c) Matching Principle: It states that-

- "Let expenses follow revenues"
- Match (record) expenses to the revenues, which they helped generate.
- Match revenues and expenses to the time period benefited.

d) Full Disclosure Principle: It states that-

- To report what a reasonable person would need to know to make an informed decision.
- Disclosure may be achieved within the body of the financial statements, the notes to those statements, or as supplementary information
- Disclosure is not a substitute for proper accounting!

Constraints or Limitations of Accounting

a) Cost-Benefit Relationship: It states that-

- The cost of information to be provided should not outweigh the benefit derived.
- Costs and benefits are not always derivable, obvious or quantifiable.
- Sound judgment must be used.

b) Materiality: It states that-

- Relates to an item's importance to a firm's overall financial operations.
- An item must make a difference to be material and be disclosed.
- Materiality has both quantitative and qualitative characteristics.
  - Quantitative--Amount must be significant to be separately disclosed.
  - Qualitative--Transaction has selected characteristics that require close attention, disclosure. (For example, a forged check of a minimal amount has cleared the company's account. This would indicate internal control problems!)

c) Industry Practices: It states that-

- Peculiar nature of some industries and business concerns sometimes requires departure from basic theory.
- The financial statements shall not mislead a reader. If following "pure" accounting theory results in statements that are not comparable or consistent, not relevant or reliable then theory should be adjusted

d) Conservatism: It states that-

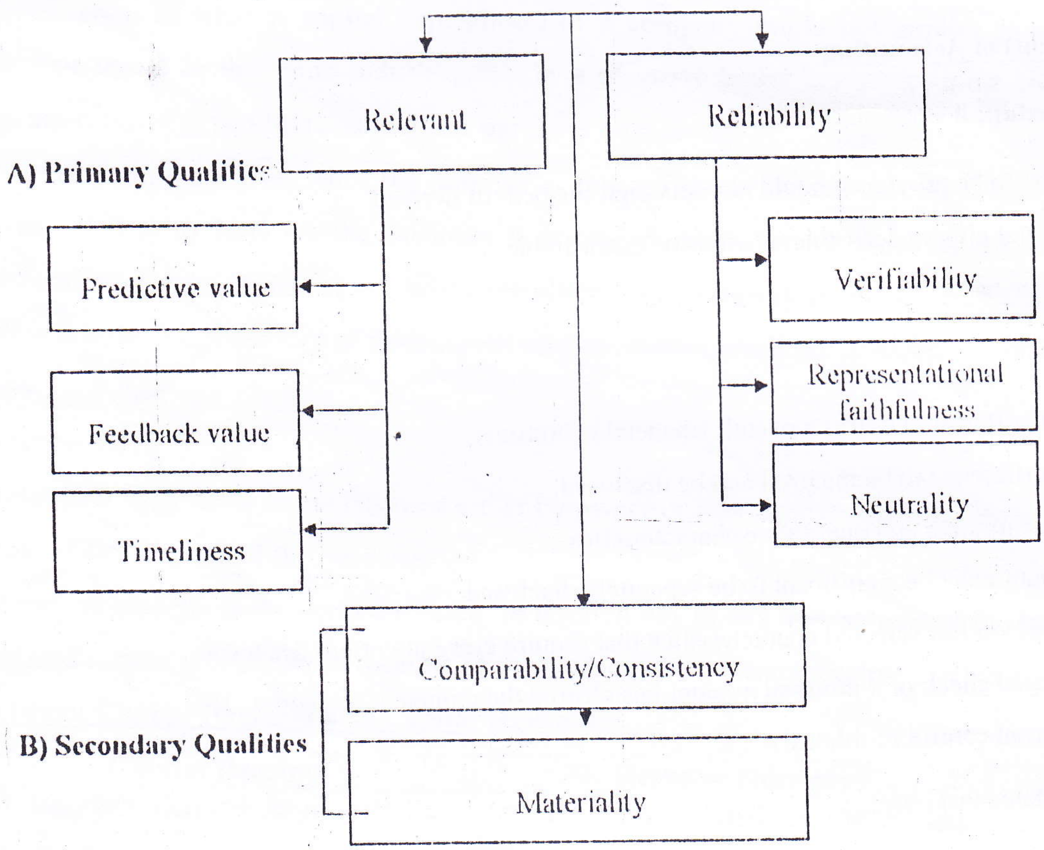
- If there is a range of equally acceptable values, select the alternative that will be least likely to overstate assets or understate liabilities.

Qualitative Characteristics of Accounting Information

Qualitative Characteristics of Accounting Information are those that help distinguish better (more useful) information from inferior (less useful) information. The understandability of accounting information depends on the following points.

- There must be a connection between users of information and the decisions they make.
- Users must be knowledgeable and information presented in a form, which users will understand and be able to employ appropriately.

Qualitative Characteristics of Accounting Information:



Primary Characteristics of Accounting Information

Primary Characteristics: Relevance and Reliability

Relevance: It states that the information should be-

- Capable of making a difference in a decision.
- Helpful in making predictions about ultimate outcomes of past, present and future events: 'Predictive value'.
- Helps users to confirm or correct prior expectations: 'feedback value'.

Contains the element of 'timeliness'. The information is available in time to influence a decision.

Reliability: It states that -

- Information can be relied on to represent the true, underlying situation to those who do not have the time or ability to verify it.
- 'Verifiability' is the ability to arrive at the same conclusion, given the same information, by independent evaluators or users.
- 'Representational faithfulness' is an important element of reliability in that it means the information represents what really existed or happened.
- 'Neutrality' is the characteristic that the information presented is free from bias. The information presented does not favor one party's interests over another.

Secondary Characteristics of Accounting Information

Secondary Characteristics are: Comparability and Consistency

Comparability: It states that-

- Information is more useful if it lends itself to comparison with similar information about another enterprise.
- Information is measured and reported in a similar manner for different enterprises.
- This characteristic allows users to identify real differences between enterprises, not those due to non-comparable accounting methods
- Allows for the allocation of resources to the areas of greatest benefit.

Consistency: It states that-

- This is achieved when an enterprise applies the same accounting principles in a similar manner from one period to the next.
- Accounting principles may be changed when it can be demonstrated the result would be preferable.

Basic Elements of Financial Statements

- **Assets:** Probable future economic events obtained or controlled by a particular entity as a result of past transactions or events.
- **Liabilities**: Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

- **Owner's Equity:** Residual interest in the assets of an entity that remains after deducting its liabilities.
- **Revenues:** Inflows or other enhancements of assets of an entity or settlement of its liabilities during a period from delivering or producing goods, rendering services, or other activities that constitute an entity's major, ongoing operations.
- **Expenses:** Outflows or other using up of assets or incurrence of liabilities during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing, major or central operations.
- **Gains:** Increases in net equity from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or investments by owners.
- **Losses:** Decreases in equity from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from expenses or distributions to owners.

Elements of Financial Statements

→ Income Statement

- Revenues
- Expenses
- Gains
- Loss

→ Balance Sheet

- Assets
- Liabilities
- Owner's Equity

Objective of Financial Reporting

Basic Objective of Financial Reporting is to provide information that is:

- Useful to those making investment and credit decisions.
- Directed at persons with a reasonable level of understanding of business and economic activities.
- Helpful to present and future investors, creditors in assessing future cash flows.
- About economic resources, the claims on those resources and changes in them.

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Imran

The Accounting Cycle

Accounting Cycle

In the process of accounting information system, accounting activities rotate in a similar way or follows the same procedure in each year .The sequence or process or steps maintained or followed by the accounting activities is called *'Accounting Cycle'*.

Steps in Account Cycle

The following steps are followed in the accounting cycle:

1. Source document collection and recording in Journal.
2. Classified posting into 'General Ledger'
3. Proving periodic arithmetical accuracy into 'Trial Balance'.
4. Adjusting General Ledger Accounts and preparation of Work Sheet.
5. Preparation of Final Financial Statement.
6. Analysis and interpretation of financial statements.

In every transaction the above-mentioned steps are followed. First the transactions are recorded in the Journal and classified them and posting into the ledger account. The third step is to check the arithmetical accuracy of the entries made through Trial Balance. In the fourth stage, adjusting entries are incorporated with the Trial Balance accounts and worksheet is prepared. And finally, various financial statements such as Income Statement, Cash Flow Statement, Retained Earnings Statements, and Balance Sheet etc. are prepared and analyzed. This entire process is called *'Accounting cycle'*.

Step 1: Identification and recording of transaction and other events into Journal.

The first step in the Accounting cycle is to record the transactions in the books of accounts. This process is called 'to record' into the journals books. The books are also called 'Book of original Entry' as transactions occur they are recorded first in the journal. Simply Journal can be defined as recordings of transactions in a set of books in a systematic way according to days. Before starting to record the transactions into the journal book, we will discuss about the **'Accounts.'** An account is simply a place where similar transactions and events, which occur during a particular period, are summarized and accumulated.

What is a Journal Entry in Accounting?

Journal entry is an entry to the journal. Journal is a record that keeps accounting transactions in chronological order, i.e. as they occur. Ledger is a record that keeps accounting transactions by accounts. Account is a unit to record and summarize accounting transactions. All accounting transactions are recorded through journal entries that show account names, amounts, and whether those accounts are recorded in debit or credit side of accounts.

Double-Entry Accounting

To record transactions in the books of accounts, accounting system uses double-entry accounting. Double-entry implies that transactions are always recorded using two sides, debit and credit. Debit refers to the left-hand side and credit refers to the right-hand side of the journal entry or account. The sum of debit side amounts should equal to the sum of credit side amounts. A journal entry is called "balanced" when the sum of debit side amounts equals to the sum of credit side amounts.

Classification of Accounts

Various types of accounts maintained in an accounting system can be grouped into three classes as follows:

1. **Personal Account:** Any person or organizations. Example: Mr. X's A/C, Bexim Co. Ltd. A/C.
2. **Real A/C:** any assets i.e. cash, bank, machinery, motorcar etc.
3. **Nominal A/C:** Nominal accounts are of two types:
   - **(a) Expense A/C:** Any expenses i.e. salary paid, commission paid etc.
   - **(b) Income A/C:** Any earnings or revenues i.e. interest earned, commission earned etc.

Debit & Credit:

The term 'Debit' & 'Credit' gives an accounting explanation of the mathematical changes in the individual accounts. There must be always equal increases and decreases for each and every transaction so that equality of the two sides of the accounting equation is maintained.

Golden Rules of Journal Entry:

1. In case of Personal Account: **Receiver-------Dr**

Donor------------Cr

Example: Mr. Hasan gives Tk.100 to Mr. Jaman. Here Mr. Hasan and Mr. Jaman both are personal A/C and Jaman is the receiver. So Jaman's A/C will be debited. On the other hand Hasan is the donor and his A/C will be credited.

Journal entry:

Mr. Jaman's A/C Dr 100

Mr. Hasan's A/C Cr 100

2. In case of Real Account: **Asset increases------Dr**

Asset decreases-------Cr

Example: Equipment purchased at a cost of Tk.1,00,000. Equipment is an asset for the organization. So it will be debited. On the other hand cash is also an asset for the organization. It will be decreased and will be credited.

Journal entry:

Equipment A/C Dr 1,00,000

Cash A/C Cr 1,00,000

3. Nominal Account:

(a) In case of Expense: **Expenses increases----Dr**

Expenses decreases ------Cr

(b) In case of Income or Revenue: **Income decreases-----Dr**

Income increases-------Cr

Example 1: Salaries paid Tk.10,000. Salaries are an expense for the organization and it will be debited. On the other hand salary is been paid in cash. Cash is an asset and it decreases so will be credited.

Journal entry would be:

Salaries A/C Dr. 10,000

Cash A/C Cr. 10,000

Example 2: Interest income Tk.5000. Interest is an income for the organization and will be credited. On the other hand income is earned in cash. So it will be debited.

Journal entry:

Cash A/C Dr. 5000

Interest income Cr. 5000

4. In case of Capital, Reserves, and Liabilities Accounts: Any decreases -----Dr

Any increase -----Cr

Example: Mr. Hasan invested tk.100, 000 in the business. Here cash is increased and on the other hand Capital is increased *(Anything given by the owner's to the business is the considered as the Capital of the business)*. So it will be credited.

Journal entry:

Cash A/C Dr.100, 000

Capital A/C Cr.100, 000

The Specimen Form of a General Journal:

Date	Particular	L.F.	Debit(Tk.)	Credit(Tk.)

Exercises on Journal

Exercise No. 1

Ahmed Nabi completed the following transactions during August of this current year:

Aug 1: Begin a Public Accounting practice by investing Tk 1500 in cash and office equipment having a fair value of Tk 1200.

Aug 1: Purchased office supplies Tk. 75 and office equipment Tk 250, from Rawsan Brothers on credit

Aug. 1: Paid three months rent in advance for office space, Tk 900.

Aug. 5: Completed accounting work for a client and collected Tk 6[illegible] cash from there

Aug. 11: Paid Rawsan Brothers Tk 125 of the amount owed for the items purchased on August 1.

Aug. 12: Paid the premium on insurance policy, Tk 375.

Aug. 15: Completed accounting work for Niloy Co. on credit. Tk 350

Aug. 20: Ahmed Nabi withdrew Tk100 from the firm for his personal expenses

Aug. 23: Completed Accounting work for Dinner Company on credit. Tk 200.

Aug. 25: Received Tk 350 from Niloy Co. for the work completed on August 15

Aug. 31: Paid the utility bills Tk 35.

***Required:* Prepare journal entries for the above transactions.**

Exercise No. 2

Listed below are the January transactions for Big Ben Clock Store, owned by Daud Hyder:

Jan. 1 Invested Tk.70,000 cash and equipment with a book value of Tk.28,000.

3 Paid first month's rent, Tk.7,000.

4 Purchases for cash Tk. 30000

5 Cash sales, Tk.14,000.

7 Purchased supplies on account, Tk.3,250.

8 Sold a clock on account, Tk.9,000.

9 Paid wages, Tk.2,750.

11 Purchased equipment, Tk.5,500 cash.

12 Cash sales, Tk.27,000.

15 Purchased equipment on account, Tk.4,000.

17 Paid for advertising, Tk.3,250.

19 Daud Hyder withdrew Tk.5,000 from the business.

21 Collection from customers Tk. 5,000.

23 Paid Tk 4,000 on account from Jan. 15 transaction.

28 Paid wages, Tk.3,250.

29 Sold clock on account, Tk.3,450.

30 Purchased merchandise for resale on account, Tk.32,000.

***Requirement:* Journalize the above transactions into Journal.**

Recording Transactions into the Journal

Illustration 1

Journalize the following transactions of Mr. Belal's business:

Jan.	4	Mr. Belal invested Tk.50,000 in his law practice
	4	Bought supplies for cash, Tk.3,000
	4	Bought equipment from Aotobi Furniture Company on Account, Tk.25,000
	15	Received Tk.20,000 in fess earned during the month
	30	Paid office rent for January, Tk.5,000
	30	Paid salary for part-time help, Tk.2,000
	31	Paid Tk.10,000 to Aotobi Furniture Company, on account
	31	After taking an inventory, Mr. Belal found that he had used Tk.2,000 worth of supplies
	31	Withdrew Tk.3,000 for personal use

Solution to Illustration 1

General Journal

Date	Description	P.R.	Debit Tk.	Credit Tk.
19X3				
Jan. 4	Cash		50,000	
	Belal, Capital			50,000
	(Investment in law practice.)			
4	Supplies		3,000	
	Cash			3,000
	(Bought supplies in cash.)			
4	Equipment		25,000	
	Accounts Payable			25,000
	(Bought equipment from Aotobi.)			
15	Cash		20,000	
	Fees Income			20,000
	(Received payment for services)			
30	Rent Expense		5,000	
	Cash			5,000
	(Paid rent for the month of Jan.)			
30	Salaries Expense		2,000	
	Cash			2,000
	(Paid salaries for part-time help.)			
31	Accounts Payable		10,000	
	Cash			10,000
	(Payment on account of Aotobi.)			
31	Supplies Expense		2,000	
	Supplies			2,000
	(Supplies used during the month.)			
31	Belal, Drawings		3,000	
	Cash			3,000
	(Personal withdrawal.)			

Illustration 2

Abraham started a business on 1st April, 2002 with Plant and Machinery Tk.40,000; Furniture Tk.10,000; Building Tk.50,000; and Cash Tk.80,000. Journalize the following transactions for the month of April:

2002			
April	1	Purchased goods for cash from Ronals	Tk.35,000
	4	Purchased goods from Nick	Tk.40,000
	7	Sold goods for cash	Tk.70,000
	12	Cash deposited into Bank	Tk.80,000
	14	Purchased Machinery for cash	Tk.10,000
	15	Sold goods to Jones	Tk.30,000
	16	Returned goods to Nick	Tk.2,000
	18	Paid to Nick by cheque	Tk.20,000
	20	Withdrew from Bank for personal use	Tk.10,000
	25	Received cheque from Jones and deposited into Bank	Tk.20,000
	25	Paid salary for the month of April	Tk.5,000
	30	Received Bank interest	Tk.400
	30	Purchased Stationery for cash	Tk.1,000

Solution to Illustration 2

General Journal

Date	Account Titles and Explanation	Ref.	Debit (Tk.)	Credit (Tk.)
2002				
April 1	Plant and Machinery		40,000	
	Furniture		10,000	
	Building		50,000	
	Cash		80,000	
	Abraham, Capital			1,80,000
	(Invested Plant and Machinery, Furniture, Building and Cash in business)			
1	Purchase		35,000	
	Cash			35,000
	(Goods purchased in cash)			
4	Purchase		40,000	
	Accounts Payable-Nick			40,000
	(Credit purchase of goods from Nick)			
7	Cash		70,000	
	Sales			70,000
	(Cash sales of goods)			

Date	Account Titles and Explanation	Ref.	Debit (Tk.)	Credit (Tk.)
12	Bank		80,000	
	Cash			80,000
	(Cash deposited into Bank)			
14	Plant & Machinery		10,000	
	Cash			10,000
	(Machinery purchased for cash)			
15	Accounts Receivable- Jones		30,000	
	Sales			30,000
	(Credit sales of goods to Jones)			
16	Accounts Payable- Nick		2,000	
	Return Outwards			2,000
	(Goods returned to Nick)			
18	Accounts Payable- Nick		20,000	
	Bank			20,000
	(Nick paid by cheque)			
20	Abraham, Drawings		10,000	
	Bank			10,000
	(Withdrew cash from bank for personal use)			
25	Bank		20,000	
	Accounts Receivable- Jones			20,000
	(Cheque received from Jones and paid into the bank)			
25	Salary		5,000	
	Cash			5,000
	(Paid Salary for the month of April)			
30	Bank		400	
	Interest Revenue			400
	(Bank interest credited by bank)			
30	Stationery		1,000	
	Cash			1,000
	(Stationery purchased in cash)			

Exercise No. 2

Listed below are the January transactions for Big Ben Clock Store, owned by Daud Hyder:

Jan. 1 Invested Tk.70,000 cash and equipment with a book value of Tk.28,000.
3 Paid first month's rent, Tk.7,000.
4 Purchases for cash Tk. 30000
5 Cash sales, Tk.14,000.
7 Purchased supplies on account, Tk.3,250.
8 Sold a clock on account, Tk.9,000.
9 Paid wages, Tk.2,750.
11 Purchased equipment, Tk.5,500 cash.
12 Cash sales, Tk.27,000.
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19 Daud Hyder withdrew Tk.5,000 from the business.
21 Collection from customers Tk. 5,000.
23 Paid Tk.4,000 on account from Jan. 15 transaction.
28 Paid wages, Tk.3,250.
29 Sold clock on account, Tk.3,450.
30 Purchased merchandise for resale on account, Tk.32,000.

Journalize the above transactions in the books of Big Ben Clock Store.

Exercise No. 3

Journalize the following transactions of Mr. Belal's business for the month of January 2009:

Jan. 4 Mr. Belal invested Tk.50,000 in his law practice
4 Bought supplies for cash Tk.3,000.
4 Bought equipment from Altway Furniture Company on Account Tk.25,000.
15 Received Tk.20,000 in fess earned during the month
30 Paid office rent for January Tk.5,000.
30 Paid salary for part-time help Tk.2,000.
31 Paid Tk.10,000 to Altway Furniture Company on account.
31 After taking an inventory Mr. Belal found that he had used Tk.2,000 worth of supplies.
31 Withdrew Tk.3,000 for personal use

GENERAL LEDGER AND TRIAL BALANCE

Ledger is a book where individual accounts are maintained separately. It is the most important book of accounts, because it includes all the summaries of transactions. Therefore, it is called the 'principal book' of all the books of accounts. It forms a permanent record of the financial transactions of a firm.

The specimen form of a General Ledger is giver below:

Dr. **Accounts Name** **Cr.**

Date	Particulars	Jounal Folio	Amount (Tk)	Date	Particulars	Jounal Folio	Amount (Tk)

Exercise

Mr. Paul is a licensed architect. During the first month of operation of his business, the following events and transactions occurred.

April	1	Invested Tk.150,000 cash.
	1	Hired a secretary-receptionist at a salary of Tk.3,000 per week payable monthly.
	2	Paid office rent for the month, Tk.8,000.
	3	Purchased architectural supplies on account from Bulu Company, Tk.15,000.
	10	Completed blueprints on a carport and billed client Tk.9,000 for services.
	11	Received Tk.5,000 cash advance from Md. Rahim for the design of a new home.
	20	Received Tk.15,000 cash for services completed and delivered to Mr. Bhatia.
	30	Paid secretary-receptionist for the month, Tk.12,000.
	30	Paid Tk.6,000 to Bulu Company on account.

Instructions

(a) Journalize the transactions.

(b) Post to the ledger accounts.

(c) Prepare a trial balance on April 30, 1999.

Normal Balances of Accounts

- Accounts have normal balances on the side where the increases in such accounts are recorded.
- Asset accounts have normal balances on debit side.
- Expense accounts have normal balances on debit side.
- Liability accounts have normal balances on credit side.
- Equity accounts have normal balances on credit side.
- Revenue accounts have normal balances on credit side.
- On the financial statements, accounts are reported on the sides where they have normal balances.
- Liability accounts have normal balances on credit side.
- Equity accounts have normal balances on credit side.

Trial Balance

Under double entry system, for every debit entry there is a corresponding credit entry of the same amount. Consequently, the total amount of all the debit entries should be equal to the total of all credit entries. In order to verify, whether the two totals are equal, a statement is prepared periodically showing the debit items in one column and the credit items in another. This statement is called the "Trial Balance".

There are two methods of preparing a trial balance- (1) Trial Balance prepared with the gross totals of the debit and credit sides of each ledger account and (2) Trial Balance prepared with the balance of each account. When both gross amounts and balances of the accounts are shown in the trial balance it becomes a third method and it is called a mixed Trial Balance. In actual practice, the first and the third methods are used very rarely while the second method is used generally.

Errors cannot be detected by Trial Balance

Different classes of errors that may exist in spite of the agreement of the Trial Balance are discussed below:

(a) *Errors of Omission:* Such an error arises when any transaction is either wholly or partially unrecorded in the in the books. In the former case, the trial balance will not be affected, and thus the error will be more difficult to detect. Where only one aspect of a transaction is recorded, the omission will throw the Trial Balance out of agreement.

(b) *Errors of Commission:* Errors of commission arise when transactions are incorrectly recorded, either wholly or partially. In the former case the Trial Balance will not the trial balance out of agreement to that extent.

incorrect posting, or a mistake in casting or the transposition of figures ... wrong account. Unless the error affects the debit and credit equally, the incorrect posting and mistakes in casting will cause the trial balance to be out of the agreement. Posting to the wrong account but on correct side, however, will not affect the agreement of the Trial Balance.

(d) ***Errors of Principle:*** An error of principle arises by reason of a transaction being recorded in a fundamentally incorrect manner. Certain errors of principle may not affect the ultimate profit, but it may cause a revenue item being posted to wrong revenue account. Major errors of principle directly affect profit. They may be caused by treating a revenue item as an asset or liability, or vice versa. These errors will not throw the trial balance out of agreement.

(e) ***Compensating Errors:*** A compensating error is one, which is counter balanced by another error or errors of the same amount either in the same account or other accounts. Such error will not cause the Trial Balance to disagree.

Above discussion made it clear that a Trial Balance may agree in spite of the presence of some errors mentioned above. Hence an agreed Trial Balance cannot be regarded as a conclusive evidence of the correctness of the books of accounts, rather it may be regarded as a prima facie proof that the posting are arithmetically correct.

Rules Regarding Trial Balance

The following rules are followed in solving a Trial Balance-

1. All assets are recorded in the Debit side
2. .All the expenses are recorded in the Debit side
3. All revenues are recorded in the Credit side
4. Capital, liabilities and Reserves are recorded in the Credit side

6

MD. ABDULLAH-AL-ZUBAER
B.Sc. Engg, CSE, RUET
ROLL NO ; 073001 SEM ; 3

Trial Balance

Trial Balance

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- **(b) *Errors of Commission:*** Errors of commission arise when transactions are incorrectly recorded, either wholly or partially. In the former case the Trial Balance will not the trial balance out of agreement to that extent.
- **(c) *Clerical Errors:*** A clerical error is a form of error of commission. It may consist of an incorrect posting, or a mistake in casting, or the transposition of figures, or posting to the wrong account. Unless the error affects the debit and credit equally, the incorrect posting and mistakes in casting will cause the trial balance to be out of the agreement. Posting to the wrong account but on correct side, however, will not affect the agreement of the Trial Balance.
- **(d) *Errors of Principle:*** An error of principle arises by reason of a transaction being recorded in a fundamentally incorrect manner. Certain errors of principle may not affect the ultimate profit, but it may cause a revenue item being posted to wrong revenue account. Major errors of principle directly affect profit. They may be caused by treating a revenue item as an asset or liability, or vice versa. These errors will not throw the trial balance out of agreement.
- **(e) *Compensating Errors:*** A compensating error is one, which is counter balanced by another error or errors of the same amount either in the same account or other accounts. Such error will not cause the Trial Balance to disagree.

Above discussion made it clear that a Trial Balance may agree in spite of the presence of some errors mentioned above. Hence an agreed Trial Balance cannot be regarded as a conclusive evidence of the correctness of the books of accounts, rather it may be regarded as a prima facie proof that the posting are arithmetically correct.

Rules Regarding Trial Balance

The following rules are followed in solving a Trial Balance-

1. All assets are recorded in the Debit side
2. All the expenses are recorded in the Debit side
3. All revenues are recorded in the Credit side
4. Capital, liabilities and Reserves are recorded in the Credit side

Examples:

1. From the following balances of accounts prepare a Trial Balance as at 31st December 1991:

Particulars	Tk	Particulars	Tk
Opening Stock Dr	41,000	Bad Debts Dr	600
Purchases Dr	1,10,000	Sales Cr	1,80,000
Drawings Dr	18,000	Sundry Debtors Dr	14,000
Sales Return Dr	6,000	Fixed Assets Dr	35,000
Wages Dr	5,400	Creditors Cr	62,500
Salaries Dr	9,000	Cash Dr	8,200
Travelling Dr	950	General Expenses Dr	1,200
Rent, Rates and Taxes Dr	2,400	Advertisements Dr	900
Purchase Returns Cr	1,500	Capital Cr	8,750
Interest Paid Dr	1,200	Investments Dr	3,500
Discount Allowed Dr	800	Bank Overdraft Cr	5,000
Insurance Charges Dr	600	Commission Received Cr	1,000

On 31st December 1991 Closing Stock was valued at Tk 16,000.

Solution:

Trial Balance

as at 31 December, 1991

Accounts	L.F.	Debit (Tk)	Credit (Tk)
Opening Stock		41,000	
Purchases		1,10,000	
Drawings		18,000	
Sales Returns		6,000	
Wages		5,400	
Salaries		9,000	
Traveling		950	
Rent, Rates and Taxes		2,400	
Purchase Returns			1,500
Interest Paid		1,200	
Discount Allowed		800	
Insurance Charges		600	
Bad Debts		600	
Sales			1,80,000

Sundry Debtors		14,000	
Fixed Assets		35,000	
Creditors			62,500
Cash		8,200	
General Expenses		1,200	
Advertisements		900	
Capital			8,750
Investments		3,500	
Bank Overdraft			5,000
Commission Received			1,000
Total		**2,58,750**	**2,58,750**

Note: Closing Stocks are not included in the Trial Balance

2. **Problems 1:**

From the following balances of accounts prepare a Trial Balance as at 31st July2000:

Accounts	**Tk**
Capital Cr	8,900
Drawings Dr	1,000
Stock (1.7.1999) Dr	3,700
Purchases Dr	23,125
Sales Cr	39,400
Motor Vehicles Dr	1,450
Cash in hand Dr	135
Sundry Creditors Cr	4,976
Sundry Debtors Dr	13,970
Bank Overdraft Cr	900
Wages and Salaries Dr	6,200
Lighting and Heating Dr	315
Equipment Dr	3,500
Carriage Outward Dr.	231
Return Inwards Dr	205
Provision for Bad Debts Cr	425
Returns Outward Cr	316
Discount Allowed Dr	280
Discount Received Cr	315
Rent, Rates and Insurance Dr	1,121

❖ Answer: Total of the Debit and Credit are **Tk 55,232.**

Notes:

1. Stock (1.7.1999) is the Opening Stock
2. 'Provision for Bad Debts' is a liability
3. Discount Allowed is an expense
4. Discount Received is a revenue

3. Problem no.: 2

The accounts in the ledger of ***Nandan Park Inc.*** are listed in alphabetical order as follows. All accounts have normal balances. The balance of the cash account has been intentionally omitted.

4,79,040
4,74,050

Accounts Payable Cr	Tk 18,750	Cr
Dr Accounts Receivable	Tk 20,500	
Capital Stock Cr	Tk 50,000	Cr
Dr Cash	?	4990
Dividends, Cr	Tk 20,000	
Fees earned Cr	Tk 3,15,000	Cr
Dr Insurance Expense	Tk 5,000	
Dr Land	Tk 1,25,000	
Dr Miscellaneous Expense	Tk 9,900	
Notes Payable Cr.	Tk 35,000	Cr
Dr Prepaid Insurance	Tk 3150	
Dr Rent Expense	Tk 58,000	
Retained Earnings Cr	Tk 60,290	Cr
Dr Supplies	Tk 4,100	
Dr Supplies Expense	Tk 5,900	
Dr Unearned Rent	Tk 6,000	
Dr Utilities Expense	Tk 41,500	
Dr. Wages Expense	Tk1,75,000	

Prepare a Trial balance, listing the accounts in their proper order and inserting the missing figure for cash.

Contra Account:

Capital → Drawings
Assets → Depreciation
Sales → Sales Return (Return inward)
purchase → purchase Return (Return outward)

Adjusting and Closing Entries

Why and when are Adjustments Made?

Adjustments are generally made at the end of an accounting period to consider some items with a view to assess the correct operational result i.e., profit or loss and to project a true and fair view of the state of affairs of an enterprise. Point-wise objectives of adjustment entries are as follows:

1. **Periodicity:** Adjusting entries are needed whenever transactions affect the revenue or expense of more than one accounting period.

For example: insurance premium paid for 3 years recorded as 'Prepaid insurance' .At the end of the year 1, one years insurance premium expired and shown as 'Insurance expense' one third of the amount and the rest two third shown as 'Prepaid insurance'.

2. **Proper matching of cost and revenue:** The accrual basis of accounting recognizes revenue when sales are made or services are rendered even though cash is not yet received. Expenses are recognized as incurred regardless of whether or not cash is paid.

3. **To consider dues and/or outstanding expenses:** If an item of expenditure does not represent full period's amount or in other words a portion of the expense remains to be paid for the period elapsed then it does require to add up the amount yet to be paid. Journal entry required for outstanding expenses is:

Relevant Expense A/C Dr.

To, Outstanding Expense A/C

4. **Deferral and accrual accounting:** A deferral is a postponement of the recognition of an expense already paid or of revenue already received.

For example: Rent income received 24,000 Tk. for two years in January 1.At the end of the first year it would not be feasible to record Tk.24,000 as income for that year. It should record Tk. 12,000 as income for that year and Tk.12,000 as advance income received (liability) for that year.

Journal:

January 1. Cash a/c Dr. 24,000

To, Rent income 24, 000

Dec .31

Rent income Dr.12, 000

To, Unearned Rent (liability) Cr.12, 000

5. **Accurate operational result and reasonable valuation of assets:** Accounting works as an information system and its primary objective is to provide accurate and valid information to its uses. Adjustment entries make accounting figures correct and thus helps users of accounting information to rationalize their decisions making.

Examples:

1. In the Trial Balance there is a Consumable Supply Expenses (Dr balance) of Tk. 3,000. In the adjustment it is said that there is a Stock of Consumable Supplies at the end of the period Tk.1, 800. To adjust the thing the following journal entry is needed:

Dec.31. Stock of Consumable Supplies Dr. 1,800

To Consumable Supply Expenses 1, 800

We assume that at the time of procuring supply, we recorded the supply as 'supply Expenses'. But when Supplies are treated or recorded as an 'Asset' the entry would be different. For example, in the T/B Supplies Stock has a Dr. Balance of Tk. 10,000. And actual physical count at the end of the year shows Tk. 3,000 of Supplies on Hand. To adjust or consider the case, the following journal entry is needed:

Dec 31. Supplies Expense Dr.7, 000

To, Supplies Stock/Supplies Inventory/Supplies on Hand 7,000

2. Depreciation to be charged on Equipment @ 10% on Tk. 40,000. To adjust the item, following journal entry is needed:

Dec 31. Depreciation Expenses Dr. 4,000

To, Accumulated Depreciation –Equipment 4,000

OR, A Company purchased a Motor Car at a cost of Tk.1,00,000 which ca be used for an estimated life of 10 years with a salvage value of Tk. 20,000.

Calculation of Annual Depreciation: Cost of Motor Car =Tk.1, 00, 000

(-) Salvage value =Tk. 20,000

Depreciable Value=Tk. 80,000

Therefore, annual Depreciation of the Car would be Tk. 8000 i.e., (Tk.80, 000/10 years). To consider the annual depreciation of the Motor Car, the following journal entry is needed:

Deprecation Expenses Dr. 8,000

To, Accumulated depreciation-Motor Car 8,000

3. Prepaid Insurance in the T/B Tk 3,000(for three years.); adjusting it at the end of the first year the following journal entry is needed:

At the end of year 1: Insurance Expense Dr. 1,000

To, Prepaid Insurance 1,000

But if the item was recorded as an expense item, the adjustment entry would be as follows:

At the end of year 1: Prepaid Insurance Dr. 2,000

To, Insurance Expense 2,000

4. Accounts Receivable of a company shows a balance of Tk. 12,000 in the T/B. it is also estimated that 5% of Accounts Receivable is uncollectible.

*Calculation of estimated uncollectible accounts= (12,000*5%) = Tk. 600*

To adjust the Accounts Receivable account and consider the thing the following journal entry is needed:

Bad Debt Expenses /Uncollectible Accounts Dr. 600

To, Allowance for Doubtful Accounts 600

5. A Company invests an amount in Fixed Deposit Account. Interest is received twice a year on May 1 and November 1 in the amount of Tk.1,200 on each date. Pass entry at the closing date of December 31, 2002.

Adjusting entry:

Dec. 31, 2003 Interest Receivable Dr. 400

To, Interest Income 400

[(1200*2/6) = Tk 400]

6. A company let out a property at a monthly rental of Tk. 300 on 10th December, 2000. Pass the entry on the calendar year closing date.

Adjusting entry:

Dec 31,2000: Rent Receivable Dr. 200

To, Rent Income 200

7. Wages paid for four weeks of December at Tk. 2,000 per week but the wages for the last three working days accrues at the year-end closing date.

Adjusting entry:

Dec 31. Wages expense Dr. 1,000

To, Wages Payable 1,000

Note: to record one half of a weeks wages

8. Rent received in advance for three years Tk. 3,000 on January 1 and the entry was:

January 1: Cash A/C Dr. 3,000

Unearned Rent Cr. 3,000

(To record the rent received in advance)

At the end of the first year the adjusting entry would be:

Dec 31. Unearned Rent Dr. 1,000

To, Rent Income 1,000

(To record portion of advance earned in current year)

Problem 1:

Selected accounts of City Real Estate are shown below as of December 31, 2003, of the current year before any adjustment:

Particulars	Dr	Cr.
Prepaid Insurance	2,700	
Supplies on Hand	750	
Office Equipment	8,400	
Unearned Rental Fees		3,000
Salaries Expenses	2,100	
Rental Fees Earned		12,000

Based on the following information, pass the necessary adjusting entries on December 31:

(a) Prepaid insurance represents premiums for 3 years paid on January 1

(b) Supplies of Tk. 450 were on hand at December 31

(c) Office Equipment is expected to last 10 years.

(d) The firm collected 6 months rent in advance on January 1 from a tenant Tk 500 per month

(e) Accrued salaries not recorded as of December 31 are Tk. 360

CLOSING ENTRY

Closing entries are made after adjustment of different accounts and are required to close all the temporary accounts (nominal accounts) at the end of a particular accounting period or at the end of a fiscal year. The following closing entries are needed to close the nominal accounts:

1. To close the Revenue:

Sales a/c Dr

Interest income a/c Dr

Dividend income a/c Dr

Gain on sale of asset a/c Dr

To, Income Summary/ Profit and Loss Account

2. To close the Expenses:

Income Summary/ Profit and Loss Account Dr

To, Purchase a/c

To, Wages a/c

To, Salaries a/c

To, Depreciation a/c

To, Interest expense a/c

3. ***To record the profit:***

Income Summary/ Profit and Loss Account Dr

To, Capital A/C or Retained Earnings

4. ***To record the loss:***

Capital A/C or Retained Earnings Dr

To, Income Summary/ Profit and Loss Account

5. ***To transfer the dividends declared:***

Retained Earnings Dr

To, Dividends Paid A/C

Financial Reporting and Financial Statements

Businesses communicate accounting information to the external users through a process known as financial reporting. Financial reporting is a process through which companies communicate financial information to the public. Financial statements are the basic means of communicating the information to those who use it. The elements of financial statements provide ".information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change resources and claims to those resources", including ".information about an enterprise's performance provided by measures of earnings and its components". The four general-purpose financial statements are the following:

- Income Statement
- Statement of Changes in Equity
- Balance Sheet
- Statement of Cash Flows

- An **Income Statement** presents revenues and expenses and resulting net income or loss for a period of time. An income statement is also called Statement of Operations, Earnings Statement, or Profit and Loss Statement (P/L).
- A **Statement of Changes in Equity** shows all changes in owner's equity for a period of time. This statement is also called Owners' Equity Statement.
- A **Balance Sheet** presents assets, liabilities and owner's equity at a specific date. A balance sheet is also called Statement of Financial Position.
- A **Cash Flow Statement** summarizes information about cash outflows (payments) and inflows (receipts). This statement may also include certain information not related to actual cash flows.

Objectives of Financial Reporting

The objectives of financial reporting are summarized in the following excerpts:

1. Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
2. Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans.
3. Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change

resources and claims to those resources.

4. Financial reporting should provide information about an enterprise's financial performance during a period. The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components.
5. Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency.
6. Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it.
7. Financial reporting should provide information that is useful to managers and directors in making decisions in the interests of owners.

Elements of Financial Statements of Business Enterprises

Elements of financial statements are the building blocks with which financial statements are constructed—the classes of items that financial statements comprise. The items in financial statements represent in words and number certain enterprise resources, claims to those resources, and the effects of transactions and other events and circumstances that result in changes in those resources and claims. The Statement of Financial Accounting Concept defines 10 interrelated elements that are directly related to measuring performance and status of an enterprise.

1. **Assets** are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
2. **Liabilities** are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
3. **Equity** is the residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.
4. **Investments by owners** are increases in net assets of a particular enterprise resulting from transfers to it from other entities of something of value to obtain or increase ownership interests (or equity) in it. Assets are most commonly received as investments by owners, but that which is received may also include services or satisfaction or conversion of liabilities of the enterprise.
5. **Distributions to owners** are decreases in net assets of a particular enterprise resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners. Distributions to owners decrease ownership interests (or equity) in an enterprise.
6. **Revenues** are inflows or other enhancements of assets of an entity or settlements of its