CHAPTER 10

BUSINESS TRANSACTIONS AND THEIR ANALYSIS AS APPLIED TO THE ACCOUNTING CYCLE OF A SERVICE FIRM (PART 1)

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THE ACCOUNTING BIG FOUR

Do you want to be an accountant? If you do, chances are you will end up being part of a global network of accounting professionals. These are huge organizations of professionals and experts from different fields, including operations management, cybersecurity, strategic management, and international taxation. These groups are called professional service firms, and one of their primary revenue streams is their audit arms. External auditors lend credibility to the financial statements produced by businesses to give users of financial statements a reasonable degree of assurance that companies make no unfair claims made on the face of the statements.

THE ACCOUNTING BIG FOUR

Currently, there are four dominant firms in global audit practice, as enumerated:

Firm	2014 Revenues	Headquarters	Philippine Member Firm
Deloitte	$34.2 billion	United States	Navarro Amper & Co
PwC	$34.0 billion	United Kingdom	Isla Lipana & Co
EY	$27.4 billion	United Kingdom	Sycip Gorres Velayo & Co
KPMG	$24.8 billion	Netherlands	R. G. Manabat & Co

THE ACCOUNTING BIG FOUR

But no matter how complex their practice is and how expansive their area of expertise may be, one thing remains true. The member firms of these professional service networks can be reduced to fit the basic business model of a service organization. Their main revenue source is the rendition of services, and not the sale of goods bought from somewhere else or manufactured in the company plant. In a service firm, the "good" being sold is the professional conduct of, for example, audit services, by very qualified auditors.

THE ACCOUNTING BIG FOUR

Auditors are expected to know a great deal of accounting, and in the Philippines, to be able to audit the financial statements of publicly traded companies, one of the requirements is a Certified Public Accountant license, the examination for which requires a degree in accountancy. The practice of accountancy starts in the recording of business transactions. In this chapter, we will learn how various economic events are translated into words and numbers, which travel the whole length of the accounting cycle, and eventually end up as numbers on the financial statements.

At the end of this chapter, the students should be able to:

1. describe the nature and give examples of business transactions;
2. identify the different types of business documents;
3. analyze common business transactions using the rules of debit and credit; and
4. solve simple problems and exercises in the analysis of business transactions

INTRODUCTION

Those four are really big firms. They serve the biggest businesses in the most powerful economies. For the purposes of this chapter, however, we will deal with a much smaller business but with a very similar format of operations-the Matalino Dormitory. All examples in this chapter and in the next will revolve around the transactions of this housing concem which was put up in 2014 by Mr. Lino Telegaku.

THE ACCOUNTING PROCESS

At the core of accounting is the accounting process. It outlines the various procedures accountants carry out that lead to the preparation of financial statements which will be used by both the external and internal users to make economic decisions.

IDENTIFYING, ANALYZING, AND MEASURING THE ECONOMIC EFFECTS OF TRANSACTIONS

The accounting process begins with the identification of an event, the analysis of the effects of that event, and the measurement of the impact of that event to the business financial statements. We are talking about events, but later in this chapter, you will learn that not all events are actually recorded in the financial statements. The following is a list of events. Some of which will be recorded in the company's books, and some will not be recorded. Which of these events do you think needs to be recorded? How do you know if an event is to be recorded in the books or not?

List of Events

1. Firm buys a printer for the office for P5 500
2. Firm hires two employees which will be paid P15 000 monthly.
3. Firm pays rent on the land where its building stands - P 12 300.
4. Firm signs a subscription contract for an Internet plan at P999 per month which will be due at the end of each month.
5. Firm orders 20 packs of brown envelopes from the bookstore at P20 per pack.

Of the five events listed, only events 1 and 3 will be recorded.

There is really no hard-and-fast rule to determine which events need to be recorded in a business' books of accounts. Generally, though, accountants record an event if it affects any of the elements of the financial statements (assets, liabilities, equity, revenues, and expenses), and if there is a

Before we delve into the details of the analysis of each of the items from the list, here is a summary of our decision-making framework:

Does it affect the composition of either assets, liabilities, equity, revenues, or expenses?

Is there a monetary amount that can be assigned to the Event?

	Yes	No
Yes	Record in the books.	Do not record.
No	Do not record.	Do not record.

Analysis of Each Event

1 .Firm buys a printer for the office for P5 500. This should be recorded in the books of the business. When the firm bought the printer, there was a direct exchange of cash in the amount of P5 500 for the printer. This direct exchange happens when the sale of an item and the payment for it happens simultaneously. In Filipino language, this is usually described as kaliwaan-"You pay; I give you what you bought"-two sides with same event. When we record simultaneously the effect of giving and receiving, we do double-entry bookkeeping. This is the most commonly used system of bookkeeping, and is based on the principle that every financial transaction involves the simultaneous receiving and giving of value, and is therefore recorded twice.

Analysis of Each Event

From the viewpoint of the firm, there was a decrease in cash (P5 500) and an increase in the number of printers the firm owns (one additional). This decrease in cash, in terms of the accounting equation, is a decrease in assets by a monetary amount of P5500. The new printer also recognized affects the equation. There was an increase in assets. But at what amount? Recall that for an event to be recordable, there has to be a monetary amount assignable to it. International standards for recording the purchase of assets such as this printer require that the printer be assigned a value equivalent to the value of the money paid to buy it. Thus, we measure the increase in the asset Printer also at P5 500, a monetary amount.

Analysis of Each Event

Notice that the sum of those two sides of the same effect is zero. There was an increase in assets in the amount of P5 500 (Printer), but there was also a decrease in assets by the same amount (less P5 500 Cash). When taken together, these do not affect the accounting equation, because there is no net change in assets. This transaction has to be recorded. While there is no net effect in the accounting equation, there was a change in the composition of one of the elements of our financial statements, which is the assets. In buying the printer for cash, we effectively converted our cash into a printer.

2. Firm hires two employees which will be paid P15 000 monthly. This event should not be recorded in the books of the business-at least not yet. There was a real event-the hiring of the employees. It is related to the business but has no effect to any elements of the financial statements.

Check assets. There is a required payment of P15 000 every month, but no one has been paid yet.

Check liabilities. While the business is required to pay P15 000 by means of contract which the employees presumably signed, the business cannot be required to pay anything until the employees render the service required. At the point of hiring, the employees have not yet worked for the company, and so there is no obligation to pay anything yet.

Check equity. No capital has been contributed or drawn. Also, no expense or revenue is recognized by the hiring (not even for salaries, for the same reason why we do not yet recognize any liability).

However, there is a monetary amount that can be assigned. But recall that our general rule to help us decide whether or not to record requires both the change in an element and a monetary amount assignable. There is a monetary amount (P15 000) but there is no effect (yet) on the elements. Thus, we do not record this transaction.

Events and Special Events: Business Transactions

Item 1 is a special event called business transaction or simply transaction. Transactions are businesses' economic events that are recorded by accountants. For an event to be recognized as a transaction, and be recorded in the books, it has to satisfy the requirements we have already outlined. But note that the exact term for "transactions" is "business transactions," so the events have to be related to the business. We should always ensure that the accounts affected are the business' own accounts not the owner's personal accounts. For example, the owner of a sole proprietorship draws P10 000 from the proprietorship's equity and buys a watch for his own use. The withdrawal of the P10 000 will be recorded in the books as a drawing, but the purchase of the watch will not be recorded. The funds of the business were used, but the purchase of the watch is outside the scope of accounting for the transactions of the business. Even if you find the receipt for the watch in the files, your knowledge that the watch is for the personal use of the owner, should get you to flag the "transaction" as a personal transaction and not a business transaction, and that you should not record the watch as an asset of the business.

3. Firm pays rent on the land where its building stands - P12 300. This item should be recorded in the books of the business. Checking one side of the event, we see the firm paying out P12 300 in cash in exchange for the right to occupy the land. The P12 300 outflow of cash is easily categorized as a decrease in assets, and it is a monetary amount. What is the other side of this transaction? To answer this question, we have to look at our source documents.

The Real Deal: Checking the Source Documents

Whenever a transaction is to be recorded, the accountant has to ascertain what accounts of assets, liabilities, equity, revenue, or expense it affects, and what monetary value is to be assigned to that effect. The various transaction details we need in order to proceed with the analyzing, identifying, and measuring phase, are found in a document called source document. Source documents typically indicate the date of the transaction and the amount. Also, from its face, we can usually determine the purpose of the transaction. For example, we can determine that cash was used to purchase office supplies if we have a cash receipt from a bookstore listing the items bought such as bond paper, ballpoint pens, and clips. The following are examples of source documents:

Source Document	Purpose as a Source Document	When Generated/By Whom
Receipt	to evidence the receipt of cash for a sale	outside, the seller firm
Sales invoice(bill)	to evidence a purchase, and thus the recording of a liability to the seller	outside, the seller firm
Bank Statement	to evidence the bank charges for the period which the firm would otherwise not know about	outside, the depository bank
Time Card	to evidence the number of hours worked by employees, to be used as basis for determining wages	within, workers

From the table, we note two things. First, source documents are essentially pieces of evidence. These documents are critical to the accounting process as they provide an accountant with an objective basis for the date, amount, and purpose of the transaction. Without an objective basis for the date of the transaction, an accountant might err and record 2015 purchases as 2014 purchases. Without an objective basis for the amount, it will be hard to justify how an accounting entry was even recorded for that transaction. Moreover, without an objective basis for the purpose, there could be misstatements such as recording souvenir ballpoint pens as office supplies rather than part of advertising expense. Second, notice that source documents may originate from either an external party or from within the firm. Numerous processes, such as the example in the table, are completed within the firm, and in the process, produce documents which actually form basis for accounting entries to be made.

It Is Not Always Direct: Purchases on Account

When firms purchase supplies or other materials for their businesses, it is not uncommon to put them "on account." Buying items on account means that there is no upfront payment: this is not a direct exchange. In these cases of purchases on account, the following steps usually occur: First, the buyer requests a quotation from the seller. This is like asking, "I need these things; how much will these cost if I buy these from you?" The seller then sends a quotation to the buyer. If the buyer is satisfied with the price and the terms of the sale, the buyer issues a purchase order to the seller. This is the ordering step. The sale is then completed when the goods are shipped to the buyer. When the seller completes the process up to the shipping part, it bills the customer for the amount due. The seller then prepares a sales invoice to be sent to the customer, which will be the customer's bill, signaling the start of the payment process on the part of the buyer.

Therefore, the buyer will only record a liability when the sales invoice or bill from the seller arrives. The buyer cannot record the purchase at the point of ordering because no goods has been received yet, and because the seller has charged nothing to the firm yet. Also, the buyer cannot record the purchase even at the point of receipt of the goods if the sales invoice has not yet arrived. This marks the importance of the sales invoice as the source document. Without it, we will not know at what amount we should record the goods we received. When the sales invoice arrives, we can then record a liability (a payable) and a corresponding increase in assets (the goods received) at an amount usually equal to the total amount billed by the seller. Going back to item 5, the purchasing process as described is just at the ordering step. Thus, we cannot record anything just yet.

Let us go back to the Matalino Dormitory. Study the following event and determine (1) whether or not it is a business transaction; (2) the two sides of the transaction; (3) which elements of the financial statements will be affected; and (4) the amount at which this transaction will be recorded.

Matalino Dormitory is a living space conceptualized by Mr. Lino Telagaku in 2013. He lives within the vicinity of a big university and he noticed that many of the students live in dormitories because their family homes are very far from the university and commuting would take them two hours every day.

Seeing this business opportunity, Mr. Telagaku searched for a building which he can use as the site of his dormitory. He found one along Mahangin St., Brgy. Maginhawa, Quezon City. It is a good spot because it is just two blocks away from one of the university's entry points, and is coincidentally bordering Brgy. Mapayapa, which is known to be a safe place even for non-residents. After thinking about it deeply and studying how he will run the business, Mr. Telagaku finally buys the building.

Being a truly business-minded and a great worker, Mr. Telagaku had quite a considerable fortune in his bank accounts. He was able to save much from his previous position as a senior manager in a bank, and he has also saved a part of his income from his milk tea business which boomed three years ago

Knowing that his business will be heavy on fixed assets, Mr. Telagaku has decided to invest P9 000 000 into the business on January 1, 2014. This investment will kick-start the business and is called capital. There will be an increase in the assets of the business by P9 000 000 (cash), and since this is an investment of the owner of some property into the business, the other side of this transaction is the increase in the equity of the business. Both sides of the transaction are recorded at an amount of P9 000 000. This is a business transaction because we are seeing changes in both the assets and equity elements, and because we have a monetary amount assignable to the transaction

Capital may be anything including cash, non-cash assets such as property, real property such as land or buildings, even licenses, trademarks, or even liabilities. Liabilities, when contributed to a business, are often attached to or are related to another asset that has been donated. For example, when an owner invests a building he owns worth P1 000 000 into the business, the business recognizes the increase in asset by that amount, with a corresponding increase in equity account or owner's capital. However, if for example, there is a mortgage attached to the building because the owner bought the building through a loan and has not completed payments on it yet, the business will recognize both the asset (the building) and the liability (the unpaid portion of the mortgage), with the difference being recognized in equity as owner's capital.

After investing cash, Mr. Telegaku then follows the business registration steps outlined by the Department of Trade and Industry for small enterprises. He prepares the necessary documentation and then goes to the city hall to obtain a business permit. He pays a total of P1 200 evidenced by an official receipt. Here, there is a decrease in cash in the amount of P1 200, representing payment for start-up costs of the business. For now, just remember that this transaction will result in a decrease in the assets and also a decrease in equity, because of the start-up expense or organization expense. We will discuss later the reason why this outflow of cash is recognized as an expense immediately.

Mr. Telagaku, now cleared for business, buys the building he saw at Brgy. Maginhawa. However, even though he had a lot of capital invested into the business, it proved to be not enough for the building, which costs P12 350 000. He, thus, decides to pay P7 350 000 in cash, and goes to the bank to get a loan for the balance. When the purchase of the building is completed and the title is transferred to Mr. Telagaku, there will be an increase in the assets of the company (represented by an increase in the building account by its worth, P12 350 000, and a decrease in cash in the amount of P7 350 000). Moreover, because of the loan taken, the business' liabilities also increased by the balance P5 000 000. The increase in the building will be evidenced by the title to the land, and the loan will be evidenced by the loan agreement.

Mr. Telegaku also printed flyers for distribution and posters for posting at a total cost of P2 330. Similar to the organization expense, this advertising expense will also affect the accounting equation by reducing assets and equity both by the amount of P2 330.

Mr. Telegaku then started to work on the interiors. For his Ethnic Filipino theme, he "signed a note" (took a loan on, evidenced by a promissory note) for the total purchase price of furniture and fixtures-P250 000. Mr. Telegaku has an objective basis for estimating the useful life of these furniture and fixtures at 8 years. This expenditure is different from the organization and advertising expenses. While it consists mainly in shelling out cash, we recognize an asset because we have objective evidence of the pattern of benefits to be provided by the furniture and fixtures. While we cannot know or estimate the extent of benefit of either the advertising or the organization expense, in the case of furniture and fixtures, we know that it will benefit the business for the entire duration of its useful life. Now, if there is an objective basis for the useful life of the items, then we are allowed to spread the expense of buying the furniture and fixtures to all the periods to be benefitted.

Matalino Dormitory underwent other major repairs and changes throughout the year 2014 in order to get it ready for its first dormers for 2015. As we move forward in the chapter, we will see how these transactions are finally recorded in the company's books. We will start with the recording of the transactions to the company's journals.

Recording to the Journals

Chapter 9 discussed the uses and various types and formats of the journals. After analyzing the transactions, these are recorded to the appropriate journals in a process aptly named journalizing. Following the format in Chapter 9, we recall that each journal entry will require a date, one or more debit account titles, one or more credit account titles, amounts, and an explanatory note to express in words what the transaction was made for. A final step is made when the journal entries are posted to the ledgers, that is, filling the reference column with the ledger cross-reference.

The Rules of Debit and Credit

We have learned in Chapter 8 that an account is the record of all the movements in a particular item of asset, liability, or equity during a period. The basic visual representation of an account is the T-account. It resembles the capital letter T: the left side contains all the debits to the account while the right side contains all credits.

Every journal entry requires at least one debited account and also at least one credited account. This means following the definition that at the very least one account has to have a movement in the left side of its T-account, and another account has to have a movement in the right side of its T-account.

The terms left and right are used to refer to the debit side and the credit side of the account, respectively. Note that when an account is debited, its value is increased or conversely, that when an account is credited, its value is decreased. Also, a debit does not mean that a profitable event has happened and that the opposite is true for a credit.

Increases and decreases in different accounts are recorded differently as debits and credits. The following is the list of rules of debits and credits:

- Increases in assets are recorded as debits; decreases are recorded as credits.
- Increases in liabilities are recorded as credits; decreases are recorded as debits
- Increases in equity are recorded as credits; decreases are recorded as debits.

Asset		Liability		Equity	
debit side	credit side	debit side	credit side	debit side	credit side
increases	decreases	decreases	increases	decreases	increases

Some complications arise when we look further into the details of the accounts comprising assets, liabilities, and equity. First, later in the book we will encounter accounts that are described as contra-asset, contra-liability, and contra-equity. These are simply accounts that are reported in the financial statements together with assets, liabilities, and equity, respectively, but follow the exact opposite rules of debit and credit as their positive counterparts.

- Increases in contra-asset accounts are recorded as credits. An example is accumulated depreciation, which is presented against machinery, equipment, vehicle, or some other assets subject to depreciation. We will learn about depreciation later on in this chapter.

- Increases in contra-liability accounts are recorded as debits. An example is discount on bonds payable, used to report a liability at the required measurement basis. Bond valuation is the subject of a higher accounting course. For now, it is enough for you to know that contra-liability accounts do exist.

- Increases in contra-equity accounts are recorded as debits. An example is treasury stock, used when a corporation buys back shares of its stock previously issued to shareholders. This is also the subject of another accounting course when you move out of proprietorships and into corporations.

Contra-Asset		Contra-Liability		Contra-Equity	
debit side	credit side	debit side	credit side	debit side	credit side
increases	decreases	decreases	increases	decreases	increases

Notice that these are the exact opposite locations of increases and decreases. The debit side still is on the left and the credit on the right.

When an asset is increased, we record a movement on its debit side. In short, we debit the asset. When a liability or equity is increased, we credit the liability or equity. The side on which increases in an account are recorded is described as its normal balance. Thus, the normal balance of an asset account is a debit, and that of liabilities and equity, credit.

Now that we know all about when to use debit (Dr.) and credit (Cr.), we can start journalizing the entries. We will illustrate the recording of some of Matalino Dormitory's transactions that we have already analyzed, and add some new transactions as well. For each recording, we will illustrate how the transaction will affect which accounts and how so, how it will impact the accounting equation, and finally how the transaction will be journalized.

Transaction 1. Investment of capital. Mr. Telagaku invested ₱9 000 000 into the business on January 1, 2014. This is recorded as follows:

ASSET		=	LIABILITY		+	EQUITY	
▲ Cash						▲ L. Telagaku, Capital	
debit side	*credit side*		*debit side*	*credit side*		*debit side*	*credit side*
9 000 000 increase							9 000 000 increase

2014			
1 Jan	*Dr. Cash*	*9 000 000*	
	Cr. L. Telagaku, Capital		*9 000 000*
	to record investment of capital into the business		

Transaction 2. Payment of business permit fees. He pays a total of ₱1 200 evidenced by an official receipt from the city hall. This is recorded as follows:

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ASSET = **LIABILITY** + **EQUITY** ?

Cash

debit side	*credit side*
	1 200 decrease

LIABILITY

debit side	*credit side*

L. Telegaku, Capital

debit side	*credit side*
1 200 decrease	

EXPENSE

ORGANIZATION EXPENSE

debit side	*credit side*
1 200 increase	

expense decrease

The transaction is initially recorded as a debit to organization expense and a credit to cash.

2014			
12 May	Dr. Organization expense	1 200	
	Cr. Cash		1 200
	payment of business registration fees		

How does this effect a decrease in the equity? You will learn in Chapter 11 that at the end-of every reporting period (usually at the end of year), a business transfers all its income and expense items to the equity accounts. For now, just understand the intuitive generalization that revenues increase equity and expenses decrease equity.

Transaction 3. Purchase of building. On June 2, 2014, Mr. Telagaku purchases a building costing ₱12.35M. He pays ₱5M in cash and signs a note with a bank for the balance.

ASSET ▼ = LIABILITY ▲ + EQUITY

Cash

debit side	credit side
	7 350 000 decrease

5,000,000

Note payable

debit side	credit side
	5 000 000 increase

7,350,000

debit side	credit side

ASSET ▲

Building

debit side	credit side
12 350 000 increase	

2014			
2 Jun	Dr. Building	12 350 000	
	Cr. Note payable		5 000 000
	Cr. Cash		7 350 000
	to record purchase of building		

One interesting thing to note in this example is how there were two credits in one journal entry. This type of journal entry contains more than one debited account or more than one credited account, or more than one of both (i.e., if the entry uses three or more accounts), which is called a compound journal entry, and is perfectly acceptable. Now, let us introduce several new transactions entered into by Matalino Dormitory

Transaction 4. Payment of fire insurance premium. Matalino Dormitory took a fire insurance policy with AntiPirena Insurance Corporation, which requires Matalino Dormitory to pay a premium of P6 000 every January 1 and July 1, each premium for 6 months of fire insurance. Matalino Dormitory pays its first premium on January 2, 2015.

We will take up this transaction with an initial debit to asset Prepaid Insurance (there is an alternative procedure which will be discussed in Chapter 11; the two procedures will result in the same amounts being reported in the financial statements). We have already paid cash to the insurance company but time has not yet passed, and no service has been rendered yet in connection with the insurance policy. Thus, we recognize an asset representing the future benefits (the convenience provided by the insurance guarantee over the period covered by the premium).

ASSET = **LIABILITY** + **EQUITY**

▼

Cash

debit side	*credit side*
	6 000 decrease

debit side	*credit side*

debit side	*credit side*

ASSET

▲

Prepaid Insurance

debit side	*credit side*
6 000 increase	

2015			
2 Jan	*Dr. Prepaid insurance*	*6 000*	
	Cr. Cash		*6 000*
	paid cash for a 6-month fire insurance contract		

Transaction 5. Receipt of cash from dormers. It is January 5, 2015 and Matalino Dormitory is finally in business. Matalino Dormitory received cash from its dormers in the amount of P60 000. Following the contract provisions, cash equivalent 1 month of rent (P30 000) is to be paid at the start of the contract as a security deposit to be returned at the end of the lease term, and cash equivalent to another month of rent (P30 000) is also to be paid at the start of the contract as advance payment, but such advance payment will be applied to the rent due on the last month of the 6-month contract. Regular rent is payable at the end of each month.

At the start of the contract, Matalino shall record a debit to cash and credits to Unearned Rent Revenue and Refundable Customer Deposits respectively for the advance rent payment and security deposits.

ASSET	=	LIABILITY	=	EQUITY
▲		▲		

Cash

debit side	credit side
60 000 increase	

Refundable deposits

debit side	credit side
	30 000 increase

(Equity)

debit side	credit side

LIABILITY

▲

Unearned rent revenue

debit side	credit side
	30 000 increase

2015

5 Jan Dr. Cash 60 000

Cr. Refundable customer deposits 30 000

Cr. Unearned rent revenue 30 000

received cash representing security deposit and advance payment

Transaction 6. Receipt of cash for January rent. Matalino Dormitory received ₱30 000 from dormers in payment of their January rent.

ASSET ▲ = LIABILITY + EQUITY ▲

Cash

debit side	credit side
30 000 increase	

(Liability)

debit side	credit side

L. Telegaku, Capital

debit side	credit side
	30 000 increase

REVENUE ▲

Rent revenue

debit side	credit side
	30 000 increase

2015			
31 Jan	*Dr. Cash*	*30 000*	
	Cr. Rent revenue		*30 000*
	received cash as payment for January rent		

Now that we have recorded the transactions in the journals, we now proceed to the next phase of the accounting cycle, posting to the ledgers.

Transferring Movements to the Ledgers

We have encountered ledgers and journals for the first time in the previous chapter. There, we learned that journals record transactions in chronological order, while ledgers group movements caused by transactions on a per-account basis. Posting to the ledgers is akin to summarizing the movements (both increases and decreases) in each of the accounts, for the period being considered.

Posting consists of recording the date, an explanatory note, the cross-reference to the journal, the amount in either the debit or the credit column as appropriate, and an updated running balance of the account. Let us start with a less active account, notes payable.

Notes Payable **Account Code: 2400**

Date	Explanation	Ref.	Debits	Credits	Balance
06/02/14	to record purchase of building	-	-	5,000,000.00	(5,000,000.00)
12/22/14	signed a note for the purchase of furniture and fixtures	-	-	250,000.00	(5,250,000.00)

The ledger account for notes payable includes two credits both from 2014 at amounts 5 000 000 and 250 000, respectively. The June 2, 2014 entry to the ledger is the Credit "line" of that journal entry, reproduced as follows:

2014			
2 Jun	Dr. Building	12 350 000	
	Cr. Note payable		5 000 000
	Cr. Cash		7 350 000
	to record purchase of building		

Note that while segregated by account, the ledger still shows the movements in chronological order. Not listing the movements in chronological order might present problems especially for transactions that happen very close to the end of the reporting period

The following is a cash ledger, a much more active ledger account of Matalino Dormitory.

Cash Account Code 101

Date	Explanation	Ref.	Debits	Credits	Balance
01/01/14	contribution of capital to the business	-	9 000 000.00	-	9 000 000.00
05/12/14	payment for business registration fees	-	-	1 200.00	8 998 800.00
06/02/14	acquired a building and paid cost part in cash	-	-	7 350 000.00	1 648 800.00
09/03/14	printing cost of flyers and posters for promoting dorm	-	-	2 330.00	1 646 470.00
12/27/14	payment for attorney's fees for drafting lease contract	-	-	2 200.00	1 644 270.00

12/30/14	paid cash for building retrofitting and major repairs	-	-	150 000.00	1 494 270.00
12/31/14	paid cash for furniture in the dorm's common areas	-	-	150 000.00	1 344 270.00
01/02/15	purchased office supplies for cash	-	-	1 575.00	1 342 695.00
01/02/15	purchased computers for the office	-	-	36 900.00	1 305 795.00
01/02/15	paid cash for a 6-month fire insurance contract	-	-	6 000.00	1 299 795.00
01/05/15	received contract payments from dormers	-	30 000.00	-	1 329 795.00
01/05/15	received contract payments from dormers	-	30 000.00	-	1 359 795.00
		...			
12/31/15	paid salaries and wages for December	-	-	20 250.00	1 079 291.56

Preparing a Trial Balance

At any point in time, each of the accounts has a balance. As we have learned from previous chapters, the accounting identity has to be maintained all throughout the accounting cycle. If our accounting identity starts true (i.e., A+L+E), then the balances of our accounts at any point in time should also prove the accounting identity true, provided that we have followed the rules of debit and credit, and the dual-effect principle. If each one of our journal entries is balanced (i.e., the sum of the debits for each journal entry is equal to the sum of all credits), then if we take all accounts with debit balances and sum up their balances, this should be equal to the sum of all the balances of all accounts with credit balances. To prove that we have maintained the equality of the debits and the credits from a total perspective, we use a trial balance. The trial balance shows all accounts with their corresponding balances, segregated into debit and credit columns. All debit balances are then added up, and the same is done to the credit balances.

A trial balance is a diagnostic tool. It acts as a first line of defense against misrecordings (in the journal) and mispostings (in the ledger). Because the trial balance is supposed to prove the equality of the debits and the credits, an accountant who finds out that the trial balance does not show equal debits and credits should not proceed further into the accounting process until the error is corrected. However, it is important to note that a balanced trial balance is not a guarantee of perfect recording and posting. The following errors, when committed, will escape the guard of the trial balance.

1. Transaction is posted twice.
2. Transaction was posted to the wrong accounts.
3. Transaction is not posted.
4. Transaction is not journalized.
5. Errors offset each other.

In cases 1, 2, and 4, so long as the journal entries are in good form (equal debits and credits, following dual-effect principle and the rules of debit and credit), the trial balance would still balance. For case 2, so long as the amount was posted to the same side of the account (Dr. of one account erroneously posted as a Dr. of another account), the trial balance would still balance. Case 5 will happen when an over-debit because of an error is corrected or offset by an under-debit due to another separate error.

Here is the trial balance of Matalino Dormitory as of 31 December 2015. Notice that the amounts reported for cash and notes payable match the last row of the running balance column in the reproduced ledgers.

Account Code	Account Name	Debit Balances	Credit Balances
101	Cash	1 079 291.56	-
130	Office Supplies	9 119.75	-
131	Prepaid Insurance	6 000.00	-
143	Building	12 500 000.00	-

145	Furniture and Fixtures	400 000.00	-
150	Computers	36 900.00	-
206	Refundable Customer Deposits	-	30 000.00
212	Notes Payable	-	5 250 000.00
300	Owner's Capital	-	8 994 270.00
301	Owner's Drawings	10 000.00	-
611	Salaries and Wages Expense	243 000.00	-
621	Utilities Expense	343 958.69	-
630	Insurance Expense	6 000.00	-
406	Rent Revenue	-	360 000.00
Totals		**14 634 270.00**	**14 634 270.00**

THANKYOU FOR LISTENING