raise additional capital by selling their shares of stock. As mentioned earlier, the incorporators are required to put up the initial capital before the SEC approves its incorporation. The company may offer its common and preferred shares of stock based on the approved par value or at the stated value. These are instances in which the corporation gains additional paid-in capital by selling stocks at a stated value that is more than the par value.

Accounting for corporate funds also includes accounting for Retained Earnings and Stockholders' Equity. Retained Earnings is the GL account where the annual net income or net loss realized is summarized to monitor the accumulation of profits. The Stockholders' Equity is the GL account that summarizes the transactions pertaining to the stocks subscribed and fully paid up by investors and stockholders alike. We will learn more of this when we get to the more advanced levels of accounting.

This section will focus on explaining the accounting entries for the capital elements of a single proprietorship. We will be using the household we hypothetically likened to a business unit in Chapter Five of this courseware.

Journal Entries for Capital Accounts

To illustrate some examples on transactions affecting capital accounts, we will assume that the owners of THE, through the head of its family, Mr. Billy Gatos, have decided to venture in a software development business. Mr. Gatos was able to raise PhP 200,000 to use as capital funds for the said business. The amount was deposited in a separate account after securing a business permit, as well as satisfying the requirements of the Department of Trade & Industry (DTI), SSS, BIR and those of other government regulatory bodies.

To distinguish the deposit from that of his personal bank account, the business deposit was given the account name, BG Software Solutions (BGSS). Mr. Gatos submitted documents to the bank to show proof that he is the owner of BGSS. His wife, Mrs. Ally Gatos, on the other hand, assumed the responsibility of maintaining the accounting records of BGSS.

1. Mr. Gatos turned over several receipts to his wife, comprising payments of municipal licenses, DTI and BIR registration fees, amounting to PhP 3,200, all of which were paid on September 05, 2016. Mr. Gatos also paid PhP 1,500 for the cost of 50 booklets of BGSS official receipts (OR) and incurred gasoline expenses worth PhP 300.

JE-1

Dr. Taxes, Licenses and Registrations Fees	PhP 3,200	
Dr. Office Supplies on Hand	PhP 1,500	
Dr. Fuel, Oil & Lubricants	PhP 300	
Cr. B. Gatos, Capital		PhP 5,000

Explanation: To record licenses and fees paid, OR cost of printing and gasoline, all incurred as pre-operating expenses.

2. On September 15, 2016, Mrs. Gatos journalized the following entries to record the transfer of cash from their personal account to the BGSS/SA-CA account:

JE-2

Dr. Cash in Bank	PhP 200,000	
Cr. B. Gatos, Capital		PhP 200,000

Explanation: To record amount of cash transferred as initial deposit of BGSS/SA-CA.

3. On September 30, 2016, Mr. Gatos, withdrew PhP 85,000 to pay for purchases intended for their home-based office. Part of the amount withdrawn included PhP 500 to set up a petty cash fund and was likewise included in the journal entries entered by Mrs. Gatos in the general journal.

Two sets of personal computer worth PhP 65,000 (Office Equipment)
Two pieces computer desks – PhP 5,000 (Furniture & Fixtures)
Two swivel chairs – PhP 3,000 (Furniture & Fixtures)
One unit executive table – PhP 4,000 (Furniture & Fixtures)
One unit executive chair – PhP 2,000 (Furniture & Fixtures)
One unit automatic voltage regulator – PhP 800 (Furniture & Fixtures)
One unit industrial fan – PhP 1,000 (Furniture & Fixtures)
Various office supplies – PhP 700 (Office Supplies on Hand)
Various computer supplies – PhP 3,000 (Office Supplies on Hand)

JE-3

Dr. Office Equipment	PhP 65,000	
Dr. Furniture & Fixtures	15,800	
Dr. Office Supplies on Hand	3,700	
Dr. Petty Cash Fund	500	
Cr. Cash in Bank		PhP 85,000

Explanation: To record two units PC, various articles of office furniture and fixtures, office supplies and petty cash fund.

4. Mr. Gatos reimbursed the license fees and other expenses he personally incurred on September 05, 2016, as pre-operating costs.

JE – 4

Dr. B. Gatos, Capital Drawings	PhP 5,000	
Cr. Cash in Bank		PhP 5,000

Explanation: Withdrawal from BGSS/SA-CA to reimburse the pre-operating expenses incurred on September 05, 2016.

5. On September 30, 2016, Mrs. Gatos paid PhP 3,000 for the installation of DSL-Internet connection, of which PhP 2,000 represented the deposit required by the utility company.

JE-5

Dr. Communication Expenses	PhP 1,000	
Dr. Other Assets - Deposit for DSL-Internet	2,000	
Cr. Cash in Bank		PhP 3,000

Explanation: To record the installation costs and deposit paid for Internet connection.

6. On October 01, 2016, Mrs. Gatos posted the journal entries from September 05 to 30, 2016 in the general ledger. Study the GL postings below:

			B GATOS, CAPITAL			BALANCE	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	5	Licenses, fees, OR gasoline pre-operating expense	JE-1		5,000		5,000
Sept.	15	Cash from personal account to BGSS'SA-CA accou	JE-2		200,000		205,000
						BALANCE	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	30	Reimbursement of pre-operating expenses	JE-4	5,000		5,000	

			CASH IN BANK			BALANCE	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	15	Cash from personal account to BGSS'SA-CA accou	JE-2	200,000		200,000	
Sept.	30	Withdrawal to purchase furniture & supplies	JE-3		85,000	115,000	
Sept.	30	Reimbursement of pre-operating expenses	JE-4		5,000	110,000	
Sept.	30	Installation cost & deposit for DSL-Internet	JE-5		3,000	107,000	
			PETTY CASH FUND			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	30	To record fund set-up	JE-3	500		500	
			OFFICE SUPPLIES ON HAND			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	5	Cost of printing 50 booklets Official Receipts	JE-1	1,500		1,500	
Sept.	30	Various office & computer purchased COD	JE-3	3,700		5,200	
			OTHER ASSETS-DEPOSIT FOR DSL			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	30	Deposit for DSL-Internet connection	JE-5	2,000		2,000	
			FURNITURE & FIXTURES			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	15	Various furniture & fixtures purchased COD	JE-3	15,800		15,800	
			OFFICE EQUIPMENT			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	15	Two units PC purchased COD	JE-3	65,000		65,000	

			FUEL, OIL & LUBRICANT			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	5	Gasoline expenses incurred as pre-operating expen	JE-1	300		300	
			COMMUNICATION EXPENSES			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	30	Installation cost of DSL-internet connection	JE-5	1,000		1,000	
			TAXES, LICENSES & REGISTRATION FEES			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	5	Licenses and fees paid - pre-operating expenses	JE-1	3,200		3,200	

7. After posting the entries, Mrs. Ally Gatos prepared a trial balance to check the accuracy of the GL debit and credit balances.

		BGSS Software Solutions		
		TRIAL BALANCE		
		As of September 30, 2016		
		ACCOUNT TITLE		
DATE			**DEBIT**	**CREDIT**
Sept.	30	Cash on Hand	107,000	
		Petty Cash Fund	500	
		Office Supplies on Hand	5,200	
		Other Assets-Deposit for DSL	2,000	
		Furniture & Fixtures	15,800	
		Office Equipment	65,000	
		Fuel, Oil & Lubricant	300	
		Communication Expenses	1,000	
		Taxes, Licenses & Registration Fees	3,200	
		B Gatos, Capital		205,000
		B Gatos, Capital Drawing	5,000	
		TOTAL	**205,000**	**205,000**

8. On October 01, 2016, Mrs. Gatos also prepared the Statement of Owner's Capital for BGSS as shown below:

BGSS Software Solutions		
Statement of Owner's Capital		
As of September 30, 2016		
B. Gatos, Capital		205,000
Less: B. Gatos, Capital Drawing		(5,000)
B. Gatos, Capital End.		200,000
Less: Expenses incurred to Date		

9. Take note that the PhP 200,000 invested by Mr. Billy Gatos as capital for his business has a remaining balance of PhP 195,500. Hence the present net worth of BGSS is only PhP 195,500, since a total of PhP 4,500 was incurred as pre-operating expenses, while the remaining amount of PhP 195,500 represents the value of the business assets.

Fuel, Oil & lubricant	300	
Communication Expenses	1,000	
Taxes, Licenses & Registration Fees	3,200	(4,500)
B. Gatos, Capital Net as of September 30		**195,500**

10. To further check the accuracy of her statement, Mrs. Gatos stated the net worth of BGSS by using the basic accounting formula Asset = Liabilities + Capital.

ASSETS	=	LIABILITIES + B.GATOS, CAPITAL
Php 195,500		PhP 0.00 + PhP 195,500

Profit and Loss Summary

In order to present a complete Statement of Owner's Capital, we need to understand the use of the Profit and Loss Summary, also known as Income Summary. This is the account used to summarize the income and expense GL balances during the post-closing stage. Since the Statement of Owner's Capital is one of the four basic reports required, we will illustrate the effect of the Profit and Loss Summary to the capital accounts at the close of each year.

Let's continue with the transactions of the newly-formed business of Mr. Billy Gatos and his wife Ally Gatos and bring the business to a year-end scenario. Mrs. Gatos is about to close the books, and below is her pre-closing or unadjusted trial balance for the GL accounts.

BG Software Solutions
TRIAL BALANCE
As of December 31, 2016

ACCOUNT TITLE	DEBIT	CREDIT
Cash on Hand	262,265	
Petty Cash Fund	500	
Office Supplies on Hand	5,200	
Other Assets-Deposit for DSL	2,000	
Furniture & Fixtures	15,800	
Office Equipment	65,000	
Sub-total -Assets	**350,765**	
Accumulated Depreciation		**4,040**
Withholding Tax Payable		1,338
SSS/MC, PH & Pag-ibig Payable		625
Power, Water & Communication Expenses Payable		2,665
VAT Taxes Payable		1,785
Sub-total-Liabilities		**6,413**
Sales Income - Software Development		200,000
Salaries & Wages	26,838	
EC-SSS/M, PH & Pag-ibig Contributions	1,875	
Fuel, Oil & Lubricant	9,300	
Transportation Expenses	1,115	
Power & Water Utility Expenses	4,135	
Communication Expenses	4,600	
Taxes, Licenses & Registration Fees	7,135	
Repairs & Maintenance	540	
Miscellaneous Expenses	110	
Depreciation Expenses	4,040	
Sub-total Expenses	**59,688**	
B Gatos, Capital		205,000
B Gatos, Capital Drawing	5,000	
Grand Total	**415,453**	**415,453**

1. Post-closing entries will be created in order to transfer the balances of the income and expense accounts to the P&L or Income Summary account. The entries will leave the income and expense accounts with zero balances.

JE-65

Dr. Sales Income-Software Development	PhP 200,000	
Cr. P&L or Income Summary		PhP 200,000

Explanation: To close Sales Income account to P&L or Income Summary.

JE-66

Dr. P&L or Income Summary	PhP 59,688	
Cr. Salaries & Wages		PhP 26,838
Cr. EC-SSS/MC/PH, Pag-Ibig Contributions		1,875
Cr. Fuel, Oil & Lubricant		9,300
Cr. Transportation Expenses		1,115
Cr. Power, Water Utility Expenses		4,135
Cr. Communication Expenses		4,600
Cr. Taxes, Licenses & Registration Fees		7,135

Cr. Repairs & Maintenance	540
Cr. Miscellaneous Expenses	110
Cr. Depreciation Expenses	4,040

Explanation: To close Expense accounts to P&L or Income Summary.

2. These entries were then posted to the P&L or Income Summary page, resulting in a credit balance of PhP 140,312. A credit balance in the Profit & Loss account denotes that income received had exceeded the total expenses incurred from September to December. The results of business operations therefore, generated a net income of PhP 140,312.

			PROFIT & LOSS SUMMARY			BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Dec.	31	To close Sales Income account to Profit & Loss	JE-65		200,000		200,000
		To close Expense accounts to Profit & Loss	JE-66				
		Salaries & Wages		26,838			173,162
		EC-SSS/MC/PH, Pag-ibig Contributions		1,875			171,287
		Fuel, Oil & Lubricant		9,300			161,987
		Transportation Expenses		1,115			160,872
		Power, Water Utility Expenses		4,135			156,737
		Communication Expenses		4,600			152,137
		Taxes, Licenses & Registration Fees		7,135			145,002
		Repairs & Maintenance		540			144,462
		Miscellaneous Expenses		110			144,352
		Depreciation Expenses		4,040			140,312

3. Since net income gained from capital investment increases the capital of the business, a journal entry will be created to transfer the P&L or Income Summary balance to the capital account, B Gatos, Capital.

JE-67

Dr. P&L or Income Summary	PhP 140,312	
Cr. B. Gatos, Capital		PhP 140,312

Explanation: To close the net income for the year to the capital account.

4. Study the illustration of the B. Gatos, Capital account, which shows the increasing effect of the net income to the capital balance. The P&L or Income Summary, on the other hand, has a zero balance.

			PROFIT & LOSS SUMMARY			BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Dec.	31	To close Sales Income account to Profit & Loss	JE-65		200,000		200,000
		To close Expense accounts to Profit & Loss	JE-65				
		Salaries & Wages		26,838			173,162
		EC-SSS/MC/PH, Pag-ibig Contributions		1,875			171,287
		Fuel, Oil & Lubricant		9,300			161,987
		Transportation Expenses		1,115			160,872
		Power, Water Utility Expenses		4,135			156,737
		Communication Expenses		4,600			152,737
		Taxes, Licenses & Registration Fees		7,135			145,002
		Repairs & Maintenance		540			144,462
		Miscellaneous Expenses		110			144,352
		Depreciation Expenses		4,040			140,312
		Close the profit & Loss balance to BG Capital	JE-67	140,312			-
			B GATOS, CAPITAL			BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Sept.	5	Licenses, fees, OR gasoline pre-operating expense	JE-1		5,000		5,000
Sept.	15	Cash from personal account to BGSS'SA-CA accou	JE-2		200,000		205,000
Dec.	31	Net Income for the year	JE-67			140,312	345,312

5. The capital drawings will likewise be taken up as a deduction against the capital balance, in order to properly reflect the actual amount of capital invested by the owner as of a given period.

JE-68

Dr. B. Gatos, Capital PhP 5,000
Cr. B. Gatos, Capital Drawing PhP 5,000
Explanation: To close the owner's drawings against capital funds.

			B GATOS, CAPITAL DRAWING			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	30	Reimbursement of pre-operating expenses	JE-4	5,000		5,000	
Dec.	31	To close the owner's drawings against capital funds.	JE-4		5,000	-	
			B GATOS, CAPITAL			**BALANCE**	
DATE		**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**DEBIT**	**CREDIT**
Sept.	5	Licenses, fees, OR gasoline pre-operating expenses	JE-1		5,000		5,000
Sept.	15	Cash from personal account to BGSS'SA-CA account	JE-2		200,000		205,000
Dec.	31	Net Income for the year	JE-67		140,312		345,312
		To close the owner's drawings against capital funds.	JE-68	5,000			340,312

6. After posting this journal entry, Mrs. Gatos prepared a final or post-adjusted trial balance to prove the equality of the GL debit and credit balances that will be presented in the financial statements.

		BGSS Software Solutions		
		TRIAL BALANCE		
		As of December 31, 2016		
		ACCOUNT TITLE		
			DEBIT	**CREDIT**
Dec.	31	Cash on Hand	262,265	
		Petty Cash Fund	500	
		Office Supplies on Hand	5,200	
		Other Assets-Deposit for DSL	2,000	
		Furniture & Fixtures	15,800	
		Office Equipment	65,000	
		Accumulated Depreciation		4,040
		Withholding Tax Payable		1,338
		SSS/MC, PH & Pag-ibig Payable		625
		Power, Water & Communication Expenses Payable		2,665
		VAT Taxes Payable		1,785
		B Gatos, Capital		340,312
		B Gatos, Capital Drawing		
		Grand Total	**350,765**	**350,765**

7. Mrs. Gatos prepared the Statement of Owner's Capital, which will also form part of the balance sheet she is about to prepare.

BGSS Software Solutions	
Statement of Owner's Capital	
As of December 31, 2016	
B Gatos, Capital, Beg.	205,000
Less: B Gatos, Capital Drawing	(5,000)
Add: Net Income from Sept. to Dec. 2016	140,312
B Gatos, Capital, End.	340,312

8. To counter check if the Total Assets and Total Liabilities plus Capital of the balance sheet will balance, Mrs. Gatos stated the total assets and total liabilities and capital, in the basic accounting equation form:

ASSETS - ACCUMULATED DEPRECIATION	LIABILITIES + B. GATOS, CAPITAL END
PhP 350,765 + (PhP 4040)	PhP 6,413 + PhP 340,312
PhP 346,725	PhP 346,725

Note: The accumulated depreciation represents a deduction against the fixed assets.

Entrepreneurship and the Importance of Accounting

Name: ____

Section: ________________ Date: ____________________

I. Read the statement and write T if it is true; write F if it is false.

_______ 1. The main advantage of running a business as a sole proprietor is the right of creditors to make claims against the business owner's personal assets.

_______ 2. The principle of "Economic Identity" is also applicable in corporate organizations.

_______ 3. The net income or net loss of a business for the year can be established by closing all income and expense accounts to the Profit & Loss or Income Summary account.

_______ 4. A corporation can sell its shares of stock at a stated value that is more than the par value of the stock.

_______ 5. A single proprietor can raise additional capital funds by issuing and selling shares of stock.

_______ 6. If a company is dissolved and its assets have been liquidated, the investors have first priority in recovering their investments.

_______ 7. If a business entity's total expenses for the year exceeds the total income for the year, a likely decrease in capital will take place.

_______ 8. Total income should exceed total expenses in order to achieve an increase in capital.

_______ 9. Total Assets should always equal the combined amounts of Total Liabilities and Capital.

_______ 10. If the financial condition of a business is stated as Assets = Capital, this denotes that all assets of the business are wholly owned by the entity.

II. Choose the correct combination of debit and credit entries for the transaction described in each statement. Write the letter of your choice.

1. Paid advance rental & deposit for a leased property

   a. Dr. Rent Expense / Cr. Cash in Bank
   b. Dr. Other Assets / Cr. Cash in Bank
   c. Dr. Income from Rent / Cr. Cash in Bank

2. Closed the debit balance of the Profit & Loss to the capital account

   a. Dr. Owner's Capital / Cr. Profit & Loss
   b. Dr. Profit & Loss / Cr. Owner's Capital
   c. None of the above

3. Increased the capital account by adding the proprietor's laptop as part of his business assets.

   a. Dr. Owner's Capital / Cr. Accounts Payable - Owner
   b. Dr. Office Equipment /Cr. Accounts Payable - Owner
   c. Dr. Office Equipment / Cr. Owner's Capital

4. The proprietor withdrew cash to pay for the annual registration fee of the deilivery van

   a. Dr. Capital Drawings / Cr. Taxes and Licenses
   b. Dr. Taxes & Licenses / Cr. Cash in Bank
   c. Dr. Taxes & Licenses / Cr. Owner's Capital

5. Increased the capital account by transferring the Profit & Loss credit balance

   a. Dr. Profit & Loss / Cr. Owner's Capital
   b. Dr. Profit & Loss / Cr. Net Income
   c. Dr. Net Income / Cr. Owner's Capital

6. The proprietor's wife withdrew from the business bank account to purchase grocery items for their household

   a. Dr. Accounts Receivable / Cr. Cash in Bank
   b. Dr. Cash Advances / Cr. Owner's Capital
   c. Dr. Capital Drawings / Cr. Cash in Bank

7. Withdrew from personal deposit to set up the Petty Cash Fund for the newly established business

   a. Dr. Petty Cash Fund / Cr. Owner's Capital
   b. Dr. Petty Cash Fund / Cr. Cash In Bank
   c. Dr. Petty Cash Fund / Cr. Cash on Hand

8. Paid for photocopying expenses using petty cash fund

   a. Dr. Miscellaneous Expenses / Cr. Petty Cash Fund
   b. Dr. Miscellaneous Expenses / Cr. Cash on Hand
   c. None of the above

CHAPTER 07

Business Accounting

Cash Basis and Accrual Basis Methods of Accounting

There are two different methods used to record the income and expenses of a business—the cash basis and the accrual method.

Cash Basis

Cash basis is how we ordinarily take into account our personal expenses. We recognize increases in our cash resources only once we actually receive the money. As far as expenses are concerned, we simply go by with whatever amount of money we have and pay for what we can afford after taking care of all necessities like utility expenses and tuition fees.

Most start-up and small-sized businesses that operate mainly on cash basis likewise use the cash method of accounting to record their business transactions. However, the problem with this method, if used for business purposes, is the tendency to overstate or understate the income and expenses. This is simply because the measure of expenses or the period in which costs were incurred does not match the measure of income or the time period for which income was recognized during an accounting period. The cash basis method does not conform to the principle of matching income and expenses.

Operators of cash-based businesses who extend credit to selected customers merely make a record of the receivable amount in the Sales book, and no journal entries will be created and posted in the GL. Once payment has been received from the customer, it is only then that a sales transaction will be journalized and posted.

Moreover, the amount of income recognized will be based on the actual amount received from the customer. Since the goods have already been delivered, the costs of the items sold on credit have become part of the entity's cost of goods sold since they are no longer on hand. This means that the cash basis method allows the full recognition or deduction of costs against partial recognition of income.

The same manner of recognition is applied if goods were obtained through credit. Stock merchandise recorded as purchases are only those that have been paid for. However, if a physical inventory of goods will be conducted, the value of the goods that are actually on hand will be more than the value of the goods that were recorded as purchases. This is why the cash basis method is regarded as suitable only for businesses that do not maintain and manage merchandise inventory.

Although popular for its simplicity and straightforward manner, this method is more concerned with the recording of cash inflows and outflows of the business. The cash basis system does not present an accurate accounting of financial data pertaining to the actual results of the entity's operations and its financial condition.

Accrual Basis

The accrual basis is a method of recognizing and recording revenue once the goods have been delivered or services have been rendered within the same accounting period, and based on the agreed terms and conditions between the buyer and the seller. This is regardless of whether actual payments in exchange for the goods delivered or services rendered have been received or not. Goods sold in exchange for a promise to pay at some future time are recorded under accounts receivable and at the same time recognized as outright income from sales.

The method also recognizes as expenses those costs that have been incurred within the same accounting period for which goods or services have been received, even if actual payments will be made at some future time. Expenses incurred for goods obtained or services received but not yet paid, whether in part or in full, are recognized as payables. These include the interest charges attributed to the accounting period but which remain unpaid as of report or statement date.

In both cases, it is important that the amount of income and expense recognized under this recording system are always measurable by a reliable method of determining the value or costs.

The concept of accounting for accrual gets broader and more complex when income and expense recognition at different points of view are considered, and will require different journal entries.

Accounting Using the Accrual Method of Recording

1. Under the accrual method, a seller who extends sales on credit recognizes income once the buyer receives the goods and signs the credit agreement.

Dr. Accounts Receivable – Trade	PhP xxx	
Cr. Sales		PhP xxx

Explanation: To record goods sold on credit and payable within 30 days.

2. On the part of the buyer, goods were received but no actual payment was made. Under the accrual system, the expense will be taken up in the books on the date the goods or services were acquired as:

Dr. Purchases	PhP xxx	
Cr. Accounts Payable – Trade		PhP xxx

Explanation: To record purchase of goods on credit.

3. Interest income is usually earned when lending money or selling on credit. Since accrual basically connotes accumulation, interest income which the lender or seller earns shall be periodically recognized. To put into record the interest income being accumulated in connection with the lending or credit activity, the following set of entries will be journalized and posted:

Dr. Accrued Interest Receivable	PhP xxx	
Cr. Interest Income – Loan		PhP xxx

Explanation: To record interests earned from loan granted to borrowers.

4. On the other hand, the borrower incurs the interest expenses regarded as interest income by the creditor or lender. Under the accrual basis, this should also be periodically recognized as expense, in order to match the income generated by the goods purchased on credit against the expenses incurred. The following journal entries will, therefore, be posted in the general ledger:

Dr. Interest Expense	PhP xxx	
Cr. Accrued Interest Payable		PhP xxx

Explanation: To record monthly interest due on loans payable.

5. The accrual method also takes into account those expenses that need to be recognized when preparing financial statements. Basically, actual payment for such expenses will take place after the cut-off date of

the financial reports; hence, journal entries will be recorded in order to include their values in the financial statements that are about to be prepared, i.e.,

Dr. Taxes and Licenses	PhP xxx	
Cr. Accrued Taxes Payable		PhP xxx

Explanation: To accrue the unpaid tax expense for the month.

Dr. Power, Water and Communications Expenses	PhP xxx	
Cr. Accrued Utility Expenses Payable		PhP xxx

Explanation: To accrue the unpaid utility expenses for the month.

6. Upon collection of the interest receivables, entries will be journalized to record the actual payment received.

Dr. Cash	PhP xxx	
Cr. Accrued Interest Receivable		PhP xxx

Explanation: To record receipt of interest payment previously accrued.

7. In the same manner, interests and other expenses that were accrued as payables and subsequently paid shall be closed out by way of the following entries:

Dr. Interest Expenses Payable	PhP xxx	
Dr. Accrued Utility Expenses Payable	xxx	
Dr. Taxes & Licenses Payable	xxx	
Cr. Cash		PhP xxx

Explanation: To close out the payable accounts of various expenses previously accrued.

Accounting for Unearned Revenues and Income Recognition

Another aspect of income recognition for purposes of adhering to the "matching principle" pertains to monies received or paid in advance. This type of transaction arises from prepayments and requires recognition of income or expenses that were actually earned or incurred within the applicable accounting period.

There are business transactions that require advance payments on a term basis such as quarterly, semi-annually, or annually. This condition may be stated in an agreement, a policy or a contract by industry providers like insurance companies, lessors and distributors of monthly publications, just to mention a few.

Accounting for Prepayments

The receiver of the advance payment initially records the value received as a liability instead of treating it as an outright income. The reason for this is that the goods, services, or use of a facility are still to be provided or delivered. This creates an obligation on the part of the service provider to fulfill the delivery or performance of such services in order to earn the income that was paid in advance. Otherwise, the buyer or the user can ask for a refund of any unfulfilled commitment.

In light of these conditions, the following journal entries will be recorded in the books of the provider to recognize the prepayment transaction:

1. A business entity engaged in distributing publications like magazines or digests may receive advance payments for term subscriptions, in exchange for a monthly, quarterly, or semi-annual delivery of a publication. The journal entries are as follows:

Dr. Cash	PhP xxx	
Cr. Unearned Subscriptions		PhP xxx

Explanation: To record subscription fees received in advance for a one-year publication.

1.1 Once the goods are delivered, part of the liability will be recognized as income via the following journal entries:

Dr. Unearned Subscriptions	PhP xxx	
Cr. Subscriptions Income		PhP xxx

Explanation: To recognize subscriptions income earned from publications delivered for the month.

2. An insurance company usually requires one-year advance payment of premiums for insurance coverage against any loss that may be suffered from unforeseen events. The journal entries upon receipt of the advance premium payment are as follows:

Dr. Cash	PhP xxx	
Cr. Unearned Insurance Premiums		PhP xxx

Explanation: To record advance payment received for a one-year insurance coverage policy.

2.1 Income is being recognized as the period of coverage elapses, regardless of whether or not the insurance policy holder suffered any losses from a fortuitous event. The journal entries for insurance premium recognition are:

Dr. Unearned Insurance Premiums	PhP xxx	
Cr. Income from Insurance Premiums		PhP xxx

Accounting for Prepayments and Expense Recognition

After delving into the entries of service providers and the advance payments they receive as part of the agreed terms and conditions, we will look into the accounting entries of the service buyer or purchaser who made the advance payment.

1. Advance payments of service buyers or purchasers are initially recognized as prepaid assets instead of treating the amount paid in advance as outright expenses. The rationale behind this accounting approach is to recognize a receivable that is payable in the form goods or services to be delivered by the service provider at some future date. In the event that the latter fails to fulfill his commitment, the amount paid in advance can still be refunded up to the value of the product or service that was not delivered.

Hence, the journal entries taken up to record the prepayments are as follows:

Dr. Prepaid Insurance	PhP xxx	
Cr. Cash		PhP xxx

Explanation: To record payment for a one-year insurance policy coverage.

Dr. Prepaid Subscriptions for Periodicals		PhP xxx
Cr. Cash		PhP xxx

Explanation: To record payment for a one-year subscription of business periodicals.

Dr. Prepaid Rent	PhP xxx	
Cr. Cash		PhP xxx

Explanation: To record payment for a one-year lease contract.

2. Upon receipt of products or services, or after the period of coverage has elapsed, the portion of the prepaid expense that was fulfilled by the delivery or the use of facilities will be treated as actual expenses.

   The related entries to put into effect the recognition of the appropriate expense accounts are as follows:

Dr. Insurance Expense	PhP xxx	
Cr. Prepaid Insurance		PhP xxx

Explanation: To recognize as expense the insurance premium for the month of August previously recorded as prepaid insurance.

Dr. Periodicals and Other Library Expenses	PhP xxx	
Cr. Prepaid Subscriptions for Periodicals		PhP xxx

Explanation: To recognize as expense the subscription fees for the month of August previously recorded as prepaid subscriptions for periodicals.

Dr. Rent Expense	PhP xxx	
Cr. Prepaid Rent		PhP xxx

Explanation: To recognize as expense the applicable rent for the month of August previously recorded as prepaid rent.

Calculating the Expense Recognized

Learning how to calculate the amount recognized as expense is equally important since the related prepaid expense account should zero out once the term has elapsed or the contract has expired.

Suppose that the amount paid as insurance premium for the renewal of a policy for one year's coverage amounted to PhP 15,300. The monthly expense to be recognized is equivalent to PhP 1,275, which was simply arrived at by dividing the prepaid amount of PhP 15,300 by 12 months.

In recording prepayments for a policy that was actually paid on the first month of coverage, the premium paid for the first month shall be treated as outright expense. If the PhP 15,300 was paid on September 01, 2016, the journal entries will take up as expense the coverage for the month of September, instead of recognizing as prepaid the entire PhP 15,300, i.e.:

Dr. Insurance Expense	PhP 1,275	
Dr. Prepaid Insurance	14,025	
Cr. Cash		PhP 15,300

However, if the one-year coverage begins on September and was paid on August 31, then the entire amount of PhP 15,300 will be initially recorded as a prepaid asset. Recognition of expense for September will be provided with appropriate expense-recognition entries at a later date during the said month.

Depreciation and the Straight–Line Method of Calculation

Furniture, fixtures, office equipment, and transportation equipment are recorded based on their historical costs, which include related expenditures such as delivery fees, shipping costs, installation fees and the like. The accounting approach, in recording the costs of these items as fixed assets instead of expenses, is called "capitalization of cost." This means that their values are treated as business investments that will bring benefits in future years, as their lifespan extends beyond the year in which they were purchased.

However, the cost of wear and tear on these assets for each year that these are used by a business entity in its operational activities needs to be recognized. The cost of wear and tear is called "depreciation expense" and shall be matched yearly to the income, which the capitalized cost helped generate.

It should be noted that depreciation expenses are not treated as outright reductions of the capital assets' acquisition cost. Instead, a valuation account is created for the purpose of summarizing the total amount of depreciation expenses that reduced the value of the asset due to wear and tear.

The valuation account is called "Accumulated Depreciation" and is presented as a contra-asset account in the balance sheet to show the current Net Book Value of the capitalized asset. A **valuation account** is a type of account used to show the accumulation of charges allocated against an asset account to furnish information about the asset's actual value. It specifically becomes a **contra-asset account** because of the decreasing effect of its credit balance, which stands opposed to the normal debit balance of an asset account.

To illustrate these methods of accounting for fixed assets, we will use the following data:

A wholesaler purchased a second-hand utility van for PhP 200,000 last August 31, to replace the old transport vehicle being used for the delivery of goods. The van required major repairs, which cost the business owner a total amount of PhP 31,500. Nevertheless, the repairs increased the useful life of the van, and the expert mechanic estimated that the van is good for another five years with an estimated scrap value of PhP 5,000.

Journal Entries for the Purchase Transaction

Dr. Transportation Equipment	PhP 231,500	
Cr. Cash in Bank		PhP 231,500

Explanation: To record the cost of second-hand utility van purchased, including the major repairs made to improve and prolong the van's useful life.

On September 30, adjusting entries were created in preparation for the third quarter financial reports. These included adjusting entries for the depreciation expense of the second-hand utility van for the month.

Calculating the Monthly Depreciation Expense Using the Straight-Line Method

Estimated useful life= 5 years or 60 months (5 years x 12 months)
Acquisition Cost = PhP 231,500; Scrap Value PhP 5,000
Depreciable Cost = PhP 231,500 – Scrap Value PhP 5,000 = PhP 226,500
Monthly Depreciation Expense = PhP 226,500/ 60 months = PhP 3,775

Journal Entries for Depreciation Expenses

Dr. Depreciation Expense – Transportation Equipment	PhP 3,775	
Cr. Accumulated Depreciation – Transportation Equipment		PhP 3,775

Explanation: To record the depreciation expense of the new utility van for the month of September.

Determining the Net Book Value

At the end of the year, the Accumulated Depreciation of the utility van would amount to PhP 15,100, comprising the depreciation expenses for the last four months of 2016 (PhP 3,775.x 4 months).

The Net Book Value (NBV) of the utility van as of December31 would be:

Transportation Equipment	PhP 231,500
Less: Accumulated Depreciation	15,100
Net Book Value	**PhP 216,400**

Merchandise Inventory and Management

In Chapter Four, the accounting concepts for Merchandise Inventory were briefly discussed in relation to the Purchases account. You will recall that determining the value of the actual goods on hand is important in computing the Cost of Goods Sold (COGS), since it may lead to the latter's understatement or overstatement. Any kind of misstatement is detrimental to a business, since the net income or net loss to be reported may become the basis of the income tax due for the year.

Merchandise Inventory Beginning

The beginning balance of the Merchandise Inventory account can be derived from the ending balance of the previous year's Merchandise Inventory.

To illustrate by way of example, assume that on December 31, 2015, the merchandise physically counted as on hand had a total value of PhP 50,000. Hence, this same amount was taken up in the book of accounts as the ending balance of the Merchandise Inventory account for 2015. It follows, therefore, that at the post-closing stage, this balance will be forwarded to the new general ledger for the year 2016. However, the PhP 50,000 ending inventory takes on a new status, as it becomes the beginning balance of the new accounting year, 2016.

Methods of Inventory Costing

Our next concern is to understand how the beginning balance affects the movement of the stocks for the next year of operation. Recall the method of inventory costing called FIFO, or the "First-In-First-Out" Method, since this is the method which will be described in the succeeding explanations.

FIFO

At the onset of operations in the year 2016, the unit cost for items released from the stockroom will take into consideration the purchase costs of the items that were carried over from the previous year. To further explain, we will use as example the Merchandise Inventory List presented in Chapter Four:

MERCHANDISE INVENTORY LIST

Date of Inventory:							
Item Code	**Brand**	**Size**	**Color**	**Lot Size**	**Unit Cost**	**Quantity/Lot**	**PhP Amount**
123	ABX	S	Natural	50/box	450	2	900
124	TNR	L	White	100/box	900	1	900
125	GOI	S	Black	50/box	550	3	1650
126	LKY	S	Blue	50/box	400	2	800
127	EJT	L	Brown	100/box	875	2	1750
128	PLLJ	Reg.	Asstd.	10kl/bag	280	1	280
129	SBMT	Reg.	White	10kl/bag	300	2	600
130	GRUP	Family	Asstd.	30kl/bag	750	1	750
TOTAL	----------------------------End of List----------------------------					14	7630

For stock price monitoring purposes, the unit cost of goods for item code numbers 123 to 130 will be based on those stated in the inventory list, up to the quantity stated. Let us further presume that five (5) boxes of Item Code 124 were purchased to replenish the available stocks for 2016. However, the product was bought at a new purchase cost of PhP 950 per box of 100s.

The store merchandiser then requisitioned for two boxes of Item Code 124; hence, the stockroom clerk will record the released stock by recognizing two different unit costs, one (1) box priced at PhP 900 per unit and the other box priced at PhP 950 per unit. If the business entity uses a computerized system, the module for inventory costing will calculate the purchase costs of stock releases in the same manner.

Keep in mind however, that stock releases and inventory costing are recorded only in subsidiary ledgers; thus, there are no journal entries created to put into effect the flow of goods into and out of the stockroom.

The FIFO costing method works on the premise that the first stocks to be released are those carried over from the previous year, followed by the earliest succeeding purchases. Any stock inventory physically counted as being on hand will be based on the latest purchase price of a particular stock item. This is why the method is aptly called First-in First-out.

LIFO

In contrast to the FIFO, the LIFO is the "Last-in First-out" Method. We will discuss this method for purposes of information only, since it is not a supported method of inventory valuation. Ordinarily, the prices of goods are on an upward trend, which denotes that the last purchase price would be higher than the purchase costs of goods carried over from the previous year.

Since LIFO considers the prices of the latest purchase costs as the value of the stock sold, the inventory costs at the end of the year will be based on the lower-priced items. This approach therefore results in an overstatement of Cost of Goods Sold, which consequently results in an understatement of the net income on which the annual income tax will be based.

comprehension check

Name: ____________________

Section: ____________ Date: ____________

I. Discern if the method being used to record the transaction described is the Cash Basis Method or the Accrual Method. Indicate your answer by putting an x-mark under Cash Basis or Accrual.

	Cash Basis	Accrual
1. The business entity monitors all purchases on account in a Purchase Book. Said book provides information on the payment due date and the actual date of payment as the bases for determining if a purchase transaction will be recorded.		
2. Goods sold on credit are recorded as sales on the same day that the credit was extended.		
3. Monthly VAT taxes are recorded as expenses on the date of payment, usually on or before the 20th of the following month.		
4. The prepaid insurance for the month of September was recognized as expense.		
5. Raw materials amounting to PhP 12,500 remain unrecorded in the GL book, awaiting the actual payment of the sales invoice.		
6. The customer paid the monthly installment due on her Accounts Receivable balance.		
7. The building administration office recorded the one-year rental collected as Unearned Rental Income.		
8. Earned portion of insurance premiums collected in advance were recognized as income before the GL book was closed at year-end.		
9. The interest receivable due from pledge loans were recognized as income before the GL books were closed at year's end.		
10. The value of the actual goods on hand is more than the total cost of purchases for the year, because purchases are being recorded only if they are already paid for.		

II. Write the account titles to be debited and credited under the appropriate column. Base your answer on the transaction described.

Dr.	Cr.	
		1. Paid PhP 1,200 as advance subscription fees for a publication
		2. Collected PhP 2,000 advance subscriptions for cable connection
		3. Posted monthly depreciation of PhP 1,555 for Office Equipment
		4. Issued Check # 101 to procure the motorcycle requested by the A/R collector
		5. To recognize the earned portion of Unearned Interest discounted
		6. To take up rent due for the month but not yet paid
		7. To record issuance of check to pay for rent previously accrued
		8. Remitted tax withheld from salaries of employees
		9. Paid the website owner PhP 12,000 one-year advertising space
		10. Cost of labor & materials paid to professional electrician

III. Write the amount under the apprioriate column to indicate if the transaction recognizes an expense or capitalized cost.

Expense	Capitalized Cost	
Php55		Example: PhP 55: Cost of photocopied documents.
		1. PhP 4,800 = Cost of one unit desktop printer
		2 . PhP 500 = Five units trash cans for the office
		3. PhP 300 = Gasoline for the delivery van
		4. PhP 2,100 = Assorted office and computer supplies
		5. PhP 7,800 = One unit box-type aircon
		6. PhP 5,600 = One unit microwave oven for the office pantry
		7. PhP 6,500 = Executive Table for new office
		8. PhP 750 = One piece wall clock for the training room
		9. PhP 185 = Cleaning tools and implements
		10. PhP 1,240 = Ink for the dektop printer

Merchandise Inventory, End

This represents the total value of the actual goods physically counted as unsold and still on hand at the end of a given period. The value can be extracted from the Merchandise Inventory List.

Since the goods physically counted represent the stock inventory unsold, its value is deducted from the value of the total goods that were available for sale during the year. Review the COGS formula from this example previously presented in Chapter Four:

Cost of Goods Sold:				
Merchandise Inventory, Beg.			Php	5,480
Add: Purchases	Php	36,500		
Less: Purchase Returns and Discounts		265		36,235
Total Goods Available for Sale			**Php**	**41,715**
Less: Merchandise Inventory, End.				7,630
Cost of Goods Sold:			**Php**	**34,085**

To recap the significance of the Merchandise Inventory, End:

- The higher the value of the ending inventory, the lower the Cost of Goods Sold since a greater amount will be deducted from the latter. The lower the COGS, the higher the resulting gross profit. A reference to gross profit means the difference between the Sales Revenue and the COGS.
- The lower the value of the ending inventory, the higher the Cost of Goods Sold, since a lower amount will be deducted from the latter. It follows therefore that the resulting gross profit would be lower since the cost of goods sold is higher.

CHAPTER 08

Closing the Books

Year-End Objectives

After going through several chapters of learning how to identify, analyze, journalize and post business transactions in the general ledger as well as prove the debit and credit balances of all GL accounts, we will now learn about the adjusting and pre-closing procedures.

What are the objectives of these procedures?

Prior to the actual closing of the GL books at the end of every year, the accounting department prepares for the final phase of the accounting cycle—the preparation of the financial statements. However, most of the adjusting entries of the pre-closing stage are also being performed on a monthly basis, and are regarded as part of the regular journal entries.

The year-end goal is to make sure that all of the account balances which will be reported in the financial statement forms will reflect the most accurate information about the total resources of the company and the results of its operations. By and large, the year-end financial statements are the official reports which each organization will refer to for evaluation purposes. Hence, it is a must for an accounting department to perform the necessary tasks that will ensure accuracy of financial data to be used and presented.

Creating accurate financial statements is also quite important legally, since government regulatory bodies like the BIR and the SEC require the submission of financial statements as the basis for their compliance review and evaluation. Furthermore, depending on the industry in which the business is engaged, a company's financial reports may also be submitted to other regulatory government units annually.

Some organizations may also require these reports as a condition for contract and license renewals to ensure that the business entity they deal with is in good financial order, which means that the business entity being dealt with has enough resources to deliver and perform its contractual commitments.

Creditors like banking institutions or high-end suppliers are also interested in ascertaining the actual financial condition of a business entity to determine if it still has the repayment capabilities and the ability to meet its upcoming obligations through the use of its present resources.

The pre-closing and post-closing stages are thus considered extremely vital, because the accounting procedure at these stages provide the most accurate and realistic financial valuations possible. Such data provides the basis of making informed decisions for both internal and external purposes.

Closing the Book of Accounts

A cut-off date should be established when closing the book of accounts or the general ledger, to determine transactions which will be considered for inclusion. Entities that observe the calendar year use December 31 as cut-off date for the related transactions, while those that observe a fiscal year use the last day of their final month of operations. The initial phase comprises the pre-closing activities while the final phase includes the post-closing tasks. Both phases consider the cut-off date, in view of the "time period" and "consistency" principles.

The pre-closing tasks at hand include, but are not limited to:

1. Determining the results of operations by summarizing income, expenses and the cost of goods sold in the profit and loss summary account. This entails performing the co-related tasks of:
    - Recognizing the income and expenses that accrue to the period but which are yet to be received or paid after the cut-off date.
    - Allocating the income or expenses received or paid in advance according to the amounts that have been actually earned or incurred during the accounting period.
    - Recording of non-cash expenses like depreciation and amortization of fixed assets and other capitalized costs. The objective is to spread out their costs over their estimated useful lives, considering that they have been used as tools for profit generation.
    - Proving the accuracy of general ledger control accounts such as the cash on hand, cash in bank, merchandise inventory, office supplies on hand, accounts receivable, accounts payable, furniture and fixtures, loans, deposits, and the like. This task is performed by reconciling the GL balances of said accounts against the corresponding subsidiary ledgers that provide the breakdown of a control account's composition.
    - Conducting a physical inventory of all merchandise inventory items to determine the value of the goods that are still on hand.
2. Ascertaining the actual liabilities by reconciling the entity's GL loan and accounts payable balances with the records of the financial institution or creditors who extended the debt or liability account.
3. Determining the actual values of the receivable accounts by aging the receivable's individual account balances. This is to determine if allowances for bad debts should be set up or if there are outstanding balances considered as bad debts and no longer collectible. The task of confirming the account balances with the customer may be necessary before these are finally treated as bad debts.
4. Ascertaining that all fixed assets are still existing within the business premises and determining their actual conditions. A physical inventory of each item is likewise performed to determine if all those that are physically present belong to the business entity and were properly booked as business assets.
5. Conducting a physical inventory of office supplies on hand, particularly the accountable or pre-numbered forms like official receipts, sales invoices, unissued checkbooks, and purchase orders, just to name a few. There is also the need to make sure that accountable or pre-numbered forms are intact and complete before determining the value of the remaining inventory on hand.

Year-End Adjusting Entries Vs. Error-Correction Adjusting Entries

In all these pre-closing procedures, there are two types of adjusting entries that will be taken into account—the pre-closing adjusting entries and the error-correction adjusting entries.

The pre-closing adjusting entries are those performed as part of the closing procedures such as:

- The accrual of income and expense transactions.
- The recognition and allocation of prepaid income and expenses.

- The booking of valuation accounts like accumulated depreciation and allowances for bad debts.
- The reclassification of purchases and beginning merchandise inventory into cost of goods sold and determining if a net income or loss has been realized.

The error-correction adjusting entries, on the other hand, refer to those created to correct errors that were discovered during the reconciliation and confirmation processes. Accounting errors may still take place despite the use of the trial balance because the latter's main concern is only the equality of the debit and credit balances.

Some examples of common accounting errors arise as a result of:

Omissions – These errors can be traced through reconciliation processes and usually crop up if the GL account balances do not tally with the total of the subsidiary ledger balances. The recording of a particular transaction may have been omitted in the subsidiary ledger but the transaction was included in the GL control account, or vice versa.

Example: A customer made an installment payment of PhP 2,500 and was among those listed in the cash receipts book. Since the bookkeeper bases his journal entry on the totals of the cash receipts book, the PhP 2,500 was taken up in the Accounts Receivable GL page.

Upon reconciliation with the subsidiary ledgers of individual customers, the total of all outstanding customers' account based on subsidiary ledger balances was greater than the Accounts Receivable GL balance by PhP 2,500. In reviewing all transactions from last reconciliation date to the present, it was discovered that the Accounts Receivable bookkeeper failed to post the official receipt for PhP 2,500, installment payment in the customer's individual record.

Since the Accounts Receivable GL balance was confirmed as accurate as far as the transaction entry is concerned, error-correction entries will not be necessary. The omission error merely calls for the posting of the payment transaction in the subsidiary ledger, in order to generate the correct individual balance for billing purposes.

Misposting – This type of error, which could have been due to a transaction being posted in the wrong GL page account, or a posting made on the wrong debit or credit column, can also be detected during reconciliation procedures. Misposted transactions tend to have varying explanations and could occur in the books of another entity.

Example: A bank deposit for PhP 10,000 cropped up as the resulting difference between the Cash in Bank per book versus the cash balance per bank statement as of November 30, 2016. The GL cash in bank entries showed that a PhP 10,000 cash deposit was made on November 05. However, the bank statement for the month of November does not reflect any cash deposit for the said amount on the same date.

This was brought to the attention of the bank's accountant who conducted her own investigation pertaining to all bank deposit transactions on the said date. It turned out that the business entity's representative erroneously indicated the Savings Account deposit number of the proprietor's personal account, instead of using the entity's SA account number.

If the proprietor decides to keep the amount in his account, adjustments will be made in the entity's book via the following adjusting entries:

AJE 1

Dr. Capital Drawings	PhP 10,000	
Cr. Cash in Bank		PhP 10,000

Explanation: To adjust the balance of cash in bank deposit account; cash was erroneously deposited to the owner's personal deposit account.

Otherwise, the owner will have to withdraw the amount from his personal account and deposit the same amount to the appropriate business deposit account. Such actions will reconcile the cash in bank balance with the bank statement as of the said cut-off date.

Transposition – This refers to the inaccuracy of the amount posted by transposing or interchanging the place values of the digits, thus altering the value of the data. Ordinarily, this error can be detected in the trial balance. However, if both debit and credit values have been transposed in such a way that the debit and credit balances are still equal, the error can only be detected through reconciliation processes.

Example: The Check Disbursement Book reflected a total amount of PhP 115,457 as check disbursements on Nov. 15, 2016. However, the journal entries created had credited the cash in bank account for PhP 115,547, instead of PhP 115,457 and debited the Power, Light & Communication Expenses for PhP 3,547 instead of PhP 3,457.

Upon reconciliation of the entity's cash in bank account, a PhP 90 difference surfaced. The difference was pinpointed when the GL transaction postings were compared against the total of the Check Disbursement Book for Nov. 15, 2016. Since the transposition error was creating a reconciliation difference between cash in bank per books versus balance per bank statement, it was important to locate and adjust the accounts that were causing the discrepancy.

Although the net effect established was for PhP 90, error correction entries should not be based on the net amount of the discrepancy. The correct procedure is to reverse the original entry and then post the entries that should have been recorded. Assuming the original entries journalized and posted in Nov. 15, 2016 were as follows:

Dr. Power, Light & Communication Expenses	PhP 3,547	
Dr. Accounts Payable – Trade	12,000	
Dr. Loans Payable – West Bank	30,000	
Dr. Interest Expense – Loans	3,575	
Dr. Salaries & Wages	66,425	
Cr. Cash in Bank		PhP 115,547

The adjusted entries to correct the Nov. 15, 2016, transposition posting error are as follows:

AJE 2

Dr. Cash in Bank	PhP 115,547	
Cr. Power, Light & Communication Expenses		PhP 3,547
Cr. Accounts Payable – Trade		12,000
Cr. Loans Payable – West Bank		30,000
Cr. Interest Expense – Loans		3,575
Cr. Salaries & Wages		66,425

Explanation: To reverse erroneous journal entries for the Nov. 15, 2016 CDB transactions.

AJE 3

Dr. Power, Light & Communication Expenses	PhP 3,457	
Dr. Accounts Payable – Trade	12,000	
Dr. Loans Payable – West Bank	30,000	
Dr. Interest Expense – Loans	3,575	
Dr. Salaries & Wages	66,425	
Cr. Cash in Bank		PhP 115,457

Explanation: To take up the correct journal entries for the Nov. 15 CDB transactions.

In performing this error correction procedure, the audit trail for the transaction error and its adjusting entries are kept intact and traceable to withstand further scrutiny and examination. Taking up these adjusting entries will eliminate the PhP 90 discrepancy between the Cash in Bank balance per books and the cash balance reflected in the Nov. 30, 2016 bank statement.

Real and Nominal Accounts

Another important aspect of accounting in relation to the closing of books at year's end are the concepts of real and nominal accounts.

Real Accounts – These refer to the GL accounts used to summarize the business transactions affecting the asset, liability and capital accounts, since these are the three fundamental elements presented in the Balance Sheet. Their balances are carried forward into the next accounting period because they are continuously maintained to reflect the status of the business resources at any given date. Balances carried starts from day one of a business entity's existence as a going concern.

These accounts are real in the sense that their presentation in the Balance Sheet depicts the actual financial condition of the business as of the established cut-off date for any financial report.

Nominal Accounts – The term nominal connotes a concept that pertains to "title" or "name," which is the essence of a nominal account. Business transactions pertaining to income and expenses make use of these accounts because their purpose is temporary in nature.

Nominal accounts are maintained during an accounting period as a means to name and classify the transactions that will bring about an increase or decrease in the capital accounts. These are presented in the Income Statement, which may be for a monthly, quarterly, semi-annual, or annual period.

However, during year-end closing procedures, nominal accounts have to be zeroed out once these are transferred to the Profit and Loss Summary or Income Summary. As explained and illustrated in Chapter Six, the net effect between the income and expense accounts will be determined through the use of this summary account. This account is also nominal in nature, which means the use of the title Profit & Loss Summary or Income Summary is arbitrary and will depend on the business owner's preference or the company's policies.

Another account that is also temporary in nature and which is used for purposes of summarizing expense transactions is the Cost of Goods Sold. It is used for determining the cost of goods that were actually sold during the year, and its resulting balance will also be zeroed out once transferred to the Profit & Loss or Income Summary account.

Closing Entries and Profit & Loss or Income Summary Account

The post-closing entries are journalized after all the necessary pre-closing tasks have been performed and the necessary adjusting entries have been put into effect. After achieving the first objective of ascertaining the accuracy of all financial data to be used for the year-end reports, the next task is to determine the results of the business operations for the year.

To fully illustrate the use of closing entries and the Profit & Loss or Income Summary account, we will use financial data that includes the Purchases and the Merchandise Inventory account.

Merchandise Inventory, Beg.	PhP 4,580
Merchandise Inventory, End.	6,320
Purchases	64,975
Purchase Returns and Discounts	875
Sales	93,540
Salaries & Wages	10,031
EC-SSS/MC/PH/Pag-Ibig Contributions	1,503
Power, Water & Communication Expenses	3,540
Transportation Expenses	2,115
Taxes, Licenses and Registration Fees	5,135
Repairs & Maintenance	1,540
Miscellaneous Expenses	385
Depreciation Expenses	2,040

Determining the Cost of Goods Sold

JE 345

Dr. Cost of Goods Sold	PhP 4,580	
Cr. Merchandise Inventory, Beg.		PhP 4,580

Explanation: Closing of the beginning inventory balance to Cost of Goods Sold.

JE 346

Dr. Cost of Goods Sold	PhP 64,975	
Cr. Purchases		PhP 64,975

Explanation: Closing of the Purchases balance to Cost of Goods Sold.

JE 347

Dr. Purchase Returns & Discounts PhP 875
Cost of Goods Sold PhP 875

Explanation: Closing of the purchase returns and discount balance to Cost of Goods Sold.

JE 348

Dr. Merchandise Inventory, End. PhP 6,320
Cr. Cost of Goods Sold PhP 6,320

Explanation: To take up the ending merchandise inventory in the Cost of Goods Sold.

JE 349

Dr. P&L or Income Summary PhP 62,360
Cr. Cost of Goods Sold PhP 62,360

Explanation: To close COGS to P&L or Income Summary account.

Study the effect of the entries in this Cost of Goods Sold general ledger page. Take note that these entries will not zero out the Merchandise Inventory account because a co-related entry took up the new balance of the inventory account.

			COST OF GOODS SOLD			BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Dec.	31	Closing of the beginning inventory balance.	JE-345	4,580			4,580
		Closing of the Purchase balance.	JE-346	64,975			64,975
		Closing of the purchase returns & discount balance.	JE-347		875		68,680
		To take-up the merchandise inventory end.	JE-348		6,320		62.360
		To close COGS to P&L	JE-349		62,360		
							-
							vvvvv

			MERCHANDISE INVENTORY			BALANCE	
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Jan.	1	Beginning balance.					4,580
Dec.	31	Closing of the beginning inventory balance.	JE-345		4,580		-
		To take-up the merchandise inventory end.	JE-348	6,320			6,320

Determining the Results of Operations

All income and expense accounts will now be transferred to the P&L or Income Summary account, which will zero out the balances of the former.

JE-350

Dr. Sales PhP 93,540
Cr. Profit & Loss or Income Summary PhP 93,540

Explanation: To close the Sales income account.

JE-351

Dr. Profit & Loss or Income Summary PhP 62,360

Cr. Cost of Goods Sold PhP 62,360

Explanation: To close the COGS.

JE- 352

Dr. Profit & Loss or Income Summary	PhP 26,289	
Cr. Salaries & Wages		PhP 10,031
Cr. SSS/MC/PH/Pag-Ibig Contributions		1,503
Cr. Power, Water & Communication Expenses		3,540
Cr. Transportation Expenses		2,115
Cr. Taxes, Licenses and Registration Fees		5,135
Cr. Repairs & Maintenance		1,540
Cr. Miscellaneous Expenses		385
Cr. Depreciation Expenses		2,040

Explanation: To close the expense accounts.

After these journal entries have been posted, the Profit & Loss or Income Summary will reveal the results of the operations for the year.

			PROFIT & LOSS				
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Dec.	31	To close the Sales income account.	JE-350		93,540		93,540
		To close the COGS.	JE-351	62,360			31,180
		To close the expense accounts.	JE-352	26,289			4,891

The end result of the closing entries reveals a credit balance of PhP 4,891, which denotes that the business gained a net income of PhP 4,891 from its 2016 operations. Since the Profit & Loss or Income Summary account is also nominal by nature, the credit balance will be transferred to the Capital account by way of the following closing entries.

JE-353

Dr. Profit & Loss or Income Summary	PhP 4,891	
Cr. Owner's Capital		PhP 4,891

Explanation: To close the Profit & Loss or Income Summary (Net Income) to the Capital account.

			PROFIT & LOSS				
DATE		EXPLANATION	REF	DEBIT	CREDIT	DEBIT	CREDIT
Dec.	31	To close the Sales income account	JE-350		93,540		93,540
		To close the COGS	JE-351	62,360			31,180
		To close the expense accounts	JE-352	26,289			4,891
		To close the P & L balance to the Capital account	JE-353	4,891			-
							vvvvv

At this point, all income and expense accounts including the Cost of Goods Sold and the Profit & Loss or Income Summary accounts have been zeroed out.

It should be noted in all this that unadjusted trial balances were prepared to ensure that the entire GL debit and credit balances are equal before performing the closing-out procedures.

Unadjusted/Adjusted Year-End Worksheets

The earlier discussion merely presented how the closing out of balances are performed. In order to illustrate the entire pre-closing and post-closing procedures, another set of financial data will be used as an example.

We will start with the unadjusted trial balance, which presents the GL account balances before the adjusting and closing entries have been posted. Follow closely the development of this trial balance as the procedures are presented in a working paper format.

		D. Imba Gaming Enterprise		
		Year-End Working Papers for Pre-Closing & Post Closing		
		For the Year Ending December 31,2016		
			Unadjusted Trial Bal.	
Date		**Account Title**	**Debit**	**Credit**
Dec.	31	Cash on Hand	4,974	
		Cash in Bank	46,570	
		Petty Cash Fund	500	
		Accounts Receivable	3,250	
		Merchandise Inventory	4,580	
		Other Assets-Prepaid Expenses	8,200	
		Furniture, Fixtures and Office Equipment	56,200	
		Accumulated Depreciation		15,180
		Withholding Tax Payable		1,338
		VAT Payable		
		SSS/MC/PH/PI Contributions Payable		
		Power,Water&Commu. Expenses Payable		
		D. Imba, Capital		100,000
		D. Imba, Capital Drawings		
		Sales		96,540
		Purchases	64,975	
		Purchase Return & Discounts		
		Cost of Goods Sold		
		Salaries and Wages	9,438	
		SSS/MC/PH/PI Employer's Contributions	1,340	
		Power, Water & Communication Expenses	3,104	
		Transportation Expenses	2,115	
		Taxes, Licenses and Registration Fees	5,477	
		Office Supplies Expense	410	
		Repairs & Maintenance	1,540	
		Insurance Expense		
		Miscellaneous Expense	385	
		Depreciation Expense		
		Profit and Loss		
		Totals	213,058	213,058

Journalize and Post the Adjusting Entries

AJE-1

Dr. SSS/MC/PH/PI Employer's Contributions –December 2016	PhP 165	
Dr. Taxes, Licenses and Registration Fees – Dec. 2016	PhP 547	
Cr. SSS/MC/PH/PI Contributions Payable		165
Cr. VAT Taxes Payable		547

Explanation: To take up SSS/MC/PH/ P-I contributions and VAT taxes for December, 2016 but due for payment on January 2017.

AJE-2

Dr. Insurance Expense	PhP 2,050	
Cr. Prepaid Insurance		PhP 2,050

Explanation: To record the insurance expense incurred for the quarter, which was not recognized as expense since its renewal in Aug. 31, 2016.

AJE-3

Dr. Depreciation Expense – FFE	PhP 1,680	
Cr. Accumulated Depreciation – FFE		PhP 1,680

Explanation: To take up depreciation expense for the month of December, 2016.

AJE-4

Dr. Purchases	PhP 875	
Cr. Purchase Returns & Discounts		PhP 875

Explanation: To reclassify purchase returns, erroneously deducted from the Purchases account.

AJE-5

Dr. D. Imba, Capital Drawing	PhP 10,000	
Cr. Cash in Bank		PhP 10,000

Explanation: To record fund transferred by owner to his personal savings account.

AJE-6

Dr. Miscellaneous Expenses	PhP 48	
Dr. Office Supplies	112	
Dr. Transportation Expenses	24	
Cash on Hand		PhP 184

Explanation: Replenished the petty cash fund in order to take up remaining December expenses disbursed via said fund.

AJE 7

Dr. Power, Water & Communications Expenses	PhP 682	
Cr. Power, Water & Communications Expenses Payable		PhP 682

Explanation: To take up December utility expenses to be paid on January, 2017.

The Post Adjusted Trial Balance

Use the same trial balance to prove the equality of the debit and credit entries and that of resulting debit and credit of the adjusted GL balance. Determine the net effect of each adjusting entry and then present the adjusted trial balance in the same worksheet.

D. Imba Gaming Enterprise							
Year-End Working Papers for Pre-Closing & Post Closing							
For the Year Ending December 31, 2016							
	Unadjusted Trial Bal.		**Adjusting Entries**			**Adjusted Trial Bal.**	
Account Title	**Debit**	**Credit**	**Debit**	**Credit**	**Ref**	**Debit**	**Credit**
Cash on Hand	4,974			184	AJE-6	4,790	
Cash in Bank	46,570			10,000	AJE-5	36,570	
Petty Cash Fund	500					500	
Accounts Receivable	3,250					3,250	
Merchandise Inventory	4,580					4,580	
Other Assets-Prepaid Expenses	8,200			2,050	AJE-2	6,150	
Furniture, Fixtures and Office Equipment	56,200					56,200	
Accumulated Depreciation		15,180		1,680	AJE-3		16,860
Withholding Tax Payable		1,338					1,338
VAT Payable				547	AJE-1		547
SSS/MC/PH/PI Contributions Payable				165	AJE-1		165
Power, Water&Commu. Expenses Payable				682	AJE-7		682
D. Imba, Capital		100,000					100,000
D. Imba, Capital Drawings			10,000		AJE-5	10,000	
Sales		96,540					96,540
Purchases	64,975		875		AJE-4	65,850	
Purchase Return & Discounts				875	AJE-4		875
Cost of Goods Sold							
Salaries and Wages	9,438					9,438	
SSS/MC/PH/PI Employer's Contributions	1,340		165		AJE-1	1,505	
Power, Water & Communication Expenses	3,104		682		AJE-7	3,788	
Transportation Expenses	2,115		24		AJE-6	2,139	
Taxes, Licenses and Registration Fees	5,477		547			6,024	
Office Supplies Expense	410		112		AJE-6	522	
Repairs & Maintenance	1,540					1,540	
Insurance Expense			2050		AJE-2	2,050	
Miscellaneous Expense	385		48		AJE-6	433	
Depreciation Expense			1,680		AJE-3	1,680	
Profit and Loss							
Totals	213,058	213,058	16,183	16,183		217,007	217,007

Journalize and Post Pre-Closing Entries – Cost of Goods Sold

JE-545

Dr. Cost of Goods Sold	PhP 4,580	
Cr. Merchandise Inventory, Beg.		PhP 4,580

Explanation: To close the beginning inventory to COGS.

JE-546

Dr. Cost of Goods Sold	PhP 65,850	
Cr. Purchases		PhP 65,850

Explanation: To close the Purchases account to COGS.

JE-547

Dr. Purchase Returns & Discount	PhP 875	
Cr. Cost of Goods		PhP 875

Explanation: To close the balance to COGS.

JE- 548

Dr. Merchandise Inventory, End.	PhP 6,854	
Cr. Cost of Goods Sold		PhP 6,854

Explanation: To take up merchandise still on hand and unsold.

Note: Inasmuch as multiple entries affect the Cost of Goods Sold, the working paper entries for the COGS account were summarized by using a T-account.

The total debit of PhP 70,430 and the total credit of PhP 7,729 were the amounts posted in the COGS for the pre-closing working papers.

	Cost of Goods Sold	
JE -545	4,580	
JE -546	65,850	
JE -547		875
JE -548		6,854
	70,430	7,729
Balance	62,701	

D. Imba Gaming Enterprise
Year-End Working Papers for Pre-Closing
For the Year Ending December 31, 2016

	Adjusted Trial Bal.		Pre-Closing Entries			Adjusted Trial Balance	
Account Title	**Debit**	**Credit**	**Debit**	**Credit**		**Debit**	**Credit**
Cash on Hand	4,790					4,790	
Cash in Bank	36,570					36,570	
Petty Cash Fund	500					500	
Accounts Receivable	3,250					3,250	
Merchandise Inventory	4,580		6,854	4,580	JE-545	6,854	
Other Assets-Prepaid Expenses	6,150					6,150	
Furniture, Fixtures and Office Equipment	56,200					56,200	
Accumulated Depreciation		16,860					16,860
Withholding Tax Payable		1,338					1,338
VAT Payable		547					547
SSS/MC/PH/PI Contributions Payable		165					165
Power, Water&Commu. Expenses Payable		682					682
D. Imba, Capital		100,000					100,000
D. Imba, Capital Drawings	10,000					10,000	
Sales		96,540					96,540
Purchases	65,850			65,850	JE-546		-
Purchase Return & Discounts		875	875		JE-547		-
Cost of Goods Sold			70,430	7,729	JE-545	62,701	
Salaries and Wages	9,438				-548	9,438	
SSS/MC/PH/PI Employer's Contributions	1,340					1,505	
Power, Water & Communication Expenses	3,104					3,786	
Transportation Expenses	2,115					2,139	
Taxes, Licenses and Registration Fees	5,477					6,024	
Office Supplies Expense	410					522	
Repairs & Maintenance	1,540					1,540	
Insurance Expense						2,050	
Miscellaneous Expense	385					433	
Depreciation Expense						1,680	
Profit and Loss							
Totals	217,007	217,007	78,159	78,159		216,132	216,132

Journalize and Post the Closing Entries – Income and Expenses

This stage of the closing procedures will determine the net income or net loss, by closing out the income and expenses account, including the Cost of Goods Sold, via the following closing entries:

JE-549

Dr. Sales	PhP 96,540	
Cr. Profit & Loss		PhP 96,540

Explanation: To close the Sales account to Profit & Loss or Income Summary.

JE-550

Dr. Profit & Loss or Income Summary	PhP 91,818	
Cr. Cost of Goods Sold		PhP 62,701
Cr. Salaries & Wages		9,438
Cr. SSS/MC/PH/PI – Employer's Contributions		1,505
Cr. Power, Water, Communications Expenses		3,786
Cr. Transportation Expenses		2,139
Cr. Taxes, Licenses & registration Fees		6,024
Cr. Office Supplies Expense		522
Cr. Repairs & Maintenance		1,540
Cr. Insurance Expense		2,050
Cr. Miscellaneous Expense		433
Cr. Depreciation Expense		1,680

Explanation: To close Cost of Goods Sold and other expenses to P&L or Income Summary.

The P&L or Income Summary shows a credit balance or net income of PhP 4,722. At this point, the figures presented in the post adjusted trial balance are now ready for the post-closing entries (which will be discussed in Chapter Nine) as a prelude to the financial statements preparation stage.

D. Imba Gaming Enterprise
Year-End Working Papers for Pre-Closing
For the Year Ending December 31, 2016

	Adjusted Trial Balance		Closing Entries			Post-Adjusted Trial Balance	
Account Title	**Debit**	**Credit**	**Debit**	**Credit**		**Debit**	**Credit**
Cash on Hand	4,790					4,790	
Cash in Bank	36,570					36,570	
Petty Cash Fund	500					500	
Accounts Receivable	3,250					3,250	
Merchandise Inventory	6,854					6,854	
Other Assets-Prepaid Expenses	6,150					6,150	
Furniture, Fixtures and Office Equipment	56,200					56,200	
Accumulated Depreciation		16,860					16,860
Withholding Tax Payable		1,338					1,338
VAT Payable		547					547
SSS/MC/PH/PI Contributions Payable		165					165
Power, Water&Commu. Expenses Payable		682					682
D. Imba, Capital		100,000					100,000
D. Imba, Capital Drawings	10,000					10,000	
Sales		96,540	96,540		JE-549		
Purchases		-					
Purchase Return & Discounts		-					
Cost of Goods Sold	62,701			62,701	JE-550		
Salaries and Wages	9,438			9,438	JE-550		
SSS/MC/PH/PI Employer's Contributions	1,505			1,505	JE-550		
Power, Water & Communication Expenses	3,788			3,788	JE-550		
Transportation Expenses	2,139			2,139	JE-550		
Taxes, Licenses and Registration Fees	6,024			6,024	JE-550		
Office Supplies Expense	522			522	JE-550		
Repairs & Maintenance	1,540			1,540	JE-550		
Insurance Expense	2,050			2,050	JE-550		
Miscellaneous Expense	433			433	JE-550		
Depreciation Expense	1,680			1,680	JE-550		
Profit and Loss			91,818	96,540			4,722
Totals	216,132	216,132	188,358	188,358		124,314	124,314

This is how the entire worksheet was used as working papers for the adjusting and pre-closing entries.

comprehension check

Closing the Books

Accounting for Basic Bookkeeping

8

Name: ____________________

Section: ____________ Date: ____________

I. Multiple choice: Choose the answer that completes the statement by writing the letter of your choice.

1. The pre-adjusting and closing procedures require the establishment of a ____________ to determine which transactions shall be included.
   a. journal date b. cut-off date c. closing date

2. The three elements of accounting are summarized and presented in the _________.
   a. Income Statement b. Cashflow Statement c. Balance Sheet

3. The ____________ are accounting entries made to bring the GL balances to the most realistic values of an entity's true financial condition.
   a. post-closing entries b. adjusting entries c. error-correction entries

4. Most accounting errors are detected through the process of ______________.
   a. evaluation b. error-correction c. reconciliation

5. A _________________ is being conducted at year end to account for all fixed assets, accountable forms and stock inventory.
   a. physical inventory b. reconciliation of accounts c. confirmation

6. A/An_______ is a type of error in which the place values of the digits are interchanged, thus altering the value of the data.
   a. omission b. transposition c. misposting

7. __________ are temporary accounts being used to classify the income and expense transactions.
   a. Profit & Loss Summary b. Real Accounts c. Nominal Accounts

8. The _________ is a temporary account used to determine the results of the business operations during the year.
   a. Profit & Loss or Income Summary b. Real Accounts c. Cost of Goods Sold

9. The Purchases account and the related Purchase Returns, as well as the Merchandise Inventory balances, are summarized in the ____ account.
   a. P&L b. COGS c. GL

10. The _____ of a fixed asset can be determined by deducting its accumulated depreciation from its acquisition cost.
    a. COGS b. P&L c. NBV

II. Write an "x" mark under the debit or credit column to indicate the kind of entry that will zero out the GL balance being described in each statement.

Debit	Credit	
		1. Purchase Returns & Discounts
		2. Sales
		3. Withholding Tax Payable
		4. Taxes, Licenses & Registration Fees
		5. Repairs & Maintenance
		6. Merchandise inventory
		7. Unearned Income
		8. Accrued Interest Receivable
		9. Accrued Interest Payable
		10. Prepaid Rent

III. Write the account title under the appropriate column for the following pre-closing and post-closing procedures

Debit	Credit	
		1. To recognize the earned portion of Unearned Rent
		2. To accrue interest expense for the month
		3. To close the Purchases account
		4. To record the merchandise inventory on hand
		5. To take up the depreciation expense for the month
		6. To take up percentage tax for the month but due and payable on the first week of the following month
		7. To close the Sales account
		8. To close the debit balance of the Income Summary
		9. To reclassify the purchase return transaction erroneously credited to the Purchases account
		10. To take up the interest earned on savings account as per bank statement

D. Imba Gaming Enterprise

Year-End Working Papers for Pre-Closing & Post Closing

For the Year Ending December 31,2016

	Unadjusted Trial Bal.		Adjusting Entries			Adjusted Trial Bal.		Pre-Closing Entries			Adjusted Trial Balance		Closing Entries			Post-Adjusted Trial Balance	
Account Title	**Debit**	**Credit**	**Debit**	**Credit**	**Ref**	**Debit**	**Credit**	**Debit**	**Credit**		**Debit**	**Credit**	**Debit**	**Credit**		**Debit**	**Credit**
Cash on Hand	4,974			184	AJE-6	4,790					4,790					4,790	
Cash in Bank	46,570			10,000	AJE-5	36,570					36,570					36,570	
Petty Cash Fund	500					500					500					500	
Accounts Receivable	3,250					3,250					3,250					3,250	
Merchandise Inventory	4,580					4,580		6,854	4,580	JE-545	6,854					6,854	
Other Assets-Prepaid Expenses	8,200			2,050	AJE-2	6,150					6,150					6,150	
Furniture, Fixtures and Office Equipment	56,200					56,200					56,200					56,200	
Accumulated Depreciation		15,180		1,680	AJE-3		16,860					16,860					16,860
Withholding Tax Payable		1,338					1,338					1,338					1,338
VAT Payable				547	AJE-1		547					547					547
SSS/MC/PH/PI Contributions Payable				165	AJE-1		165					165					165
Power,Water&Commu. Expenses Payable				682	AJE-7		682					682					682
D. Imba, Capital		100,000					100,000					100,000					100,000
D. Imba, Capital Drawings			10,000		AJE-5	10,000					10,000					10,000	
Sales		96,540					96,540					96,540	96,540		JE-549		
Purchases	64,975		875		AJE-4	65,850			65,850	JE-546		-					
Purchase Return & Discounts				875	AJE-4		875	875		JE-547		-					
Cost of Goods Sold								70,430	7,729	JE-545	62,701			62,701	JE-550		
Salaries and Wages	9,438					9,438				-548	9,438			9,438	JE-550		
SSS/MC/PH/PI Employer's Contributions	1,340		165		AJE-1	1,505					1,505			1,505	JE-550		
Power, Water & Communication Expenses	3,104		682		AJE-7	3,788					3,786			3,788	JE-550		
Transportation Expenses	2,115		24		AJE-6	2,139					2,139			2,139	JE-550		
Taxes, Licenses and Registration Fees	5,477		547			6,024					6,024			6,024	JE-550		
Office Supplies Expense	410		112		AJE-6	522					522			522	JE-550		
Repairs & Maintenance	1,540					1,540					1,540			1,540	JE-550		
Insurance Expense			2050		AJE-2	2,050					2,050			2,050	JE-550		
Miscellaneous Expense	385		48		AJE-6	433					433			433	JE-550		
Depreciation Expense			1,680		AJE-3	1,680					1,680			1,680	JE-550		
Profit and Loss													91,818	96,540			4,722
Totals	213,058	213,058	16,183	16,183		217,007	217,007	78,159	78,159		216,132	216,132	188,358	188,358		124,314	124,314

CHAPTER 09

Summarizing the Results of Business Operations

Types of Financial Statements

We have reached the final stage of the accounting cycle in which all the data identified, analyzed, journalized and posted in the general ledger will be presented in financial statement forms. Although these statements may be prepared in monthly, quarterly or semi-annual periods, the statements for the entire accounting period serve as the official representation of a business entity.

During the preparation stage, a thorough review of the GL account balances was performed to make sure that the financial position and the results of operations will be presented in the most objective manner. Business owners, incorporators, stockholders, government regulatory bodies, suppliers, creditors, and even employees (all of whom are also known in the business world as "stakeholders") make use of annual financial statements as bases for evaluating a company's net worth and profit-generating abilities.

There are four basic types of financial statements, namely:

- The Balance Sheet;
- The Income Statement;
- The Statement of Owner's Equity (single proprietorship) or the Statement of Stockholders' Equity (corporations); and
- The Cash Flow Statement or the Statement of Changes in Financial Position.

Each statement has a story to tell about a business entity. Thus, it is a must that the financial data contained in these statements are reliable, relevant, verifiable, comparable, and most of all comprehensible. The statements should exhibit financial information about:

- The entity's total resources;
- The amount of capital funds invested by the owners and co-owners to establish and sustain their business operations;
- The results of such operations; and
- The change brought about by the said results in the entity's cash resources and the business owner's capital investment.

All these important aspects should be conveyed when preparing financial statements. These should be presented in a way that can withstand the scrutiny and evaluation of the different stakeholders who rely on these statements to make informed decisions.

To show how this financial report is prepared, we will make use of the adjusted trial that was utilized in the preceding chapter.

Account Title	Adjusted Trial Balance Debit	Adjusted Trial Balance Credit	Closing Entries Debit	Closing Entries Credit		Post-Adjusted Trial Balance Debit	Post-Adjusted Trial Balance Credit
Cash on Hand	4,790					4,790	
Cash in Bank	36,570					36,570	
Petty Cash Fund	500					500	
Accounts Receivable	3,250					3,250	
Merchandise Inventory	6,854					6,854	
Other Assets-Prepaid Expenses	6,150					6,150	
Furniture, Fixtures and Office Equipment	56,200					56,200	
Accumulated Depreciation		16,860					16,860
Withholding Tax Payable		1,338					1,338
VAT Payable		547					547
SSS/MC/PH/PI Contributions Payable		165					165
Power,Water&Commu. Expenses Payable		682					682
D. Imba, Capital		100,000					100,000
D. Imba, Capital Drawings	10,000					10,000	
Sales		96,540	96,540		JE-549		
Purchases		-					
Purchase Return & Discounts		-					
Cost of Goods Sold	62,701			62,701	JE-550		
Salaries and Wages	9,438			9,438	JE-550		
SSS/MC/PH/PI Employer's Contributions	1,505			1,505	JE-550		
Power, Water & Communication Expenses	3,786			3,788	JE-550		
Transportation Expenses	2,139			2,139	JE-550		
Taxes, Licenses and Registration Fees	6,024			6,024	JE-550		
Office Supplies Expense	522			522	JE-550		
Repairs & Maintenance	1,540			1,540	JE-550		
Insurance Expense	2,050			2,050	JE-550		
Miscellaneous Expense	433			433	JE-550		
Depreciation Expense	1,680			1,680	JE-550		
Profit and Loss			91,818	96,540			4,722
Totals	216,132	216,132	188,358	188,358		124,314	124,314

Completing the Post-Closing Procedures

Study the remaining accounts presented in the post-adjusted trial balance after the income and expense accounts were summarized in the Profit & Loss or Income Summary account. However, bear in mind that the Profit & Loss is a nominal account and should therefore be zeroed out as part of the post-closing procedure, by way of the following entries:

JE- 551

Dr. Profit & Loss	PhP 4,722	
Cr. D. Imba, Capital		PhP 4,722

Explanation: To close the P&L credit balance representing net income for the year, to the capital account.

The Capital Drawing account balance should likewise be zeroed out and debited against the capital to bring the latter account to its present balance, by using these entries:

JE – 552

Dr. D. Imba, Capital	PhP 10,000	
Cr. D. Imba, Capital Drawings		PhP 10,000

Explanation: To close the capital drawings to the capital account.

These post-closing entries represent the post-closing procedures to arrive at the final post-adjusted trial balance. The remaining balances are considered as final for financial statements presentation and may be forwarded as beginning balances of the new book of accounts for the incoming year.

DATE		ACCOUNT TITLE	POST-ADJUSTED TRIAL BALANCE DEBIT	POST-ADJUSTED TRIAL BALANCE CREDIT	POST-CLOSING ENTRIES DEBIT	POST-CLOSING ENTRIES CREDIT		ADJUSTED TRIAL BALANCE DEBIT	ADJUSTED TRIAL BALANCE CREDIT
		D. Imba Gaming Enterprise							
		Year-End Working Papers for Pre-Closing							
		For the Year Ending December 31, 2016							
Dec.	31	Cash on Hand	4,790					4,790	
		Cash in Bank	36,570					36,570	
		Petty Cash Fund	500					500	
		Accounts Receivable	3,250					3,250	
		Merchandise Inventory	6,854					6,854	
		Other Assets-Prepaid Expenses	6,150					6,150	
		Furniture, Fixtures and Office Equipment	56,200					56,200	
		Accumulated Depreciation		16,860					16,860
		Withholding Tax Payable		1,338					1,338
		VAT Payable		547					547
		SSS/MC/PH/PI Contributions Payable		165					165
		Power,Water&Commu. Expenses Payable		682					682
		D. Imba, Capital		100,000	10,000	4,722	JE 551-552		94,722
		D. Imba, Capital Drawings	10,000						
		Sales				10,000			-
		Purchases							
		Purchase Return & Discounts							
		Cost of Goods Sold							
		Salaries and Wages							
		SSS/MC/PH/PI Employer's Contributions							
		Power, Water & Communication Expenses							
		Transportation Expenses							
		Taxes, Licenses and Registration Fees							
		Office Supplies Expense							
		Repairs & Maintenance							
		Insurance Expense							
		Miscellaneous Expense							
		Depreciation Expense							
		Profit and Loss		4,722	4,722				
		TOTALS	124,314	123,314	14,722	14,722		114,314	114,314

Income Statement

The Income Statement basically furnishes information on how much the business owner gained from his business operations during a particular period, which in this case, is for the year 2016. Using financial data and account titles, the statement communicates how income was generated, the cost needed to generate said income and how much was realized as return from investing in the business venture.

There are two ways by which Income Statements are presented—the Single Step Method and the Multiple Step Method.

The Single Step Method simply shows a formal presentation of the Profit & Loss Summary, without going into further details about the components comprising the income and the calculation of the Cost of Goods Sold. This step is suitable for small-scale businesses that employ the cash basis accounting since they do not maintain an inventory account. In addition, revenue from sales is presented by its net amount in case there were sales returns or discounts accommodated.

The Multiple Step Method is the exact opposite, as it provides details on how the cost of goods sold or manufactured was calculated. It presents relevant data on sales such as sales returns and discounts granted plus any other sources of income aside from its main income-earning activity.

By and large, the multiple step method is the most widely used because it furnishes the financial statement's readers with comprehensive overviews of how the business conducts its operations, and how inventory levels and purchasing activities are managed and maintained. Information regarding Sales Returns and Discounts is indicative of a business entity's merchandising abilities.

In line with this, we will now focus on income statement preparation using the multiple-step method. The discussion continues by using the same working papers for the post-closing procedures, in which the income and expenses were summarized in the Profit and Loss Summary.

Preparing the Income Statement

1. The Income Statement should be properly labeled with the name of the business from which the net income or net loss was derived or incurred. The heading should make it clear to the reader that the information being provided is only for a particular period.

2. Begin by presenting income at its gross amount, which means there are no valuation reductions made against the reported income. Any reductions should be presented separately before deducting the cost of goods sold.

D. Imba Gaming Enterprise
Income Statement
For the Year ended December 31, 2016

Gross Revenue from Sales		PhP 96,540
Less: Sales Returns and Discounts		- 0 -
Add: Income from Other Sources		- 0 -
Total Revenue from Sales		**PhP 96,540**
Cost of Goods Sold:		
Add: Merchandise Inventory, Beg.	PhP 4,580	
Add: Purchases	65,850	
Less: Purchase Returns & Discounts	875	
Total Goods Available for Sale	PhP 69,555	
Less: Merchandise Inventory, End.	6,854	
Cost of Goods Sold	**PhP 62,701**	**PhP 62,701**
Gross Profit from Sales		**PhP 33,839**
Operating Expenses		
Salaries & Wages		PhP 9,438
SSS/MC/Ph/P-I Employer's Contributions		1,505
Power, Water & Communication Expenses		3,786
Transportation Expenses		2,139
Taxes, Licenses & Registration Fees		6,024
Office Supplies Expenses		522
Repairs & Maintenance		1,540
Insurance Expense		2,050
Miscellaneous Expenses		433
Depreciation Expenses		1,680
Total Operating Expenses		**PhP 29,117**
Net Income		**PhP 4,722**

Balance Sheet

The Balance Sheet contains information about the three basic elements of the business: the assets, or what the business owns; the liabilities, or how much the business owes; and the capital, or how much has been invested by the business owner.

These components are presented in accordance with the basic accounting equation:

Assets = Liabilities + Capital, which is the same format observed in presenting financial data in a Balance Sheet form.

Preparing the Balance Sheet

1. Write the heading, which should be labeled with the name of the business, the type of financial statement being presented and the cut-off date, which should be stated as: "as of December 31, 20___" or the applicable fiscal year-end date of the entity's accounting period.

2. Indicate the Balance Sheet component being presented in each section, and in the same order as the fundamental accounting equation. This denotes that the presentation starts with the assets. It is also important to categorize each component according to its most liquid condition. The term "liquid" means those assets that are in the form of cash or can be readily convertible into cash. Categorize and label the assets, either as current or fixed.

   In addition, make it a point to show the acquisition value of the fixed assets but deduct the accumulated depreciation. This is done to indicate the present net book value before extending the latter to its proper column.

3. We now have a presentation of the total resources owned by the single proprietorship, and from the information provided, it is evident that a large part of the assets owned by the business is liquid. The liabilities and capital components will be presented in the second half of the Balance Sheet, based on the fundamental accounting equation.

D. Imba Gaming Enterprise
Balance Sheet
As of December 31, 2016

ASSETS

Current Assets:		
Cash on Hand		PhP 4,790
Cash in Bank		36,570
Petty Cash Fund		500
Accounts Receivable		3,250
Merchandise Inventory		6,854
Other Assets: Prepaid Expenses		6,150
Total Current Assets		**PhP 58,114**
Fixed Assets:		
Furniture, Fixtures & Equipment	PhP 56,200	
Less: Accumulated Depreciation	16,860	
Net Book Value	PhP 39,340	PhP 39,340
Total Fixed Assets		**PhP 39,340**
TOTAL ASSETS		**PhP 97,454**
		vvvvvvvvvvv

LIABILITIES & CAPITAL

Current Liabilities:	
Withholding Tax Payable	PhP 1,338
VAT Payable	547
SSS/MC/PH/P-I Employer's Contributions Payable	165
Power, Water & Communications Expenses Payable	682
Total Current Liabilities	**PhP 2,732**
Long-Term Liabilities	**PhP -0-**
Total Liabilities	**PhP 2,732**
Statement of Owner's Capital:	
D. Imba, Capital, Beg.	PhP 100,000
Less: D. Imba, Capital Drawings	10,000
D. Imba, Capital, Net of Drawings	PhP 90,000
Add: Net Income for 2016	**4,722**
D. Imba, Capital, End.	PhP 94,722
TOTAL LIABILITIES & CAPITAL	**PhP 97,454**

In the same manner in which the assets were presented, the business entity's liabilities will be categorized, either as current or long term. The capital account will serve as the statement of the owner's capital, by presenting the beginning balance and the factors that brought about any changes to the capital account as of statement date.

4. It can be surmised from the Balance Sheet presented above that the entire resources of the business are wholly owned by the entity, except for a minimal amount of PhP 2,732, which represents ordinary expenses that are due for payment after the cut-off date. Considering the amount of cash available, the entity is shown to have enough resources to pay for its immediate obligations.

Statement of Changes in Financial Position (Cash Flow Statement)

The Statement of Changes in Financial Position (SCFP) is commonly known as the Cash Flow Statement, since it provides information about the cash position and the effects of the transactions that transpired during a specific period. The resulting net cash flow is not the same as the net income reflected by the Income Statement, since the SCFP deals mainly with the cash that came in and went out. The aim of the SCFP is to determine how much of the cash generated by business operations actually resulted in a cash increase or decrease.

Ideally, a business venture is profitable if it has the capability to generate the funds that can sustain the business operations. Although working capital is available to initially defray all costs, it is expected that in every undertaking, the operational activities will bring in funds to replenish the capital fund that was used. Otherwise, the business is not deemed profitable if available cash resources take the downward trend.

Preparing the Statement of Changes in Financial Position

In preparing a Statement of Changes in Financial Position, the initial objective is to determine the sources of cash and how much was added to the beginning cash balance. This means that we need to get additional information by referring to beginning balances of the cash and the receivable accounts.

Remember that this statement takes into account only the cash transactions for the year; hence, accounts receivables are deducted from the income derived from sales. In the same way, purchases on account as well as purchase returns are also deducted from the cost of purchases. Prepayments paid in cash will be included, while accrued expenses will also be eliminated as part of the expenses since cash outlays are yet to be incurred.

Using the Balance Sheet prepared in the previous cycle and the following additional data, we will prepare the SCFP to show if the business actually resulted to a net cash increment or denouement.

After taking away the receivables from the actual cash collections and considering only the cash expenses, it can be shown that the net amount of PhP 93,290 that flowed in was derived from cash sales.

The actual cash used that flowed out to sustain the business operations amounted to PhP 97,168, while PhP 10,000 was withdrawn by the business owner. Overall total cash outlay amounted to PhP 107,168.

Based on the Statement of Changes in Financial Position, the entity's beginning cash balance decreased by PhP 13,878, since total cash outflows exceeded the total cash inflows by the same amount. However, it can be shown that, from the total decrease of PhP 13,878, PhP 10,000 went to the owner and only PhP 3,878 exceeded the actual funds derived from operations.

D. Imba Gaming Enterprise
Statement of Changes in Financial Position
For the Year Ended December 31, 2016

Cash In-Flow from Operations:			
Sales	PhP	96,540	
Less Accounts Receivable	PhP	(3,250)	
Total Cash InFlow from Sales Operations	PhP	**93,290**	**93,290**
Cash-OutFlow from Operations:			
Purchases (net of Purchase Returns)	PhP	64,975	
Operating Expenses	PhP	23,993	
Prepaid Insurance	PhP	8,200	
Total Cash Used for Operations	PhP	**97,168**	
Cash-OutFlow Withdrawn by Owner	PhP	10,000	
Total Cash Out-Flow	PhP	**107,168**	**107,168**
Cash Increase / (Decrease)	PhP		**(13,878)**
Cash on Hand & In Banks, Beg.	PhP	55,508	
Add: Increase (Decrease)	PhP	13,878	
Cash on Hand & In Banks	PhP	41,630	
Cash on Hand, End	PhP	4,790	
Cash in Bank, End.	PhP	36,570	
Total Cash on Hand & Banks	PhP	**41,360**	

Financial Statement Certification

Financial statements accompanied by certification signify that the business entity's financial reports were audited by a Certified Public Accountant (CPA) who is not in any way connected to the reporting entity. The audit entails verifying all the financial data presented in the Balance Sheet, Income Statement, Statement of Owner's Capital/Statement of Stockholders' Equity and the Statement of Changes in Financial Position.

In the event that the independent CPA finds exceptions pertaining to non-compliance with generally accepted accounting principles, or if there are material discrepancies between the data reported per statement against the data in the entity's books, the auditor will include a qualifying opinion in his or her audit certification. This is done to inform and forewarn the financial statement users about the reliability of the financial reports when using these in their decision-making processes.

Different countries have varying rules in requiring financial statement certification. However, the purpose of the rules is basically the same—that is, to ensure that the financial statements submitted were thoroughly examined to ascertain that the information provided are fair presentations of the business and of the results of its operations.

The BIR requires the submission of certified financial statements and the Account Information Form from taxpayers whose gross sales or receipts exceed PhP 150,000 for the quarter, or PhP 600,000 annually. However, the certification issued is only for the annual financial statements and is submitted to the BIR upon filing of the annual income tax return. As mentioned earlier, different regulatory units like the SEC require the submission of audited financial statements and other reportorial requisites from corporate organizations.

Filing of Income Tax Return – Single Proprietorship

Individuals deriving income from compensation or any form of trade or business or engaged in the practice of one's profession, e.g., doctors, lawyers, accountants, engineers, etc. are required to file BIR Form 1701 or Annual Income Tax Return, regardless of the amount of gross income earned. The deadline for filing and payment of taxes is on or before April 15 of the year following the taxable year.

Married individuals file their income taxes jointly with their spouses, although there are certain instances in which the filing of separate tax returns may be allowed. Each individual is entitled to claim a personal deduction of PhP 50,000 from their taxable income regardless if the taxpayer is single or married. However, claims for additional personal exemption for every dependent child shall be claimed by the husband, unless the latter waives his right in favor of his wife.

The amount of additional exemption for each dependent child is PhP 25,000 and may include those considered as illegitimate or legally adopted. However, claims for additional exemptions are limited up to four dependent children living with the taxpayer and that the dependent child is not more than 21 years of age.

Individuals deriving gross receipts from trade, business or profession can choose either the optional standard deduction or the itemized method of calculating the taxable income. Should the taxpayer opt for the optional standard deduction, it is important for him or her to mark the appropriate box to signify his choice. Otherwise, the absence of any mark to indicate the method chosen will be deemed as having chosen the itemized method.

Optional Standard Deduction (OSD) – Under this method, the taxpayer shall be allowed to claim as deduction an amount that is equivalent to 40% of his gross sales or receipts. This means that 60% of the gross sales or receipts will be deemed as the taxpayer's taxable income.

In choosing this, an individual is exempt from submitting the required Account Information Form and the audited financial statements. This option, however, is not available to non-resident aliens doing business in the Philippines.

Itemized deduction – A taxpayer who chooses this method of determining the taxable income will be allowed to deduct all the ordinary and necessary business expenses incurred and attributable to his or her reported gross sales or receipts for the taxable year.

Calculating the Taxable Income and the Tax Due – OSD

Let us use D. Imba Gaming Enterprise's gross sales of PhP 96,540 in the following examples.

If the business owner decides on the Optional Standard Deduction, 40% of this amount shall be deducted from his gross receipts, calculated as follows:

Allowable Deduction based on OSD = PhP 96,540 x 40% = PhP 38,616
Taxable Income based on OSD = PhP 96,540 - PhP 38,616 = PhP 57,924

Prior to the calculation of the tax due, we still have to deduct the PhP 50,000 personal deduction of D. Imba. If D. Imba has no qualified dependent child, his taxable income will be PhP 7,924 after applying the personal deduction. In determining the tax due, reference will be made against the BIR's tax table.

Inasmuch as D. Imba's taxable income falls under the "Taxable Income that is not over PhP 10,000," the applicable tax rate is 5% which will be multiplied on a straight-line basis.

Tax Due = PhP 7,924 x 5% = PhP 396.20

Calculating the Taxable Income and the Tax Due and Payable – Itemized Deduction

Suppose D. Imba chooses the Itemized Deduction. His taxable income, therefore, would be the bottom line figure of PhP 4,722, reported as Net Income in the Income Statement. Consider that D. Imba is entitled to claim PhP 50,000 as personal deduction; this means that no amount of tax will be due for payment, although, D. Imba still has to file the 1701 BIR Form to show how the exemption was arrived at.

For purposes of discussion and illustration, let us suppose that D. Imba's Net Income for the year is PhP 157,924 and that he has two qualified dependent children to claim as additional exemption. Tax due and payable under the itemized deduction method shall be computed as follows:

Taxable Income	PhP 157,924
Less: Individual personal deduction	50,000
Less: Additional personal exemption (2 x PhP 25,000)	50,000
Net Taxable Income	PhP 57,924

Computation of Tax Due

D. Imba's tax rate will be referenced against the "Taxable Income for Income over PhP 30,000 but not over PhP 70,000" and computed in the manner presented below:

Tax due on the first PhP 30,000	PhP 2,500
Tax due on amount exceeding PhP 30,000:	4,188.60
PhP 57,294 – PhP 30,000 = PhP 27,924 at 15%	6,688.60
PhP 27,924 x 15% = PhP 4,188.60	PhP 4,188.60
Total tax due	PhP 6,688.60

However, one should also consider the fact that the BIR requires the filing of quarterly income tax for taxpayers engaged in business, trade or in the practice of one's profession. Any tax payments made during the past three quarters of the taxable year will be deducted from the amount of tax due and payable for the entire year of business operations.

Assume that D. Imba's total tax payments for the previous three quarters amounted to PhP 4,754.75; the tax due and payable on or before April 15, 2012 will be PhP 1,933.85. This was arrived at by deducting the previously paid amount of PhP 4,754.75 from the total tax due for the year of PhP 6,688.60.

comprehension check

Summarizing the Results of Business Operations

9

Name: ______________________________

Section: ______________ Date: ______________

I. Identify the following:

______________ 1. Business term used in collectively referring to business owners, incorporators, stockholders, investors, suppliers, government regulatory bodies, creditors and employees.

______________ 2. Another name for the Statement of Changes in Financial Position.

______________ 3. A stakeholder who wants to know the results of the business operations for a given period will refer to this financial statement.

______________ 4. This financial statement provides information about the changes that took effect in the owner's capital.

______________ 5. This financial statement contains information about the three basic elements of a business.

______________ 6. The account to which the Income Summary balance will be closed.

______________ 7. A business term used to denote the assets that can be easily converted into cash.

______________ 8. The method of presenting the Income Statement in a way which provides an overview of how the inventory level is maintained.

______________ 9. This document accompanies the set of financial statements to signify that the financial information provided was audited by an independent CPA.

______________ 10. The method of determining taxable income by deducting 40% of the gross receipts or sales.

II. Identify under which financial statement can a stakeholder find the following information.

_______________ 1. Net cash increment for the year.

_______________ 2. The expenses which a taxpayer can use as deductions for his or her reported total gross sales or receipts.

_______________ 3. The amount invested by the entreprenur in his business.

_______________ 4. The total amount of cash that flowed into the business during an entire year of operation as a going concern.

_______________ 5. The cost of goods sold.

_______________ 6. The total amount of resources which a business entity owns.

_______________ 7. The total amount of cash used in sustaining the business operations during a particular year.

_______________ 8. The gross profit from sales.

_______________ 9. The elements of the fundamental accounting equation.

_______________ 10. The Statement of Owner's Capital.

III. Calculate the following:

_______________ 1. Total personal deduction and exemptions of a married individual with 3 qualified dependent children.

_______________ 2. Taxable income of an unmarried individual under the OSD method, if gross receipts for the year amounted to PhP 85,000

_______________ 3. If the the tax due on the first PhP 30,000 is PhP 2,500 and the tax rate for the amount in excess of PhP 30K but not exceeding PhP 70K is 15%, calculate the total tax due on a taxable income of PhP 63,000.

_______________ 4. Based on the answer arrived at in Item (c), calculate the tax payable if the taxes paid in the previous quarters amounted to PhP 3,075.

_______________ 5. If the gross receipts from sales is PhP 115,000 and the Cost of Goods Sold is PhP 34,500 while the allowable expenses incurred totaled PhP 33,115, how much is the taxable income of a taxpayer who uses the OSD method?

Amount of Net Taxable Income		Rate
Over	But not over	
	P10,000	5%
P10,000	P30,000	P500 + 10% of the Excess over P10,000
P30,000	P70,000	P2,500 + 15% of the Excess over P30,000
P70,000	P140,000	P8,500 + 20% of the Excess over P70,000
P140,000	P250,000	P22,500 + 25% of the Excess over P140,000
P250,000	P500,000	P50,000 + 30% of the Excess over P250,000
P500,000		P125,000 + 32% of the Excess over P500,000 in 2000 and onwards

source: bir.gov.ph

CHAPTER 10

A Bookkeeping Walk-Through for Single Proprietorship

Opening a Business and Maintaining the Books of Accounts

We will finish this courseware by applying the accounting concepts and methodologies learned from the previous chapters. A business case example will exhibit how the accounting concepts learned in the previous chapters can be applied.

Our entrepreneur is Felipe O. Santos, who has been dabbling in the buying and selling of scrap and junk materials for quite some time. Mr. Santos has decided to formally set up his junkshop business, since the large-scale wholesale buyers of recyclable materials require their suppliers to issue BIR-registered official receipts.

Rather than pass up the business opportunity presented to him, Mr. Santos decided to register his junk shop and scrap dealership business with the proper government regulatory offices. These were the steps taken by our entrepreneur:

1. Registered the trade name “FOS Junk and Scrap Yard” with the Department of Trade and Industry and paid PhP 500 as registration fees.
2. Secured a license to operate and paid the municipal office a total amount of PhP 2,115.
3. Registered the business under his Taxpayer’s Identification Number (TIN) and paid PhP 500 as registration fee and PhP 1,500 to the BIR-accredited printer for the cost of printing 50 booklets of Official Receipts as a Non-VAT business entity.
4. Registered with the Social Security System (SSS) and PhilHealth and submitted the names of his employees—a driver and two helpers.
5. Incurred PhP 260 in transportation expenses and PhP 120 in miscellaneous expenses.
6. Opened a separate deposit account with BPI and transferred PhP 100,000 as initial investment in the business.
7. Paid two months’ advance rental deposit of PhP 5,000 for a vacant lot, to be used as official trading site and junk yard.
8. Purchased the following additional operating equipment:

One unit heavy duty weighing scale	PhP	6,700
One unit 50-kg hanging weighing scale		3,800
Cash box		850
Desktop calculator with printer		1,800
Various stationery and office supplies		750
2pcs plastic tables and 5pcs chairs		1,750
2pcs plastic filing cabinets		1,400

9. Unfortunately, Mr. Santos did not keep any records of the tools and equipment he previously purchased; hence, he requested a professional appraiser to establish the fair market value of the following items, which he will use as the basis for booking purposes:

Two second-hand metal pushcarts	PhP 1,700
Acetylene torch	3,500
Acetylene gas tank	1,200
Pulley set	4,500
Various hand tools (steel saw, pliers, vice grips, screw drivers, hammer)	1,050
Second-hand pick-up truck	225,000
Junk and scrap stock inventory	42,785

10. Mr. Santos commissioned a contractor to build a sturdy shack that will serve as the office/selling area; Contract Price is PhP 30,000.

11. A Purchase Fund of PhP 20,000 was established for all junk- and scrap-buying activities.

The business became official in July, 2016, with his wife, Mrs. Lisa Santos acting as the bookkeeper-accountant and Mr. Felino O. Santos as the manager-cashier. Prior to the official start of the buying and selling in the junkyard, Mr. Santos was able to submit the documents required by the wholesale buyers of used plastic, aluminum, copper, zinc, scrap metal, paper, rubber, battery, and wood materials.

Setting up the General Ledger

Mrs. Santos organized all the receipts in order to make a complete accounting of the pre-operating costs and the newly acquired fixed assets. In addition to the general journal and the general ledger, she set up four transaction books: Sales Book, Purchases Book, Cash Receipts Book, and Cash Disbursement Book.

She journalized the following entries in the general journal and subsequently posted all the entries in the general ledger book. She wanted to set up all the account balances prior to the official start of the junk and scrap trading activities.

Date: July 05, 2016

JE-1

Dr. Cash in Bank	PhP 100,000	
Cr. F.O. Santos, Capital		PhP 100,000

Explanation: To establish the amount of working capital funds for the business.

JE-2

Dr. Taxes, Licenses & Registration Fees	PhP 3,115	
Dr. Office Supplies on Hand	1,500	
Dr. Transportation Expenses	260	
Dr. Miscellaneous Expenses	120	
Cr. Cash in Bank		PhP 4,995

Explanation: To take-up the pre-operating expenses incurred by Mr. Santos in registering the business:

DTI Registration	PhP 500	(Taxes, Licenses & Registration Fees)
Municipal Permits & License	2,115	(Taxes, Licenses & Registration Fees)
BIR Registration	500	(Taxes, Licenses & Registration Fees)
Cost of Printing (ORs)	1,500	
Transportation Expenses	260	
Miscellaneous Expenses	120	

JE-3

Dr. Junkyard Tools & Equipment	PhP 10,500	
Dr. Office Furniture & Equipment	5,800	
Dr. Office Supplies on Hand	750	
Cr. Cash in Bank		PhP 17,050

Explanation: To record the acquisition costs of the following additional tools and equipment for the yard:

One unit heavy-duty weighing scale	PhP 6,700	(Junkyard Tools & Equipment)
One unit 50-kg hanging weighing scale	3,800	(Junkyard Tools & Equipment)
Cash box	850	(Office Furniture & Equipment)
Desktop calculator with printer	1,800	(Office Furniture & Equipment)
Various stationery and office supplies	750	(Office Supplies on Hand)
2pcs plastic tables and 5pcs chairs	1,750	(Office Furniture & Equipment)
2pcs plastic filing cabinets	1,400	(Office Furniture & Equipment)

JE-4

Dr. Other Assets – Advance Rental Deposit	PhP 5,000	
Cr. Cash in Bank		PhP 5,000

Explanation: To record payment of advance rental deposit to owner of vacant lot.

JE-5

Dr. Leasehold Improvement – Junkyard Shack	PhP 33,865	
Cr. Cash in Bank		PhP 33,865

Explanation: To record total construction cost of the junkyard shack.

JE-6

Dr. Junkyard Tools & Equipment	PhP 11,950	
Dr. Transportation Equipment	225,000	
Dr. Junk and Scrap Stock Inventory	42,785	
Cr. F.O. Santos Capital		PhP 279,735

Explanation: To capitalize the existing tools and equipment of the business.

Two second-hand metal pushcarts	PhP 1,700	(Junkyard Tools & Equipment)
Acetylene torch	3,500	(Junkyard Tools & Equipment)

Acetylene gas tank	1,200 (Junkyard Tools & Equipment)
Pulley set	4,500 (Junkyard Tools & Equipment)
Various hand tools (pliers, vice grips, steel saw, screw drivers, hammer)	1,050 (Junkyard Tools & Equipment)
Second-hand pick-up truck	225,000 (Transportation Equipment)
Junk and scrap stock inventory	42,785

JE-7

Dr. Purchase Fund	PhP 20,000	
Cr. Cash in Bank		PhP 20,000

Explanation: To record the purchase fund held by Mr. F.O. Santos, which will be used for the junk and scrap buying activities.

Mrs. Santos prepared a trial balance to make sure that the debit and credit balances of the GL are equal.

	FOS Junk and Scrap Yard		
	TRIAL BALANCE		
	July 05, 2016		
DATE		**DEBIT**	**CREDIT**
July 05	**ACCOUNT TITLE**	-	
	Cash on Hand	19,090	
	Cash in Bank	20,000	
	Purchase Fund	2,250	
	Office Supplies on Hand	42,785	
	Junk & Scrap Stock Inventory	5,000	
	Others Assets-Advance Rental Deposit	5,800	
	Office Furniture & Equipment	22,450	
	Junkyard Tools & Equipment	225,000	
	Transportation Equipment	33,365	
	Leasehold Improvement- Junkyard Schack		379,735
	F.O.Santos, Capital	3,115	
	Taxes, Licenses & Registration Fees	260	
	Transportation Expenses	120	
	Miscellaneous Expense		
	Totals	**379,735**	**379,735**

Maintaining the Books for Business Transactions

Purchases from Walk-in Sellers

1. As the manager-cashier of the business, Mr. Santos is in charge of weighing in the junk or scrap being purchased and prepares a weigh-in slip. This is where he indicates the unit price per kilogram and calculates the amount to be paid to the seller.

2. The seller signs the weigh-in slip to acknowledge receipt of payment.

3. Mr. Santos retains a copy of the weigh-in slip and will ask a store helper to log them in the Purchase Book.

4. The original copy of the weigh-in slip will be forwarded to Mrs. Santos for recording in the Cash Disbursement Book.

To show an example of how the business monitors its purchases, its junk stock inventory, and the balance of the Purchase Fund, the following transaction books and ledgers are maintained.

PURCHASE BOOK

Date	W/ Slip No.	Amount Paid	Description of Item Purchased	QTY.	Price/Unit
6-Jul	#01-11	275.00	Used car battery	1	275/unit
	#01-12	200.00	PET bottles med.	100	2/pc.
	#01-13	105.00	Aluminum cans	3.5	30/kg
	#01-14	30.00	PET bottles regular	30	1/pc.
	#01-15	50.00	PET bottles regular	50	1/pc.
	#01-16	50.00	PET bottles regular	50	1/pc.
	#01-17	37.50	Aluminum cans	1.3	30/kg
	#01-18	15.00	Newspaper	30	0.50/kg
	#01-19	25.00	Newspaper	50	0.50/kg
	#01-20	75.00	Scrap metals-ordinary	1.5	50/kg
	Total	**862.50**			

SUBSIDIARY LEDGER -PET BOTTLES (Reg.)

Date	W/ Slip No.	QTY.	Price/Unit	Purchase Cost
6-Jul	#01-14	30	1/pc.	30.00
	#01-15	50	1/pc.	50.00
	#01-16	50	1/pc.	50.00

CASH DISBURSEMENT BOOK

Date	W/ Slip No.	Amount Paid	Expnse Vo.#	Amount Paid	Fuel & Lub.	Supplies Exp.	Misc.
6-Jul	#01-11	275.00	EV#	230	200	30	
	#01-12	200.00					
	#01-13	105.00					
	#01-14	30.00					
	#01-15	50.00					
	#01-16	50.00					
	#01-17	37.50					
	#01-18	15.00					
	#01-19	25.00					
	#01-20	75.00					
	TOTALS	862.50		230	-	30	

5. Some minor expenses will also be paid from the fund, and a voucher supported by official receipts will be forwarded to Mrs. Santos for recording in the Cash Disbursement Book. Mr. Santos retains a copy of the voucher, which he uses in monitoring and ascertaining the actual cash on hand.

6. At the end of the day, Mr. Santos will reconcile the balance of his Purchase Fund by deducting all weigh-in slips and expense vouchers paid.

Daily Report on Purchase Fund Usage		**Date:**	6-Jul-16
Beg. Balance		PhP	20,000
Less:			
Junk Stock Purchases: W/S #01-00 to #01-20		PhP	862.50
Junk Stock Expenses:			
Fuel & Lubricant	PhP 200		
Miscellaneous	PhP 30		230
End of Day Balance		PhP	18,907.50

Accounting Entries: *(The following entries are based on the transaction books and are not necessarily in chronological order).*

A Bookkeeping Walk-Through for a Single Proprietorship

Accounting for Basic Bookkeeping

10

Name: ____

Section: ________________ Date: ____________________

I. Choose the correct answer and fill in the blank with the corresponding letter:

1. The first step in setting up a business is to register the _____ with the DTI.
   a. Industry type of the business
   b. Organization type of the business
   c. Trade name of the business

2. The local municipal office grants the _______ to operate a business within its boundaries.
   a. Accreditation and membership
   b. Business permits and licenses
   c. Business forms and official receipts

3. Business owners as employers are required to submit the _____ to SSS and PhilHealth.
   a. names of suppliers
   b. names of employees
   c. names of customers

4. BIR Form 1701Q is also known as _______.
   a. Quarterly Income Tax Return
   b. Quarterly Percentage Tax Return
   c. Quarterly Vat Return

5. Construction costs for building add-ons, renovations and extensions on leased properties are booked as _________.
   a. Leasehold Improvements
   b. Leasehold Additions
   c. Leasehold Constructions

6. The 3% Percentage Tax is imposed on businesses with annual gross receipts or sales of ____.
   a. not more than PhP 150,000 per year
   b. not more than PhP 1,500,000 per year
   c. not more than PhP 150,000 per quarter

7. If a taxpayer uses the Itemized Method of deduction, taxable income will be based on the _________ reported in the Income Statement.
   a. gross receipts
   b. net income
   c. gross profits

8. If the gross receipts or sales of the business exceeds PhP 150,000 per quarter, the BIR requires that a _____ accompany the financial statement.
   a. computation
   b. notation
   c. certification

9. In classifying personal or existing assets as part of the business, those that will bring _____ should be capitalized.
   a. future years' benefit
   b. future years' savings
   c. future year's expenses

10 Official Receipts used as supporting documents for expenses claimed as tax deductions should be registered with the______.
   a. DTI
   b. BIT
   c. BIR

II. Write RT if the accounting entries are for a regular transaction or PCT if the entries are for pre-closing transactions:

	1. Dr. Taxes, Licenses & Registration Expenses / Cr. Accrued Expenses Payable
	2. Dr. Profit & Loss Summary / Cr. Owner's Capital
	3. Dr. Unearned Income from Rent / Cr. Rent Income
	4. Dr. Rent Expense / Cr. Cash in Bank
	5. Dr. Purchases / Cr. Accounts Payable
	6. Dr. Other Assets - Prepaid Insurance / Cr. Cash in Bank
	7. Dr. Cash on Hand / Cr. Unearned Interest Income
	8. Dr. Accrued Interest Receivable / Cr. Interest Income
	9. Dr. Office Supplies on Hand / Cr. Cash on Hand
	10. Dr. Petty Cash Fund / Cr. Cash in Bank

Purchases and junkyard expenses are recorded upon replenishment of the Purchase Funds. The first replenishment was recorded in July 25, 2016, which covered all purchases from July 06 to 24, 2016. Mrs. Santos prepared the following journal entries based on a summary of the Purchases Books, in order to provide for the fund replenishment:

JV -13 (July 25, 2016)

Dr. Junk Stock Purchases	PhP 16,748	
Dr. Fuel & Lubricant	1,200	
Dr. Miscellaneous Expenses	153	
Cr. Cash in Bank		PhP 18,101

Explanation: To replenish Purchase Fund and to record the cost of the junkyard stocks purchased beginning July 06 to 24, 2016.

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