Basics of bookkeeping

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First edition

Noordhoff Uitgevers

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Introduction

Basics of bookkeeping has been written to meet the needs of accounting students and practitioners in understanding the complexities of bookkeeping.

Because some knowledge of bookkeeping and a basic understanding of the balance sheet, income statement and cash flow statement are indispensable to an education in business economics, the principles of accounting are discussed in this book. After a brief study in elementary accounting, the user of this book can without problems start studies such as cost accounting, financial accounting and financial management. Apart from students, the book is also useful for practitioners without a financial background, because of the concise approach.

In the book we use both American and British terminology. The following list shows the equivalent terms in American and British language.

American term	**British term**
cash	bank, petty cash
accounts receivable	debtors
accounts payable	creditors
inventories	stock
note payable	bank loan
net income	profit

The book provides a practical approach. Each new topic will be followed by simple examples. And especially in the first two chapters, the user can immediately start with Problems for review. For the concepts used we refer as much as possible to IFRS.

Outline of the book
The "accounting cycle" is discussed in Chapter 1. The ultimate goal of this cycle is the construction of the income statement and the balance sheet. The income statement or Profit and Loss Account (P&L) shows the revenues and costs over the past period. The balance sheet provides a snapshot of the company's assets on the one hand and the company's equity and liabilities on the other.
Chapter 2 deals with special issues of the accounting cycle like correcting entries, the closing and opening of ledger accounts and value added tax.
In Chapter 3 we discuss accrual accounting. In accrual accounting the effects of all financial transactions are recognized in the accounting periods when they occur, rather than when cash or its equivalent is received or paid. Financial statements prepared on the accrual basis inform users not only of past transactions involving the receipt and payment of cash but also of

obligations to pay cash in the future and of amounts owing to the entity in the form of receivables.
Chapter 4 explains the administration of fixed and current assets. After completing this part, you should be able to understand the various assets of a business and how to account for them.
In Chapter 5 we identify the characteristics of the most commonly used forms of enterprises. We discuss the sole proprietorship, the partnership and the corporation with limited liability. Regarding the different forms of enterprise we will use the same format to discuss each of the categories of enterprises. The format includes the start-up or founding of the enterprise, the development of owner's equity and the appropriation of profits.
In Chapter 6 we discuss the credit side of the balance sheet. We cover the administration of a private loan, a bond loan, and convertible bonds. With regard to the different forms of debt, entries are covered regarding the moment of issuing a loan, the interest costs, the repayment (or redemption) of a loan and (in case of a convertible bond loan) the conversion of the loan into shares.
In Chapter 7 several types of provisions used by firms are discussed. Frequently used provisions are provisions against assets (accounts receivable and goods that cannot be sold); maintenance; and warranties. We distinguish the static model and the dynamic model and explain these models with several of the provisions.
Chapter 8 deals with the third financial statement of the annual report: the cash flow statement. The income statement provides a measure of the firm's profit over a given period of time. However, it does not indicate the amount of cash the firm has earned. The cash flow statement of the firm utilizes the information from the income statement and balance sheet to determine how much cash the firm has generated by its operations and from financing activities, and how the cash has been allocated during a set period.

The authors hope this book meets the needs and wishes of all users. Any comments or suggestions are warmly welcomed.

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1 The accounting cycle

The most crucial topic of this book is the topic of this chapter: the “accounting cycle” or “bookkeeping cycle”. The ultimate goal of this cycle is the construction of the income statement and the balance sheet. The income statement or Profit and Loss Account (P&L) shows the revenues and costs over the past period. The balance sheet provides a snapshot of the company’s assets on the one hand and a company’s equity and liabilities on the other.

The order of the steps in the accounting cycle are: i) the opening balance sheet, this is the starting point of the cycle, ii) recording of the financial events and transactions via journal entries in the journal, iii) posting the journal entries from the journal to the general ledger, iv) preparing the worksheet in order to produce the financial statements, i.e. the v) income statement and the closing balance sheet.[1]

Before we discuss the different steps of the accounting cycle we first introduce and clarify the basic assumptions on which the accounting cycle is based and the accounting equation.

1 Given the income statement and balance sheet, firms construct the cash flow statement.

1

1.1 Accounting assumptions

The assumptions are the 1) entity or business entity assumption, 2) the accrual basis of accounting assumption, 3) the going concern or continuity assumption and 4) the measurement assumption.

Entity or business entity assumption

One of the basic assumptions in accounting is that the firm is seen as an entity which assumes an independent position in relation to its environment (*entity or business entity assumption*). We draw boundaries around each entity so as not to confuse its affairs with those of other entities.

Consider a firm called "Wasneeplus Lawn Service". Assume Benjamin Wasneeplus started with €1,000 in cash. Assume he borrowed the money from a bank and invested it in the firm. Following the entity principle, Benjamin would present the assets and liabilities of his firm separately from his personal assets (such as clothing and car) and liabilities. To mix the €1,000 of firm's cash with his personal assets would make it difficult to measure the success or failure of Wasneeplus Lawn Service. The same applies for the liabilities.

Accrual basis of accounting assumption

The second assumption, *the accrual basis of accounting assumption* states that the effects of all transactions and other events are recognised in the accounting records when they occur, rather when cash or its equivalent is received or paid. Financial statements prepared on the accrual basis inform users not only of past transactions involving the receipt and payment of cash but also of obligations to pay cash in the future and of amounts owing to the entity in the form of receivables.

Going concern or continuity assumption

Another basic assumption of the accounting cycle is the going concern assumption. Under *the going concern* or *continuity assumption*, a business is assumed to continue operating long enough to meet its contractual commitments and plans. If a firm was not expected to continue, for example, due to the likelihood of bankruptcy, then its assets and liabilities should be valued and reported on the balance sheet as if the company were to be liquidated (that is, discontinued, with all of its assets sold and all debts paid).

Measurement assumption

Paragraph 99 of the *Framework*[2] says that the measurement assumption is "the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and income statement". This assumption enables accounting to measure economic events.

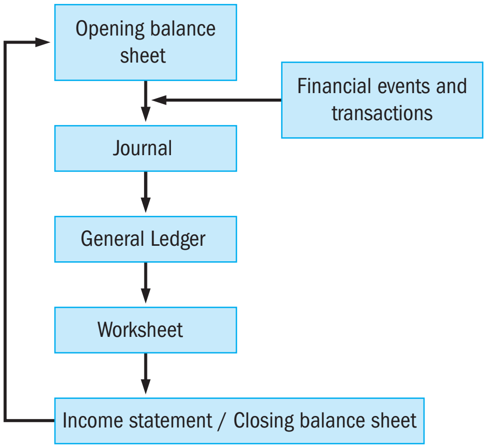
1.2 The accounting equation

Accounting equation

The accounting equation shows the relationship of assets, liabilities and equity. The equation provides the underlying framework for the accounting cycle (see Figure 1.1).

2 "The IFRS Framework describes the basic concepts that underlie the preparation and presentation of financial statements for external users." See http://www.iasplus.com/en/standards/standard4.

Figure 1.1 The accounting cycle



By adding up what belongs to a firm (the assets) and deducting what the firm owes (the liabilities), you can determine the owner's equity or capital. Financial accounting is based on this very simple idea. It is known as the accounting equation that applies to all economic entities. The equation provides the underlying framework for recording and summarizing economic events.
The relationship among assets, liabilities and owner's equity may be stated as follows:
Assets = Liabilities + Owner's Equity
or
Owner's Equity = Assets – Liabilities

Assets Assets are, according to the Framework of International Accounting Standards Board (IASB), resources controlled by the entity as "a result of past events and from which future economic benefits are expected to flow to the entity" and in the current Framework a liability is defined as "a present obligation of the entity arising of resources from the past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits". **Liability**

In example 1.1 we show the accounting equation of a retailer.

Example 1.1 The accounting equation

The accounting equation of Gert Tolkamp, who is a retailer in jeans (for the brand "Doggy Bag"), shows as of January 1, 2012 the following:

Assets		
Land	€ 60,000	
Buildings	€ 200,000	
Jeans in stock	€ 120,000	
Accounts receivable	€ 37,000	
Balance at Stevinbank	€ 12,000	
Cash	€ 6,000	
Total Assets		€ 435,000

Liabilities		
Mortgage loan	€ 180,000	
Accounts payable	€ 95,000	
Total liabilities		€ 275,000
Owner's equity		€ 160,000

Inventory list

Equity

Note that the *inventory list* presents the assets and liabilities of a firm. If you construct the inventory list of a firm it's just one step to determine firm's equity. According the IASB Framework *equity* is the residual interest in the assets of the enterprise after deducting all its liabilities. Defining equity in this manner shows clearly that it cannot be defined independently of the other elements.

1.3 The balance sheet

Balance sheet or statement of financial position

The balance sheet or statement of financial position lists the entity's assets, liabilities and owner's equity as of a specific date, usually the end of a month or a year. The balance sheet is like a snapshot of the entity. For this reason, it is also called the statement of the financial position. The balance sheet is very important. On the balance sheet (in account form) you find on the left, or debit side, the assets, and on the right, or credit side, the liabilities and owner's equity (or capital). Instead of presenting the assets on the left side and the liabilities and equity on the right side firms often choose to present the assets *above* the liabilities and owner's equity (this is called the balance sheet in report form).

The general representation of the balance sheet in account form is as follows:

Debit		**Balance sheet**	**Credit**
Assets	€	Owner's equity*	€ ....
		Liabilities	
	€		€ ....

* From the perspective of the firm, Owner's equity can also be called Liabilities to the Owner.

Assets and liabilities are classified in a manner that facilitates the evaluation of an entity's financial structure and its liquidity, solvency and financial flexibility. The classification of the assets is based on International Accounting Standard 1 (IAS 1). "An entity shall classify an asset as current when: (a) it expects to realize the asset, or intends to sell or consume it, in its normal operating cycle; (b) it holds the asset primarily for the purpose of trading; (c) it expects to realize the asset within twelve months after the reporting period; or (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period. An entity shall classify all other assets as non-current."

Debit	Balance sheet Gert Tolkamp, 1 January 2013 (in €)		Credit
Assets		**Owner's equity and liabilities**	
Non-current (fixed)			
Land	60,000	Owner's Equity	160,000
Buildings	200,000		
		Non-current liabilities	
Current		6% Mortgage loan	180,000
Inventory (Jeans in stock)	120,000		
Accounts receivable	37,000	*Current Liabilities*	
Bank	12,000	Accounts payable	95,000
Cash	6,000		
	435,000		435,000

So an entity has to present current and non-current (fixed) assets as separate classifications in its balance sheet except when a presentation based on liquidity provides information that is more reliable and more relevant. When that exception applies, an entity shall present all assets in order of liquidity. IAS 1 states whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled for each asset line item in one of the two categories: (a) no more than twelve months after the reporting period; (b) more than twelve months after the reporting period.
Examples of non-current assets are buildings, land and machines. Examples of current assets besides cash are stock of goods and accounts receivable.

In conformity with paragraph 60 of IAS 1, an entity shall also present current and non-current liabilities. The classification of the liabilities is similar to the approach that is used for the assets. An example of a non-current or long-term liability is the 6% mortgage loan (assuming we do not redeem the loan within a year) and an example of a current or short-term liability is accounts payable (assuming we pay these liabilities within a year). Other examples of short-term liabilities are short-term debts and current maturities of long-term debt.

Problem for review 1.1

A. Faas who lives in Kampen wants to start a jeans store by January 1, 2013. He has budgeted the following items:

- Buildings €190,000, Faas can get an 8% mortgage loan of €150,000.
- Store Equipment €25,000.
- Inventory (Jeans in stock) €15,000, of which €10,000 is financed by the supplier “Blue Jeans” (accounts payable). The remainder will be paid on purchase.
- Required amount of cash is €5,000.
- Mr. B. Faas, Sr. (A. Faas’ father) is willing to provide a long-term loan of €20,000.
- A. Faas is going to borrow €10,000 from a bank in Kampen.

Questions

a How much equity does A. Faas need in order to open his jeans store on 1 January, 2013?

1

b Present the balance sheet on 1 January, 2013. Take the logical "liquidity sequence" into account.

Solution to Problem for review 1.1

a

Buildings	€ 190,000	
Store Equipment	€ 25,000	
Inventory	€ 15,000	
Cash	€ 5,000	
Total assets		€ 235,000
Liabilities		
8% mortgage loan	€ 150,000	
Loan from B. Faas Sr	€ 20,000	
Loan from bank	€ 10,000	
Accounts payable	€ 10,000	
Total liabilities		€ 190,000
Equity		€ 45,000

b

Debit	**Balance sheet A. Faas, 1 January 2013 (in €)**		**Credit**
Assets		**Equity and Liabilities**	
Non-current Assets			
Buildings	190,000	Equity	45,000
Store Equipment	25,000		
		Non-current Liabilities	
Current Assets		8% Mortgage loan	150,000
Inventory (= Jeans in stock)	15,000	Loan from B. Faas Sr.	20,000
Cash	5,000	Loan from bank	10,000
		Current Liabilities	
		Accounts payable	10,000
	235,000		235,000

1.4 Financial transactions and changes in the balance sheet

Financial transaction

Bookkeeping is based on financial transactions, not on opinions and desires. A financial transaction is any event that affects the financial position of the business and can be measured reliably. To measure a financial transaction, you must decide when the transaction occurred (the recognition issue), what value to place on the transaction (the valuation issue) and how the components should be categorized (the classification issue).

The recognition issue refers to the difficulty of deciding when a financial transaction should be recorded. The resolution of this issue is important because the date on which a transaction is recorded affects amounts in the financial statements.

The valuation issue focuses on assigning a monetary value to a financial transaction and accounting for the assets and liabilities that result from financial transactions. Generally accepted accounting principles (gaap) state that all financial transactions should be valued at fair value when they occur. Fair value is defined as the exchange price of an actual or potential financial transactions between market participants. The practice of recording transactions at exchange price at the point of recognition is commonly referred to as the cost principle. It is used because the cost or exchange price is verifiable.

Gaap

The classification issue has to do with assigning all the transactions in which the firm engages into appropriate categories, or accounts. Classification of debts can affect a firm's ability to borrow money and classification of purchases can affect its income.
To illustrate this let's now look at how a series of transactions affects the balance sheet.

Example 1.2 Influence of financial transactions on the balance sheet

A Heuvelink, in Kampen, is a sole proprietor. The firm is called Mr. Donut, a company that bakes and sells donuts to various supermarkets across the country.

"Mr. Donut" has the following opening balance sheet:

Balance sheet of 1 January, 2013 in €

Company car	60,000	Equity	35,000
Furniture and fixtures	10,000	Loan MS BANK	25,000
Raw materials	5,750	Loan W. Heuvelink	13,500
Cash	1,500	Accounts payable	7,500
Bank	3,750		
	81,000		81,000

Financial transactions for the month of January:

January 4th	Purchase of 500 kilograms of flour at €2 per kilo from Fuite Bakeries BV IJsselmuiden. Paid cash.
January 6th	Buy cinnamon sugar on account from BV Honas for €250.
January 13th	Withdrawal from bank €2,500, invested in Cash.
January 18th	€5,000 is redeemed to W. Heuvelink. Paid by bank.
January 22th	€750 cash paid for a new mixer, type G *vbm 2012 deluxe.*

We now examine the impact of the financial transactions on the balance sheet. For each date we create a new balance sheet.

<u>January 4th</u> Purchase of 500 kilograms of flour at €2 per kilo from Fuite Bakeries BV IJsselmuiden. Paid cash.

1

This transaction affects only the assets or the debit side of the balance sheet. The balance sheet totals do not change. The cash purchase of raw materials increases the asset Raw materials by €1,000 and decreases the asset Cash by €1,000.

Balance sheet as of January 4, 2013 (in €)

Company car	60,000	Equity	35,000
Furniture and fixtures	10,000	Loan from ABN Amro	25,000
Raw materials	6,750	Loan from W. Heuvelink	13,500
Cash	500	Accounts payable	7,500
Bank	3,750		
	81,000		81,000

<u>January 6th</u> Buy cinnamon sugar on account from Honas for €250.

This purchase increases both the assets and the liabilities. The asset Raw materials increases by €250 and the liability to creditor Honas will increase Accounts payable by €250. A payable is always a liability. As you can see the balance sheet totals also increase by €250.

Balance sheet as of January 6, 2013 (in €)

Company car	60,000	Equity	35,000
Furniture and fixtures	10,000	Loan from MS Bank	25,000
Raw materials	7,000	Loan from W. Heuvelink	13,500
Cash	500	Accounts payable	7,750
Bank	3,750		
	81,250		81,250

<u>January 13th</u> Withdrawal from bank €2,500, invested in Cash.

The asset Bank decreases by €2,500 cash while the asset Cash increases by €2,500.

Balance sheet as of January 13, 2013 (in €)

Company car	60,000	Equity	35,000
Furniture and fixtures	10,000	Loan from MS Bank	25,000
Raw materials	7,000	Loan from W. Heuvelink	13,500
Cash	3,000	Accounts payable	7,750
Bank	1,250		
	81,250		81,250

<u>January 18th</u> €5,000 is redeemed to W. Heuvelink. The payment is a bank payment.

The bank balance is only €1,250 so the asset Bank decreases by €1,250 and turns into a liability of €3,750. The liability Loan from W. Heuvelink decreases by €5,000. The balance sheet totals decrease by € 1,250 to €80,000.

Balance sheet as of January 18, 2013 in €

Company car	60,000	Equity	35,000
Furniture and fixtures	10,000	Loan from MS Bank	25,000
Raw materials	7,000	Loan from W. Heuvelink	8,500
Cash	3,000	Accounts payable	7,750
		Bank	3,750
	80,000		80,000

January 22th €750 cash paid for a new mixer, type G *vbm 2012 deluxe.*

The asset Furniture and fixtures[3] increases by €750 and the asset Cash decreases by €750.

Balance sheet at January 22, 2013 in €

Company car	60,000	Equity	35,000
Furniture and fixtures	10,750	Loan from MS Bank	25,000
Raw materials	7,000	Loan from W. Heuvelink	8,500
Cash	2,250	Accounts payable	7,750
		Bank	3,750
	80,000		80,000

Problem for review 1.2

The balance sheet of trading company PIEBIE is given as of 1 January, 2012.

Balance sheet PIEBIE, 1 January, 2012

Inventory	€ 50,000	Equity	€ 56,000
Accounts receivable	€ 20,000	Accounts payable	€ 30,000
Bank	€ 10,000		
Cash	€ 6,000		
	€ 86,000		€ 86,000

The bookkeeper of the company, Mr A. van Lier, has collected the following data for the month of January 2012:

January 3rd Goods bought on account for €42,000.
January 6th Sold on account goods for €36,000. The purchase price of the goods is €30,000.

3 In furniture, we generally include desks, chairs, tables, storage racks. A fixture is that type of furniture which is fixed in a specific place and position of a building.

1

January 10th	Received from debtors / customers €19,000 on the bank account.
January 15th	Withdrew €27,000 from the bank account and invested in cash.
January 16th	Paid €32,000 cash to creditors / suppliers.
January 17th	Sold for cash and delivered goods for €12,000. The purchase price of the goods is €10,000.
January 20th	Paid cash for the following expenses in January:

Rent	€ 800
Wages	€ 3,200
Other costs	€ 1,000
Total:	€ 5,000

January 27th	For private purposes, €500 was withdrawn from the cash holdings by the owner of company PIEBIE.
January 31st	Received a loan of €35,000 from Bank CRAM. The money has been received on the bank account.

Questions

a Clearly indicate the changes in the Balance sheet for each financial fact, Profits and losses result in a change of equity.
b Adjust and construct the Balance sheet on 31 January, 2012.

Solution to Problem for review 1.2

a

January 3rd Purchased on account and received goods for €42,000.

Inventory	increase	€ 42,000
Accounts payable	increase	€ 42,000

January 6th Sold on account goods for €36,000. The purchase price of the goods is €30,000.

Accounts receivable	increase	€ 36,000
Inventory	decrease	€ 30,000
Equity	increase	€ 6,000

The difference between the selling price and the purchase price is a profit which results in a change of equity. In the case of a loss we see a decrease of owner's equity.

January 10th Received by bank €19,000 from debtors (= accounts receivable).

Bank	increase	€ 19,000
Accounts receivable	decrease	€ 19,000

<u>January 15th</u> Withdrew €27,000 from the bank account and invested in cash.

Cash	increase	€ 27,000
Bank	decrease	€ 27,000

<u>January 16th</u> Paid €32,000 cash to creditors (= accounts payable).

Accounts payable	decrease	€ 32,000
Cash	decrease	€ 32,000

<u>January 17th</u> Sold for cash and delivered goods for €12,000. The purchase price of the goods is €10,000.

Cash	increase	€ 12,000
Inventory	decrease	€ 10,000
Equity	increase	€ 2,000

<u>January 20th</u> The following expenses were paid in cash in January:

Rent	€ 800
Wages	€ 3,200
Other costs	<u>€ 1,000</u>
Total:	€ 5,000

Equity	decrease	€ 5,000
Cash	decrease	€ 5,000

Expenses have the same effect on owner's equity as a loss. Owner's Equity decreases.

<u>January 27th</u> For private purposes, €500 was withdrawn from the cash holdings by the owner of the company PIEBIE.

Equity	decrease	€ 500
Cash	decrease	€ 500

The owner's withdrawal of €500 cash decreases Cash and also the owner's Equity of the business. Owner's withdrawals do not represent an expense because the cash is used for the owner's personal use. We record this decrease in owner's equity as withdrawals or as drawings. (In Chapter 2 we use a separate (ledger) account to record the decrease in (owner's) equity.)

January 31st Borrowed €35,000 from a bank. The money has been received on the bank account.

Bank	increase	€ 35,000
Loan	increase	€ 35,000

b

Balance sheet on January 31, 2012

Inventory	€ 52,000	Equity	€ 58,500
Accounts receivable	€ 37,000	Loan	€ 35,000
Bank	€ 37,000	Accounts payable	€ 40,000
Cash	€ 7,500		
	€ 133,500		€ 133,500

Cash and equity both increase by €500. As a result, the totals of the debit side and the credit side of the balance sheet increase.

1.5 Recording financial transactions in the Journal

Journal
Journal entry

In the previous paragraph, we have shown the influence of various financial transactions on the balance sheet. In practice, we first record all these changes in a "book" which is called the *journal*. The notation of the changes in accounts caused by one financial transaction is called a *journal entry*. So, the complete set of *journal entries* (in chronological order) is called the (*general*) *journal*.

The process of making journal entries has three steps:

1 Identify each relevant account and its type (asset, liability or equity)
2 Determine what accounts have increased or decreased.
3 Record the transaction in the journal. The journal contains several columns: one column provides space for a date; one for the names of the accounts that change and two columns for the amounts (the changes), one for debits and one for credits. The debit side of the entry is entered first. Total debits should always equal total credits. The general format of a journal entry is as follows:

Date	Name of account that changes	Debit	Credit

Example 1.3 Journal entries

Record the following transactions in the journal of Eenennaam, a trader in used cars in Rotterdam:

a Bought on account from L. van Drunen in Vlaardingen, 8 cars for €32,000. The invoice and the cars have been received.
b Sold for cash and delivered to W. Schauten in Delft, 1 car with a selling price of €5,200 (€2,400 purchase price).
c Received from H. Tervoort from Roosendaal €6,500 cash.
d Paid cash to creditor L. van Drunen from Vlaardingen an amount of €4,000.

a Bought on account from L. van Drunen in Vlaardingen, 8 cars for €32,000. The invoice and the cars have been received.

Step 1: The accounts affected by the purchase on account are Inventory and Accounts payable. Inventory is an asset and Account payable is a liability.
Step 2: Both accounts increase by €32,000. Therefore, we debit Inventory, the asset and we credit Account payable, the liability.
Step 3: The journal entry is:

Date	Name of account that changes	Debit	Credit
	Inventory	€ 32,000	
	To Accounts payable		€ 32,000

b Sold for cash and delivered to W. Schauten in Delft, one car for a sum of €5,200; (purchase price €2,400).

Step 1: The accounts affected by the sale in cash are Cash, Inventory and Equity. Cash and Inventory are assets and Equity is Owner's equity.
Step 2: Cash increases by €5,200. Therefore, we debit Cash. The asset Inventory decreases by €2,400 so we credit Inventory. The difference between the selling price and the purchase price is profit so Equity will increase. We record €2,800 in the credit column.
Step 3: The journal entry is:

Date	Name of account that changes	Debit	Credit
	Cash	€ 5,200	
	To Inventory		€ 2,400
	To Equity		€ 2,800

c Received from debtor H. Tervoort from Roosendaal €6,500 cash.

Step 1: The accounts affected by the payment in cash of Tervoort are Cash and Accounts receivable. Both accounts are assets.
Step 2: Cash increases by €6,500. Therefore, we debit Cash. Accounts receivable decreases so we credit Accounts receivable.
Step 3: The journal entry is:

Date	Name of account that changes	Debit	Credit
	Cash	€ 6,500	
	To Accounts receivable		€ 6,500

d Paid €4,000 cash to creditor L. van Drunen from Vlaardingen.
Step 1: The accounts affected by payment in cash are Cash and Accounts payable. Cash is an asset and Accounts payable is a liability.
Step 2: Both accounts decrease by €4,000. Therefore, we debit Accounts payable, the liability, and we credit Cash, the asset.
Step 3: The journal entry is:

Date	Name of account that changes	Debit	Credit
	Accounts payable	€ 4,000	
	To Cash		€ 4,000

Problem for review 1.3

The balance sheet for Crijns on 1 January, 2012 is as follows:

Balance sheet for Crijns of 1 January, 2012 (in €)

Building	100,000	Equity	60,000
Inventory	14,200	8% Mortgage	30,000
Accounts receivable	4,500	Accounts payable	31,700
Cash	3,000		
	121,700		121,700

Question

Give the journal entries for the month January 2012. The financial transactions are given in chronological order. Use only the accounts mentioned in the balance sheet.

a Purchased on account inventory for €230. The invoice and goods have been received.
b Sold on account goods with a total sales value of €3,000. The purchase price of the goods is €1,200. The invoice and goods were sent to the customer.
c Cash withdrawal for personal use: €200.
d €350 cash deposited into the bank account. The bank statement has been received.
e Returned goods arrived in the warehouse: the goods were sold for €200. The purchase price was €100. The credit invoice has been sent to the customer.
f Sold in cash: goods with a sales value of €12,000. The purchase price was €4,000. The goods have been handed over to the customer.
g Redeemed the mortgage loan: €1,000 cash.

Solution to Problem for review 1.3

Date		Debit	Credit
a	Inventory	€ 230	
	To Accounts payable		€ 230
b	Accounts receivable	€ 3,000	
	To Inventory		€ 1,200
	To Equity		€ 1,800
c	Equity	€ 200	
	To Cash		€ 200
d	Bank	€ 350	
	To Cash		€ 350
e	Inventory	€ 100	
	Equity	€ 100	
	To Accounts receivable		€ 200
f	Cash	€ 12,000	
	To Inventory		€ 4,000
	To Equity		€ 8,000
g	Mortgage Loan	€ 1,000	
	To Cash		€ 1,000

1.6 The General Ledger including permanent and temporary accounts

Financial transactions can cause changes in the assets, liabilities and owner's equity. A journal entry shows the changes caused by each financial transaction in the balance sheet. If we record financial facts for a certain period, we can, of course, produce a new balance sheet each time a financial transaction occurs, using the amounts in the relevant journal entries. However, instead of doing this, all changes in the journal are transferred to the general ledger. The general ledger consists of accounts for all assets, liabilities and owner's equity. The general form of a ledger account (also called a T-account) is:

General ledger

Debit			**Name ledger account**		**Credit**
Date	Description	Amount	Date	Description	Amount

1

The general ledger consists of many ledger accounts. At the beginning of a bookkeeping cycle, accounts for assets are opened on the debit side of the ledger accounts and accounts for liabilities and equity are opened on the credit side. This is done by copying the amounts from the *last* balance sheet to the various ledger accounts in the general ledger. Note that Balance sheet accounts are also called "permanent" or "real" accounts for that reason; the amount at the end of the previous cycle is equal to the amount at the beginning of the next cycle.

"Permanent" or "real" accounts

After opening the general ledger (or more specifically, the accounts in the ledger), the ledger can be updated. If an amount in a journal entry is recorded in the debit (credit) column, this amount will debited (credited) in the corresponding ledger account listed in the general ledger. Updating the ledger thus means copying the amounts from the journal entries into the various ledger accounts.

IAS 1 requires an income statement: "All items of income and expense recognized in a period shall be included in profit or loss unless a Standard or an Interpretation requires otherwise".
From now on, increases and decreases of equity are not recorded on the account "owner's equity", but on the "temporary" or "nominal" accounts of equity. These temporary accounts give a specification of the increases (profits, revenues and owner's investments) and decreases (losses, expenses or costs and owner's withdrawals). Note that the profit and loss account over a specified period is nothing more than the presentation of the balances of the temporary accounts at the end of the same period (excluding owner's investments and owner's withdrawals). These accounts are, as such, not accounts that are shown on the balance sheet. At the beginning of a new bookkeeping period, the amounts of these accounts are zero (since the revenues / expenses and investments / withdrawals are zero at the beginning of the new accounting period[4]). That's why these accounts are called temporary accounts (in contrast to the permanent balance sheet accounts).

Temporary accounts

Example 1.4 Financial facts and the general ledger

Ton van Haperen in Schijndel has a wholesale company specializing in office furniture. On 1 January, 2012, he opened the accounts with the following balances:

Balance sheet at 1 January, 2012 (in €)

Furniture and fixtures	100,000	Equity	158,500
Inventory of furniture	52,000	Loan	35,000
Accounts receivable	27,000	Accounts payable	40,000
Bank	37,000		
Cash	17,500		
	233,500		233,500

The income statement, or profit and loss account, consists of the following accounts: gross profit, rent, salary and other costs.

4 Here we refer to the "sole trader".

1 Bought inventory on account from supplier “Le Corbusier”. The invoice and furnishings have been received. The purchase price is €142,000.
2 Sold on account inventory for €136,000. The invoiced goods had a total purchase price of €130,000 and have been delivered.
3 Received by bank from customers €119,000.
4 Transferred €27,000 from bank to cash.
5 Paid to suppliers by bank €102,000. Sold cash and delivered goods for €120,000. The purchase price of these goods is €50,000.
6 The following operating costs in January were paid in cash:

Rent	€ 1,800
Wages	€ 13,200
Other costs	€ 11,000
Total:	€ 26,000

Questions
a Prepare the journal entries of the financial transactions.
b Open the ledger accounts.
c Update the ledger accounts with the information shown in the journal entries made in question a.

Answers
a

Date	Ledger account that changes	Debit	Credit
1	Inventory	€ 142,000	
	To Accounts payable		€ 142,000
2	Accounts receivable	€ 136,000	
	To Inventory		€ 130,000
	To Gross profit		€ 6,000
3	Bank	€ 119,000	
	To Accounts receivable		€ 119,000
4	Cash	€ 27,000	
	To Bank		€ 27,000
5	Accounts payable	€ 102,000	
	To Bank		€ 102,000
	+		
	Cash	€ 120,000	
	To Inventory		€ 50,000
	To Gross profit		€ 70,000
6	Rent	€ 1,800	
	Wages	€ 13,200	
	Other Costs	€ 11,000	
	To Cash		€ 26,000

1

b

Furniture and fixtures (in €)

BS	100,000		

Equity (in €)

		BS	158,500

Inventory (in €)

BS	52,000		

Loan (in €)

		BS	35,000

Accounts receivable (in €)

BS	27,000		

Accounts payable (in €)

		BS	40,000

Bank (in €)

BS	37,000		

Wages (in €)

Cash (in €)

BS	17,500		

Other costs (in €)

Rent (in €)

Gross profit (in €)

c

1	Inventory	€ 142,000	
	To Accounts payable		€ 142,000

Inventory (in €)

BS	52,000		
	142,000		

Accounts payable (in €)

		BS	40,000
			142,000

2	Accounts receivable	€ 136,000	
	To Inventory		€ 130,000
	To Gross profit		€ 6,000

Accounts receivable (in €)

BS	27,000		
	136,000		

Inventory (in €)

BS	52,000		**130,000**
	142,000		

Gross profit (in €)

			6,000

3	Bank	€ 119,000	
	To Accounts receivable		€ 119,000

Bank (in €)

BS	37,000		
	119,000		

Accounts receivable (in €)

BS	27,000		**119,000**
	136,000		

4	Cash	€ 27,000	
	To Bank		€ 27,000

Cash (in €)

BS	17,500		
	27,000		

Bank (in €)

BS	37,000		**27,000**
	119,000		

5	Accounts payable	€ 102,000	
	To Bank		€ 102,000

Accounts payable (in €)

	102,000	BS	40,000
			142,000

Bank (in €)

BS	37,000		27,000
	119,000		**102,000**

6	Cash	€ 120,000	
	To Inventory		€ 50,000
	To Gross profit		€ 70,000

Cash (in €)

BS	17,500		
	27,000		
	120,000		

Inventory (in €)

BS	52,000		130,000
	142,000		**50,000**

Gross profit (in €)

			6,000
			70,000

1

7	Rent	€ 1,800	
	Wages	€ 13,200	
	Other costs	€ 11,000	
	To Cash		€ 26,000

Rent (in €)

	1,800		

Cash (in €)

BS	17,500		**26,000**
	27,000		
	120,000		

Wages (in €)

	13,200		

Other Costs (in €)

	11,000		

The complete General Ledger looks as follows:

Furniture and fixtures (in €)

BS	100,000		

Equity (in €)

		BS	158,500

Inventory (in €)

BS	52,000		130,000
	142,000		50,000

Loan (in €)

		BS	35,000

Accounts receivable (in €)

BS	27,000		119,000
	136,000		

Accounts payable (in €)

	102,000	BS	40,000
			142,000

Bank (in €)

BS	37,000		27,000
	119,000		102,000

Wages (in €)

	13,200		

Cash (in €)

BS	17,500		26,000
	27,000		
	120,000		

Other Costs (in €)

	11,000		

Rent (in €)	
1,800	

Gross profit (in €)	
	6,000
	70,000

Problem for review 1.4

The following review gives an overview of the assets and liabilities of volleyball wholesaler P. de Vries in Rotterdam on 1 January, 2012:

Balance sheet on 1 January, 2012 (in €)

Commercial building	240,000	Equity	336,457
Furniture	45,000	Mortgage	20,000
Fleet	22,000		
Inventory	10,310	Accounts payable	13,490
Cash	18,000		
Bank	24,937		
Accounts receivable	9,700		
	369,947		369,947

The income statement consists of the following ledger accounts:

- Gross profit
- Interest costs
- Incidental results

Questions

a Prepare journal entries of the financial transactions of this company.
b Open the general ledger accounts.
c Update the general ledger accounts by recording the data from the journal entries made in question a.

Date	Financial transaction
January 3	Paid by bank an outstanding invoice of €840.
January 5	Received by bank €5,000 from debtor (buyer) Jansen.
January 6	Purchased on credit and received volleyballs for €4,000.
January 9	Sold volleyballs for €8,385 on credit to B100 Sports store. The delivery was made with our delivery van. Purchase price for these volleyballs is €5,435.
January 14	Paid by bank €2,210 to supplier Apollo.
January 22	Sold volleyballs on credit to Henk Vrolijk for €880. Purchase price was €900. These volleyballs were delivered immediately.
January 27	Paid by Bank: Mortgage settlement € 10,000 Interest for the month of January € 250

1

Solution to Problem for review 1.4

a

Date	Ledger Account that changes	Debit	Credit
3 / 1	Accounts payable	€ 840	
	To Bank		€ 840
5 / 1	Bank	€ 5,000	
	To Accounts receivable		€ 5,000
6 / 1	Inventory	€ 4,000	
	To Accounts payable		€ 4,000
9 / 1	Accounts receivable	€ 8,385	
	To Inventory		€ 5,435
	To Gross profit		€ 2,950
14 / 1	Accounts payable	€ 2,210	
	To Bank		€ 2,210
22 / 1	Accounts receivable	€ 880	
	Incidental results	€ 20	
	To Inventory		€ 900
27 / 1	Mortgage	€ 10,000	
	Interest Costs	€ 250	
	To Bank		€ 10,250

b

Commercial building (in €)

Debit		Credit	
Balance	240,000		

Equity (in €)

Debit		Credit	
		Balance	336,457

Furniture (in €)

Debit		Credit	
Balance	45,000		

Mortgage (in €)

Debit		Credit	
		Balance	20,000

Fleet (in €)

Debit		Credit	
Balance	22,000		

Accounts payable (in €)

Debit		Credit	
		Balance	13,490

Inventory (in €)

Debit		Credit	
Balance	10,310		

Gross profit (in €)

Debit		Credit	

Cash (in €)

Debit		Credit	
Balance	18,000		

Interest costs (in €)

Debit		Credit	

Bank (in €)

Debit		Credit	
Balance	24,937		

Incidental results (in €)

Debit		Credit	

Accounts receivable (in €)

Balance	9,700		

c

3 / 1	Accounts payable	€ 840	
	To Bank		€ 840

Bank (in €)

Balance	24,937	3/1	**840**

Accounts payable (in €)

3/1	**840**		13,490

5 / 1	Bank	€ 5,000	
	To Accounts receivable		€ 5,000

Accounts receivable (in €)

Balance	9,700	5/1	**5,000**

Bank (in €)

Balance	24,937	3/1	840
5/1	**5,000**		

6 / 1	Inventory	€ 4,000	
	To Accounts payable		€ 4,000

Inventory (in €)

Balance	10,310		
6/1	**4,000**		

Accounts payable (in €)

	840	Balance	13,490
		6/1	**4,000**

9 / 1	Accounts receivable	€ 8,385	
	To Inventory		€ 5,435
	To Gross profit		€ 2,950

Accounts receivable (in €)

Balance	9,700	5/1	5,000
9/1	**8,385**		

Gross profit (in €)

		9/1	**2,950**

Inventory (in €)

Balance	10,310	9/1	**5,435**
	4,000		

1

14 / 1	Accounts payable	€ 2,210	
	To Bank		€ 2,210

Bank (in €)

Balance	24,937		840
	5,000	14/1	**2,210**

Accounts payable (in €)

	840	Balance	13,490
14/1	**2,210**		4,000

22 / 1	Accounts receivable	€ 880	
	Incidental results	€ 20	
	To Inventory		€ 900

Accounts receivable (in €)

Balance	9,700		5,000
	8,385		
22/1	**880**		

Incidental results (in €)

22/1	**20**		

Inventory (in €)

Balance	10,310		5,435
	4,000	22/1	**900**

27 / 1	Mortgage	€ 10,000	
	Interest costs	€ 250	
	To Bank		€ 10,250

Bank (in €)

Balance	24,937		840
	5,000		2,210
		27/1	**10,250**

Mortgage (in €)

27/1	**10,000**	Balance	20,000

Interest costs (in €)

27/1	**250**		

The full ledger for P. de Vries is as follows:

Commercial building (in €)

Balance	240,000		

Equity (in €)

		Balance	336,457

Furniture (in €)

Balance	45,000		

Mortgage (in €)

	10,000	Balance	20,000

Fleet (in €)

Balance	22,000		

Accounts payable (in €)

	840	Balance	13,490
	2,210		4,000

Inventory (in €)

Balance	10,310		5,435
	4,000		900

Gross profit (in €)

			2,950

Cash (in €)

Balance	18,000		

Interest costs (in €)

	250		

Bank (in €)

Balance	24,937		840
	5,000		2,210
			10,250

Incidental results (in €)

	20		

Accounts receivable (in €)

Balance	9,700		5,000
	8,385		
	880		

1.7 The worksheet

Worksheet

The next stage in the bookkeeping cycle is the worksheet. The worksheet is used to prepare the income statement and the closing balance sheet. A common format of a worksheet has one column for account names and multiple columns with the following headings: totals, trial balance, income statement and closing balance sheet.

The general form of the worksheet is as follows:

Account names	Totals		Trial Balance		Income statement		Closing Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit

1

The first step in preparing the worksheet is to set up the column Totals (see example 1.5). The background of this step is to check whether the general ledger is in balance. The totals consist of two columns, namely a debit and a credit column. For each account in the debit column the total of the amounts debited on the corresponding ledger-account is listed (including an opening balance – if any), the credit column shows the total of the amounts credited.

Example 1.5 Totals, the first 2 columns of the worksheet

The totals derived from the ledger of Ton van Haperen (in €):

Account names	Totals		Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Furniture and fixtures	100,000							
Inventory	194,000	180,000						
Accounts receivable	163,000	119,000						
Bank	156,000	129,000						
Cash	164,500	26,000						
Owner's Equity		158,500						
Loan		35,000						
Accounts payable	102,000	182,000						
Rent	1,800							
Wages	13,200							
Other costs	11,000							
Gross profit		76,000						
Net result								
	905,500	905,500						

Problem for review 1.5

Prepare the column Totals for P. de Vries. Use the general ledger from the solution of Problem for review 1.4.

Solution to Problem for review 1.5 (in €)

Account names	Totals		Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Commercial	240,000							
Furniture and fixtures	45,000							
Fleet	22,000							
Inventory	14,310	6,335						
Cash	18,000							

Account names	Totals		Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Bank	29,937	13,300						
Accounts receivable	18,965	5,000						
Owner's Equity		336,457						
Mortgage	10,000	20,000						
Accounts payable	3,050	17,490						
Gross profit		2,950						
Interest costs	250							
Incidental result	20							
Net result								
	401,532	401,532						

The trial balance is compiled of totals of the numbers on the ledger accounts. The balance – this is the difference between the amounts debited and credited on the account – of each ledger account is calculated. A debit balance in a ledger account is placed in the debit column of the trial balance, and a credit balance in the credit column. See example 1.6.

Example 1.6 Trial balance, columns 3 and 4 of the worksheet
On basis of the above column Totals, the Trial balance (for Ton van Haperen) looks as follows (in €):

Account names	Totals		Trial balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Furniture and fixtures	100,000		100,000					
Inventory	194,000	180,000	14,000					
Accounts receivable	163,000	119,000	44,000					
Bank	156,000	129,000	27,000					
Cash	164,500	26,000	138,500					
Owner's Equity		158,500		158,500				
Loan		35,000		35,000				
Accounts payable	102,000	182,000		80,000				
Rent	1,800		1,800					
Wages	13,200		13,200					
Other costs	11,000		11,000					
Gross profit		76,000		76,000				
Net result								
	905,500	905,500	349,500	349,500				

Problem for review 1.6
Prepare the Trial balance. Use the column Totals from Problem for review 1.5.

Solution to Problem for review 1.6 (in €)

Account names	Totals		Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Commercial	240,000		240,000					
Furniture and fixtures	45,000		45,000					
Fleet	22,000		22,000					
Inventory	14,310	6,335	7,975					
Cash	18,000		18,000					
Bank	29,937	13,300	16,637					
Accounts receivable	18,965	5,000	13,965					
Owner's Equity		336,457		336,457				
Mortgage	10,000	20,000		10,000				
Accounts payable	3,050	17,490		14,440				
Gross profit		2,950		2,950				
Interest costs	250		250					
Incidental result	20		20					
Net result								
	401,532	401,532	363,847	363,847				

The next phase of the worksheet is preparing the income statement. Each tempory account is extended to its place as a debit or a credit in the income statement. The net result (= net profit or net loss) is the difference between total debits (expenses or costs) and credits (revenues) of the income statement columns. In the case revenues (credit column) exceed expenses (debit column) we have a net profit which is entered in the debit side of income statement column. When a net loss occurs, the opposite rule applies. The excess of expenses over revenues – net loss – is placed in the credit side of the income statement columns as a balancing figure. See example 1.7.

Example 1.7 The income statement, columns 5 and 6 of the worksheet

On basis of the above Totals and Trial balance (Ton van Haperen) the following income statement can be prepared (in €):

Account names	Totals		Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Furniture and fixtures	100,000		100,000					
Inventory	194,000	180,000	14,000					
Accounts receivable	163,000	119,000	44,000					

Account names	Totals		Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Bank	156,000	129,000	27,000					
Cash	164,500	26,000	138,500					
Owner's Equity		158,500		158,500				
Loan		35,000		35,000				
Accounts payable	102,000	182,000		80,000				
Rent	1,800		1,800		1,800			
Wages	13,200		13,200		13,200			
Other costs	11,000		11,000		11,000			
Gross profit		76,000		76,000		76,000		
Net result					50,000			
	905,500	905,500	349,500	349,500	76,000	76,000		

Problem for review 1.7

Prepare the Income statement. Use the Trial balance from Problem for review 1.6.

Solution to Problem for review 1.7 (in €)

Account names	Totals		Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Commercial	240,000		240,000					
Furniture	45,000		45,000					
Fleet	22,000		22,000					
Inventory	14,310	6,335	7,975					
Cash	18,000		18,000					
Bank	29,937	13,300	16,637					
Accounts receivable	18,965	5,000	13,965					
Owner's Equity		336,457		336,457				
Mortgage	10,000	20,000		10,000				
Accounts payable	3,050	17,490		14,440				
Gross profit		2,950		2,950		2,950		
Interest costs	250		250		250			
Incidental result	20		20		20			
Net result					2,680			
	401,532	401,532	363,847	363,847	2,950	2,950		

The final phase of the worksheet is preparing the closing or final balance sheet. Starting point is the trial balance. The debit balances of the assets accounts are transferred to the debit side of the balance sheet. The credit balances of the liability accounts are transferred to the credit side of the balance sheet. Special attention is needed to determining the balance

1

amount of owner's equity. Owner's equity increases with net profit and decreases with net loss. See example 1.8.

Example 1.8 The balance sheet, columns 7 and 8 of the worksheet

After the trial balance and income statement (Ton van Haperen), the closing balance sheet can be prepared (in €).

Account names	Totals		Trial balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Furniture and fixtures	100,000		100,000				100,000	
Inventory	194,000	180,000	14,000				14,000	
Accounts receivable	163,000	119,000	44,000				44,000	
Bank	156,000	129,000	27,000				27,000	
Cash	164,500	26,000	138,500				138,500	
Owner's Equity		158,500		158,500				208,500
Loan		35,000		35,000				35,000
Accounts payable	102,000	182,000		80,000				80,000
Rent	1,800		1,800		1,800			
Wages	13,200		13,200		13,200			
Other costs	11,000		11,000		11,000			
Gross profit		76,000		76,000		76,000		
Net result					50,000			
	905,500	905,500	349,500	349,500	76,000	76,000	323,500	323,500

Owner's equity is calculated as follows:

Owner's equity, Jan. 1:	€ 158,500
The net result:	€ 50,000
Owner's equity, Dec. 31	€ 208,500

Problem for review 1.8

Prepare the closing balance sheet. Use the income statement and trial balance (see solution for practice Problem for review 1.7).

Solution to Problem for review 1.8 (in €)

Account names	Totals		Trial balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Commercial	240,000		240,000				240,000	
Furniture and fixtures	45,000		45,000				45,000	
Fleet	22,000		22,000				22,000	

Account names	**Totals**		**Trial balance**		**Income statement**		**Balance sheet**	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Inventory	14,310	6,335	7,975				7,975	
Cash	18,000		18,000				18,000	
Bank	29,937	13,300	16,637				16,637	
Accounts receivable	18,965	5,000	13,965				13,965	
Owner's Equity		336,457		336,457				339,137
Mortgage	10,000	20,000		10,000				10,000
Accounts payable	3,050	17,490		14,440				14,440
Gross profit		2,950		2,950		2,950		
Interest costs	250		250		250			
Incidental result	20		20		20			
Net result					2,680			
	401,532	401,532	363,847	363,847	2,950	2,950	363,577	363,577

List of concepts

1

Accounting cycle	A series of steps that needs to be taken to provide useful financial information to decision makers.
Accounting equation	The basic tool of accounting, measuring the resources of the firm and the claims to those resources: assets = liabilities + owner's equity.
Accrual basis of accounting assumption	This assumption states that the effects of all transactions and other events are recognised in the accounting records when they occur, rather when cash or its equivalent is received or paid.
Assets	Resources controlled by the entity as "a result of past events and from which future economic benefits are expected to flow to the entity".
Balance sheet or statement of financial position	Lists the entity's assets, liabilities and owner's equity on a specific date.
Entity or business entity assumption	The firm is seen as an entity which assumes an independent position in relation to its environment.
Financial transaction	Any event that affects the financial position of the business and can be measured reliably.
Framework	The (IFRS) Framework describes the basic concepts that underlie the preparation and presentation of financial statements for external users.
General Ledger	All ledger accounts.
Income statement (or Profit & Loss account)	A firm's summary of all items of revenue and expense recognized in an accounting period.
Inventory list	A presentation of the assets and liabilities of a firm.
Journal	A summary of all journal entries.
Journal entry	The notation of the changes in accounts caused by a financial transaction.

Liabilities	Present obligations of the entity arising of resources from the past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
Measurement assumption	The process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and income statement. This assumption enables accounting to measure economic events.
Owner's equity	The residual interest in the assets of the enterprise after deducting all its liabilities.
Permanent or real accounts	Balance sheet accounts of which the balances are transferred to the next accounting period.
Temporary or nominal accounts of equity	Accounts that give a specification of the increases (profits, revenues and owner's investments) and decreases (losses, expenses or costs and owner's withdrawals) of equity.
Worksheet	A multiple-column format used in the accounting cycle to prepare the income statement and the closing balance sheet. A common form of a worksheet has one column for account names and multiple columns with the following headings: totals, trial balance, income statement and closing balance sheet.

Exercises

1

1.1 Diana Barels is the owner of a beauty salon. On 1 January 2014, she has the following inventory list, with the annexes Debtors and Creditors:

Inventory list Diana Barels on 1 January 2014 (in €)

Assets	
Business premises	240,000
Office equipment	28,650
Stock of goods	15,680
Debtors (see Annex I)	7,400
Bank	6,540
Cash in hand	900
	299,170
Liabilities	
Creditors (see Annex II)	18,300
5% Loan A. de Jong	14,600
6% Mortgage loan	155,600
	188,500

Annex I: Debtors		
G. Immerzeel	€	300
K. van Baal	–	2,200
H. Tolkamp	–	900
N. Ketting	–	960
S. van den Berg	–	3,040
	€	7,400

Annex II: Creditors		
L'Or, Paris	€	2,000
Bos, Rotterdam	–	13,900
Niva, Luxembourg	–	2,400
	€	18,300

Questions

a Calculate the amount Diana Barels herself has invested in the business on 1 January 2014.

b Prepare the balance sheet on 1 January 2014.

1.2 The commercial enterprise EVALECLERCQ wants to prepare the balance sheet on 1 January 2014. The following data have been collected:

- On 1 January 2004 the building was purchased for €310,000. Yearly depreciation is €15,000.
- The stock consists of 400 goods of which the purchase price is €80 a piece.
- The accounts receivable have a book value of €12,000.
- The bank sent a message saying that the bank account has a credit balance of €3,250.
- The cash balance is €2,000.
- The 6% mortgage loan of €280,000 dates from 1 January 2004. Each year on 1 July, starting in 2004, €10,000 is repaid. Interest for the elapsed period has to be paid on this date as well.
- The company received a supplier credit amounting to €6,500.
- Amount owing for renting a warehouse is €3,500.

Question
Prepare the balance sheet on 1 January 2014.

1.3 At the end of December 2013, Marc Barels decided to start working independently as an accountant. At that time, he had €7,500 in a bank account and a balance of €25,000 in a savings account.
On 31 December 2013, Marc bought an office building for €150,000, 70% of which he financed with a 7% mortgage loan, to be repaid linearly over 30 years. Repayment and interest are due annually on December 31. The remaining part of the purchase price was borrowed from his family, at 4% interest per year, with no repayments to be made in the first few years.
On the same date Marc Barels traded in his €8,000 car for a nice second-hand car, for representative reasons. He needed to pay an additional €19,000 which he financed with a revolving credit from the bank, for which 0.75% interest has to be paid monthly, and no obligatory repayments have to be made.
The current bank and savings accounts were also used by Marc to finance a €5,000 laptop, €10,000 in office equipment, and €2,000 in office supplies, all at the end of December 2013.

Question
Prepare the balance sheet on 1 January 2014.

1.4 **Balance sheet of F. Ferres on 1 January 2013 (in €)**

Premises	68,000	Capital	36,000
Stock of goods	40,000	Mortgage Loan	65,000
Debtors	10,500	Creditors	40,000
Bank	17,500	Other short-term debt	1,500
Cash in hand	6,500		
	142,500		142,500

1

In the month January 2013 F. Ferres collected the following data:

January 5: Purchased on credit and received: goods for €30,250.
January 6: Withdrawn €15,000 from the bank to have cash in hand.
January 7: According to invoices sent, goods for €26,000 were sold on credit. The invoiced goods, with a total purchase price of €22,000, have been delivered.
January 11: Received by bank €19,000 from a customer.
January 15: Sold goods for €12,000 cash. The goods, with a total purchase price of €9,500, have been delivered.
January 16: Paid €22,000 cash to suppliers.
January 21: Contracted a loan of €42,000 with the Rabobank in Geldrop. F. Ferres received the money on his bank account.
January 22: Paid cash for the following operating expenses, regarding the month of January 2013:

Salaries	€ 750
Rent garages	€ 2,250
Other expenses	€ 500
	€ 3,500

Questions

a Show the possible changes in the balance sheet as a result of the data collected regarding January. Profits and/or losses are booked as a change in capital.
b Prepare the balance sheet as at 31 January 2013.

1.5 Mr. G. Evers in Enschede has drawn up the following balance sheet on 1 January 2013:

Balance sheet as at 1 January 2013 (in €)

Workshop	65,000	Capital	84,000
Office equipment	5,000	Loan bank	3,600
Inventory (bikes)	13,800	Creditors	3,400
Inventory (parts)	2,870		
Debtors	530		
Cash in hand	1,300		
Bank	2,500		
	91,000		91,000

Next to the accounts on the balance sheet, the following general ledger accounts are used:
Wages and salaries
Result bikes
Result parts
Selling expenses

January 2013 shows the following events:

January 3 Paid by bank to creditor R.S. Baars €1,800.
January 5 Purchased on credit and received from the Wholesale Centre:

Tools	€ 300
Bikes	€ 4,420
Parts	€ 480
	€ 5,200

January 11 Received €422 cash from P. Krijger.

January 15 Cash received from store sales in first half of January:

Bikes (purchase price €2,960)	€ 3,820
Parts (purchase price €348)	€ 511
	€ 4,331

January 17 Deposited on the bank account €5,000. Message received from the bank saying that the money has been transferred to the account.

January 20 Paid by bank to the Wholesale Centre €3,420. The bank has withdrawn the money.

January 22 Sold on credit and delivered to P. Krijger: 2 bikes (purchase price €650 per bike) for €845 per bike.

January 23 Discount given to P. Krijger because one of the bikes delivered on January 22, was slightly damaged. The amount of credit invoice nr. 1 is €25.

January 27 Purchases on credit from R.S. Stokvis:

Bikes	€ 1,300
Parts	€ 80
	€ 1,380

The bikes and parts have been stored in the warehouse.

January 31 Paid by cash:

Marketing expenses	€ 80
Wage of sales clerk	€ 460
	€ 540

January 31 Received from store sales in the second half of January:

Bikes (purchase price €3,610)	€ 4,670
Parts (purchase price €299)	€ 436
	€ 5,106

Questions

a Prepare journal entries of the financial facts that took place in January.
b Open the ledger accounts on January 1 and update them.
c Prepare the extended trial balance sheet (worksheet) for January for P. Evers.
d Prepare the profit and loss account.
e Prepare the balance sheet on 31 January.

1

1.6 Questions

a Prepare the balance sheet on 1 March using the following data:

Premises	€ 150,000
6% mortgage loan	€ 120,000
Goods	€ 40,000
Creditors	€ 20,000
Cash in hand	€ 10,000
Bank (deposit)	€ 30,000
Debtors	€ 65,000
Net profit	€ 24,000
Capital	€ 131,000

In March, the following financial facts take place:

March 2	Received by bank from customer H. Wiseman €4,000.
March 5	Sold on credit and delivered goods for €15,000, purchase price €8,000.
March 9	Repaid by bank €10,000 on the mortgage loan.
March 11	Purchased on credit and received from E. van Capelle goods for €7,000.
March 14	Paid by bank to supplier T. Geerts €7,000.
March 14	Received returned goods with a purchase price of €1,000. The sales value of these goods was €2,100. The returned goods have been added to the stock.
March 19	Purchased on credit and received goods for €6,000 from supplier Joost Klerks.
March 22	Paid €120 cash for electricity costs.
March 25	Cash sales amounted to €8,000. The goods delivered had a purchase price of €5,000.
March 26	Returned goods with a purchase price of €500. Received credit invoice from the supplier.

b Prepare journal entries of the financial facts that took place in March. Use the following profit and loss accounts: Sales results, General Expenses, Insurance costs, Depreciation costs, and Interest costs.
c Open the ledger accounts and update them using the journal entries from b.
d Prepare the extended trial balance sheet over March.
e Prepare the profit and loss account.
f Prepare the balance sheet as at March 31.

Multiple choice questions

1.1 What is shown in the balance sheet?
A The assets and liabilities at a certain date.
B The assets and liabilities for the upcoming period.
C The assets and liabilities of the previous period.

1.2 The profit and loss account gives an overview of what?
A The costs and revenues at a certain date.
B The costs and revenues of the previous period.
C The receipts and payments of the previous period.

1.3 In the accounts, financial facts are processed, from which, eventually, the profit and loss account and the balance sheet are derived.

In what order should the financial facts be processed?

A Journal – Ledger – Trial balance.
B Ledger – Journal – Trial balance.
C Journal – Trial balance – Ledger.

1.4 Entrepreneur WASNEEPLUS contracted a loan from his bank. He receives the money he borrowed on his bank account. He records this receipt on the debit side of his ledger account Bank. What is the final effect of this financial fact on the balance sheet?
A Capital increases and the assets increase.
B The assets increase and the liabilities increase.
C The capital increases and the liabilities increase.

1.5 Mr. Bosma, a sole trader in cars in The Hague, enters in his books a payment by bank of his provisional tax assessment. After this booking, capital is still positive (the company still owes money to Mr. Bosma). Prior to this payment, the car dealer had sufficient funds on his bank account.
What effect will the above-mentioned booking have on the operating income and the balance sheet total?

A The operating income remains equal, the balance sheet total decreases.
B Both the operating income and the balance sheet total remain equal.
C The operating income decreases, the balance sheet total decreases.

Case related to questions 1.6-1.8

The following is given for enterprise PIEBIE:

Totals as at 31 December 2014

Account	Debit	Credit
Debtors	€ 75,000	€ 66,000
Creditors	€ 36,000	€ 42,000

1.6 What is the function of the totals?
A The totals check if the balance sheet is balanced.
B The totals check if the journal is balanced.
C The totals check if the general ledger is balanced.

1.7 What does the credit amount on the account “Debtors” show us, among other things?
A The amount still receivable from debtors.
B The amount still payable to debtors.
C The amount received from debtors in this year.

1.8 What does the credit amount on the account “Creditors” indicate?
A The payments made by bank to creditors during the entire financial year.
B The amount owing to creditors at the end of the current financial year.
C The total amount of received invoices from creditors, including the balance at opening.

End of case