



Module Fundamentals OF Accounting 1

ACCOUNTANCY (Our Lady of Fatima University)

FUNDAMENTALS

OF

ACCOUNTING 1

MODULE

FOR

GRADE 11

TYPES OF MAJOR ACCOUNTS

LESSON 8.1 : TYPES OF MAJOR ACCOUNTS

The Philippine Accounting Standards (PAS) defines elements as the basic categories that appear on the financial statements. Three of the five elements (assets, liabilities and capital) are related to the status of an entity at a particular point in time (Statement of Financial Position) . The other elements such as comprehensive income and expenses are related to the performance of an entity over a period of time (income statement / Statement of Financial Performance) .

ASSETS - A present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.

Current Assets – An asset should be classified as current asset when:

- it is expected to be realized in, or held for sale or consumption in the normal course of the enterprise's operating cycle.
- it is held primarily for trading purposes.
- it is expected to be realized within twelve (12) months of the balance sheet date.
- it is cash or a cash equivalent asset, which is not restricted in its use. Some examples are cash, checks received from customers, postal orders, etc.

The following items would be classified as current assets :

1. Cash and cash equivalents
2. Marketable Equity securities
3. Receivables include accounts and notes receivable, receivable from affiliate companies and officers and employees receivables
4. Inventories
5. Prepaid Expenses

Non-Current Assets. The non-current includes tangible, intangible, operating and financial assets of a long-term nature. The IAS does not prohibit the use of alternative description for non-current assets as long as the meaning is clear.

1. Long-term investments
2. Property, Plant and Equipment
3. Intangible. Examples of this type of assets are:
 - a. Patent
 - b. Goodwill
 - c. Franchise
 - d. Lease and
 - e. Trademarks
 - f. Copyrights

LESSON 8.2 : TYPICAL ACCOUNT TITLES / ELEMENTS OF FINANCIAL POSITION – ASSETS

Accounting work is done easier when uniform account titles are used for similar transactions. Some typical account titles used to record the business transactions in the books of account are :

CURRENT ASSETS

1. Cash – It consists of coins, currency, bank deposits and negotiable instruments such as money orders, checks and bank drafts.
2. Accounts Receivable – These arises when the business sold or rendered services on open account.
3. Notes Receivable – These are claims of the business against third parties when such claims are evidenced by a promissory note.
4. Office Supplies – These are costs of stationary, typewriting papers, carbon, computer papers, ribbons, computer ink, etc., which are used by the business for the office.

NON-CURRENT ASSETS

1. Furniture and Fixtures – These are office desks, chairs and tables, filing cabinets and other improvements in the office.
2. Store Furniture and Fixtures – These are store drawers, store cabinets, display cabinets, trays that are used by the business for store operations.
3. Land – This is the cost of the land where the building and other fixed structures are erected.
4. Building – This represents the structure attached to the land.
5. Accumulated Depreciation – A contra-valuation account. This is the sum total of all depreciation expense recognized during the life of the assets.

LESSON 8.3 : ELEMENTS OF FINANCIAL POSITION - LIABILITIES AND OWNER'S CAPITAL

LIABILITIES – Liabilities are economic obligations of an enterprise that are recognized and measured in conformity with generally accepted accounting principles. These are present obligations of the enterprise arising from past transactions or events the settlement of which is expected to result in an outflow from the of resources embodying economic benefits. The liabilities are normally reported in the balance sheet in the order of payment

CURRENT LIABILITIES – are those obligations that are reasonably expected to be liquidated through the use of existing resources properly classified as current assets or the creation of another current - liabilities, within the normal operating cycle of one year, whichever is longer. Accordingly, an obligation is considered current when it is expected to be settled in the normal course of the enterprise's operating cycle, or, is due o be settled within 12 months of the balance sheet date. The major items that are usually found under the classification of current liabilities are best described as follows:

1. Accounts Payable
2. Notes Payable
3. Accrued liabilities or accrued expenses
4. Income taxes payable
5. Estimated liabilities

EQUITY – is the residual interest in the assets that remains deducting its liabilities. Equity arises from ownership relation and is the basis for distribution of earnings to the owners. Distribution of enterprise assets to owners is voluntary. Equity is increased by owner's investments and comprehensive income and is reduced by distributions to owners.

LESSON 8.4 : TYPICAL ACCOUNT TITLES / ELEMENTS OF FINANCIAL POSITION – LIABILITIES AND OWNER’S CAPITAL

Accounting work is done easier when uniform accounts are used for similar transactions. Some typical account titles used to record the business transactions in the books of account are:

CURRENT LIABILITIES

1. Accounts Payable – This obligation arises when it purchased materials, supplies or inventory with an oral promise to pay in the near future.
2. Notes Payable – This obligation arises when the business has liability to pay is evidenced by a promissory note.
3. Salaries Payable – These are obligations for salaries due but are not paid.
4. Income Tax payable – This is a liability to the government for income taxes.

NON-CURRENT LIABILITIES

1. Mortgage Payable – This is a long-term liability of the business payable beyond the accounting period. This account arises when the business mortgage a property to obtain a loan from a bank.

CAPITAL

1. Owner’s Capital – This account is used for recording initial and additional investment made by the owner.
2. Owner’s Drawing / Withdrawal – This account is used to record drawings or withdrawals in a form of cash or non-cash made by the owner of the business.

LESSON 8.5 : ELEMENTS OF FINANCIAL PERFORMANCE – INCOME AND EXPENSE.

Comprehensive Income. This is the change in equity during a period from transactions and other events and circumstances from non-owner sources. This includes all changes in equity during a period, except those from investments or withdrawals by the owners.

Expenses. These are decreases in benefits during the accounting period in the form of outflows or incurrence of liabilities that result in decrease in equity, other than those relating to the withdrawals of owners, or distribution of equity to owners.

Income. These are increases in economic benefits during the accounting period in the form of inflows or enhancements of assets that result in increase in equity, other than those relating to contribution from equity participants.

LESSON 8.6 : TYPICAL ACCOUNT TITLES / ELEMENTS OF FINANCIAL POSITION – INCOME AND EXPENSES

INCOME / COMPREHENSIVE INCOME

1. Service Income – This is the account used when the business will record revenue from sale of services . Other titles may be used instead of service income are professional fees earned, retainers income, service fees earned, etc.

2. Interest Income –This is the account used when the business earns interest from notes receivables.
3. Commission Income - This is the account used to record income from task (commission) done by the business, example, is selling products on behalf of other entity.

EXPENSES

1. Salary Expense – This is the account used to record the payment of salary to workers.
2. Rent Expense – This is the account used when the business pays rent for the space it occupies. If the payments is for the office, rent expense is used. If the payment is for the store, store rent is used.
3. Utilities Expense – These are payments for electricity, light and water use. Utility expense may also be used instead of light, heat and water.
4. Telephone Expense – These are expenses for the use of telephone and telegram.
5. Interest Expense – This is the expense for the interest payments when an interest is paid for the notes payable.
6. Depreciation Expense – This is the expense recorded by business for the physical deterioration of assets like machinery, equipment, furniture, etc. It is the cost to expense during the accounting period.

BOOKS OF ACCOUNTS

LESSON 9.1 : BOOKS OF ACCOUNTS

Aside from the traditional general journals which are used to record a specific transaction general ledgers used to transfer or post transactions from the journal to the ledger, merchandising companies use specific journals designed to record specific transactions of a similar nature.

These special journals are the following:

1. **Sales Journal** – journal normally used to record sales of goods on credit only.

Date	Customer	Invoice No.	Posting Ref.	Accounts Receivable (Debit)	Sales (Credit)	Output Tax (Credit)

2. **Purchase Journal** – journal normally used to record all purchases on credit only.

Date	Customer	Invoice No.	Posting Ref.	Purchases (Debit)	Accounts Payable (Credit)	Input Tax (Credit)

3. **Cash Receipts Journal** – special journal normally used to record all receipts of cash.

Date	Particulars	PR	Sales (Credit)	Accounts Receivable (Credit)	Sales Discounts (Debit)	Cash (Debit)	Sundry Accounts	Account Title

4. **Cash Payments Journal** – special journal normally used to record all payments of cash.

Date	Check No.	PR	Accounts Payable (Debit)	Purchase Discounts (Credit)	Cash (Credit)	Sundry Accounts	Account Title

ACCOUNTING FOR SERVICE BUSINESS

THE NATURE OF THE SERVICE BUSINESS

The nature of the service business normally involves the rendering of a service depending on the needs of the customers that requires specialized skills and competencies. Common of this type of business are restaurants, fast food chains, beauty parlours, hospitals and repair service shops. CPA's offering assurance and consultancy services to their clients while medical doctors rendering medical services to their patients. Lawyers assist their clients in legal matters and issues. Service business is considered one of the most profitable industries in the Philippines.

LEARNING OBJECTIVES:

1. Define accounts and its normal balances.
2. Demonstrate how to record journal entries.
3. Appreciate the relationship of value received and value parted with in recording business transaction and
4. Analyse how transactions are recorded in the T-account.

In accounting system, the business transactions are recognized when it is recorded through the use of “double-entry system” which means transactions are necessary to be recorded twice. The method of recording this transaction involves dual effect to the elements of accounting equation so called double-entry method of bookkeeping.

ACCOUNT

It is defined as individual record that summarizes the increase and decrease of each asset, liability and owner's equity transaction. Each account will have title and corresponding account number. It shows the debit and credit side of an account. The debit side represent the left side and the credit side represents the right side. Always remember that both sides must always be equal.

THE T-ACCOUNT

It is similar to big capital letter T, that’s why it is called T-account. It is known to be the simplest form of account which is used to demonstrate the debit and the right side of an account. Furthermore, it is important to remember that each side, represent the left and the right side.

Account Title	
Debit Side Left Side	Credit Side Right Side

LESSON 10.1 : THE NATURE OF DEBIT AND CREDIT

The word debit and credit came from the Latin word “debere” which means to “owe” and “credere” which means “ to trust or to believe”. Debit is abbreviated as “Dr” and credit as “Cr”. In recording transaction, the debit and credit signifies an increase and decrease of an account. There are accounts which normally increases when it is debited, there are some that increases when it is credited.

Debit to Increase in assets Decrease n liabilities Decrease in owner’s equity <ul style="list-style-type: none"> • Withdrawal of assets • Increase in expenses and losses • Decrease in income 	Credit to Decrease in assets Increase in liabilities Increase in capital due to: <ul style="list-style-type: none"> • Investment by the owner • Decrease in expenses and losses • Increase in income
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In general, bookkeeper will say “debit to” rather than “place an entry to debit side of an account”, or “credit to” rather than “place an entry to credit side of an account”. For better understanding, the table below summarizes the normal balances of all account.

Account	Normal Balance
Assets	Debit side
Liabilities	Credit side
Capital	Credit side
Revenue / Income	Credit side
Expenses	Debit side
Drawing	Debit side

ACCOUNTING CYCLE

The following are the steps by step procedures followed in accounting cycle.

1. Journalizing
2. Posting
3. Preparation of the trial balance
4. Adjusting the entries
5. Preparation of the worksheet
6. Preparation of financial statements
7. Closing the entries
8. Reversing the entries

JOURNALIZING

This is the first step in accounting cycle. This is the process of recording business transaction in a journal.

A **journal** is a book of accounts wherein business transactions are recorded for the first time. It is also called the book of original entry. There are two kinds of journal – **the general journal and the special journals**. Cash receipts journal, cash payments journal, sales journal, purchases journal and some other forms of combination journals are special journals. The type to be used depends on the size and the need of the business.

General Journal is the simplest form of journal wherein the two-column form may be used.

ILLUSTRATION 1

GENERAL JOURNAL OF JPL AUTOMOBILE SERVICES

Date	Particulars	PR	Debit	Credit
2012				
June 1	Cash	111	20,000	
	JP. Lee, Capital	311		20,000
	JP.Lee invested cash in shop business			
2	Salaries Expense	511	2,000	
	Cash	111		2,000
	Paid salaries of employees			
3	Accounts Receivable	112	5,000	
	Service Income	411		5,000
	Rendered services on account			
4	Equipment	117	5,000	
	Accounts Payable	211		5,000
	Bought cash register on account			
5	Furniture and Fixtures	116	4,000	
	Accounts Payable	211		4,000
	Bought furniture on account			
6	Rent Expense	512	2,500	
	Cash	111		2,500
	Paid rent for cash			
7	Taxes and Licenses Expense	517	600	
	Cash	111		600
	Paid taxes and licenses of the business			

8	Office Supplies	114	3,000	
	Cash	111		3,000
	Bought office supplies for cash			
9	Notes Receivable	113	4,000	
	Service Income	411		4,000
	Received from customer a promissory note for the services rendered.			
10	Utilities Expense	516	3,000	
	Cash	111		3,000
	Paid light and water bill			
11	Accounts Payable	211	4,000	
	Cash	111		4,000
	Paid the furniture on account bought last June 5.			
12	Cash	111	5,000	
	Accounts Receivable	112		5,000
	Received payment from customer for the services rendered on account. Last June 3.			
13	Cash	111	5,000	
	JP Lee, Capital	311		5,000
	Additional cash investment of JP Lee.			
14	JP Lee, Drawings	312	10,000	
	Cash	111		10,000

JP Lee made a withdrawal for personal use

15	Cash	111	10,000	
	Service Income	411		10,000
	Received payment for services rendered.			

THE LEDGER

A group of accounts is called ledger. This ledger provides a summary of transaction for accounting period. Each account has individual record in the general ledger; it is so-called book of final entry.

POSTING

Posting is the process of transferring the entries from journal to the accounts in the ledger. If an account is debited in the journal, it will also be posted on the debit side of

THE RECORDING PROCESS

The following are the steps by step procedures followed in accounting cycle.

1. Journalizing
2. Posting
3. Preparation of the trial balance
4. Adjusting the entries
5. Preparation of the worksheet
6. Preparation of financial statements

7. Closing the entries
8. Reversing the entries

JOURNALIZING

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A journal is a book of accounts wherein business transactions are recorded for the first time. It is also called the book of original entry. There are two kinds of journal – the general journal and the special journals. Cash receipts journal, cash payments journal, sales journal, purchases journal and some other forms of combination journals are special journals. The type to be used depends on the size and the need of the business.

General Journal is the simplest form of journal wherein the two-column form may be used.

A general journal contains the following columns:

1. Date –the date of the transaction is entered in this column; transactions are recorded in a systematic order and in a chronological order.
2. Account Titles and Explanation – this column contains the debit and credit accounts and a brief explanation of the entries.
3. Folio – this contains the post reference number or the ledger page in which the accounts are transferred.
4. Debit – contains the amounts debited.
5. Credit – contains the amounts credited.

A journal entry is a record of business transactions in the journal. A journal entry consists of debit accounts and credit accounts. There are two types of journal entry: the simple journal entry which contains only one debit and one credit accounts, and the compound journal entry which contains either one debit and two or more credits; or two or more debits and one credit; or two or more debits and two or more credits.

THE IMPORTANCE OF POSTING REFERENCE

The posting reference is important to establish the audit trail. The audit trail is the path that is used to trace transactions from the source document to the accounts or vice-versa.

DEFINITION OF CHART OF ACCOUNTS

Chart of accounts is the list of account titles used by the business with corresponding account number for easier reference of bookkeeper in recording of transaction called chart of accounts. It is classified according to the nature of the accounts.

JOURNALIZING AND POSTING: COMPLETE ILLUSTRATION

Transactions

2012

- Sept. 1 – G. Alajar opened a television repair he called “ Sure Repair Shop “. He began business by investing P2,500 in cash and the following assets: repair tools P1,200, repair supplies P1,500 and a truck P20,000.
- 2 – Paid P250 for newspaper advertising announcing the opening of his shop.
- 3 – Purchased office tables , chairs and filing cabinets from Cruz Furniture on credit P6,500.
- 5 – Completed repair work for R. Gil on credit, P1,200.
- 9 – Completed repair work for M. Soriano P2,200. Accepted P1,000 in cash and promised to pay the balance after five days.
- 15 – Paid the wages of the shop helper, P450.
- 18 – Paid one-half of the account due to Cruz Furniture and issued a promissory note

- for the other half.
- 20 – R. Gil paid his account.
 - 25 – Withdrew cash for P750 for personal use.
 - 28 – Received P2,500 from S. Serna for repair service rendered.
 - 30 – Paid the monthly utility bills, P150.
 - 30 – Paid the month's rent of the shop, P450.
 - 30 – Wages of the shop helper, P450.

ILLUSTRATION OF JOURNALIZING

GENERAL JOURNAL OF SURE REPAIR SHOP

Date	Account Titles and Explanation	F	Debit	Credit
2012				
Sept. 1	Cash	11	2,500	
	Repair Tools	14	1,200	
	Repair Supplies	15	1,500	
	Service Truck	17	20,000	
	G. Alajar, Capital	31		25,200
	To record the initial investment of G. Alajar			
2	Advertising Expense	51	250	
	Cash	11		250
3	Payment for newspaper advertising.		Page 3	of 14
	Furniture and Fixture	16	6,500	
	Accounts Payable – Cruz Furniture	21		6,500
	Purchased of tables, chairs and filing cabinets on credit.			
5	Accounts Receivable – R. Gil	12	1,200	
	Service Income	41		1,200
	Repair service rendered on account.			
9	Cash	11	1,000	
	Accounts Receivable – M. Soriano	13	1,200	
	Service Income	41		2,200
	Repair service rendered.			
15	Salaries and Wages	52	450	
	Cash	11		450
	Payment of the wages of the shop helper for the first half of the month.			
18	Accounts Payable – Cruz Furniture	21	6,500	
	Cash	11		3,250
	Notes Payable	22		3,250
	Payment of the account due to Cruz Furniture.			
20	Cash	11	1,200	
	Accounts Receivable – R. Gil	12		1,200
	Full payment of R. Gil			
25	G. Alajar, personal	32	750	
	Cash	11		750
	Drawing of the owner for personal use.			
28	Cash	11	2,500	

	Service	41		2,500
	Amount receives for services rendered.			
30	Utility Expense	53	150	
	Cash	11		150
	Payment of monthly utility bills.			
30	Rent Expense	54	1,000	
	Cash	11		1,000
	Payment of monthly rental.			
30	Salaries and Wages	52	450	
	Cash	11		450
	Payment of the wages of the shop helper for the second half of the month.			

NEED FOR A JOURNAL

1. To provide in one place a complete record of each transaction. Such will link together the debits and credits of the transactions.
2. The records make it possible to trace the debits and credits of the accounts when errors are committed.

POSTING

A posting is the process of transferring the records from the journal to the ledger. A ledger constitute a group of accounts. It is also called the “ book of final entry “. The simpler form of a ledger is the “ T-account “. And the ledger is the modified T-account.

NEED FOR A LEDGER

1. Items of similar nature are grouped together.
2. It is easier to locate the item if an information about is needed.

PROCEDURE IN POSTING

1. Locate the corresponding account title in the ledger.
2. Transfer to the ledger the following information from the journal:
 - a. Date
 - b. Explanation
 - c. Amount

Debit accounts from the journal are posted on the debit side of the ledger and credit accounts are posted on the credit side of the ledger.

3. Place the page number journal in which the information was taken to the folio column of the ledger.
4. Place in the folio column of the journal the page number of the ledger in which the information was posted.

Inserting the account number in the journal folio column serves two purposes:

1. It serves as a cross-reference when it is desired to trace the amount from one record to another.
2. Writing the account number in the journal indicates that posting is completed.

ILLUSTRATION OF POSTING

GENERAL LEDGER OF SURE REPAIR SHOP

CASH

Account No. 11

Date	Explanation	F	Debit	Credit	Balance
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Sept. 1	Initial investment	J-1	P 2,500		P 2,500
2	Newspaper advertising	J-1		250	2,250
9	Service rendered	J-1	1,000		3,250
15	Wages of shop helper	J-1		450	2,800
18	Partial payment to Cruz Furniture	J-1		3,250	(450)
20	Partial payment of R. Gil	J-1	1,200		750
25	Drawing account	J-1		750	0
28	Service rendered	J-1	2,500		2,500
28	Service rendered	J-1	2,500		2,500
30	Utility expense	J-1		150	2,350
30	Monthly rental	J-1		1,000	1,350
30	Wages of shop helper	J-1		450	900

ACCOUNTS RECEIVABLE – R.GIL

Account No. 12

Date	Explanation	F	Debit	Credit	Balance
Sept. 5	Service rendered	J-1	P 1,200		P 1,200
20	Full payment of account	J-1		1,200	0

ACCOUNTS RECEIVABLE – M. Soriano

Account No. 13

Date	Explanation	F	Debit	Credit	Balance
Sept. 9	Service rendered	J-1	P 1,200		P 1,200

REPAIR TOOLS

Account No. 14

Date	Explanation	F	Debit	Credit	Balance
Sept. 1	Investment	J-1	P 1,200		P 1,200

REPAIR SUPPLIES

Account No. 15

Date	Explanation	F	Debit	Credit	Balance
Sept. 1	Investment	J-1	P 1,500		P 1,500

FURNITURE AND FIXTURES

Account No. 16

Date	Explanation	F	Debit	Credit	Balance
Sept. 1	Purchased on account	J-1	P 6,500		P 6,500

SERVICE TRUCK

Account No. 17

Date	Explanation	F	Debit	Credit	Balance
Sept. 1	Purchased of furniture on account	J-1	P20,000		P20,000

ACCOUNTS PAYABLE – CRUZ FURNITURE

Account No. 21

Date	Explanation	F	Debit	Credit	Balance
Sept. 3	Purchased of furniture	J-1		P 6,500	P 6,500
18	Full payment of account	J-1	6,500		0

NOTES PAYABLE

Account No. 22

Date	Explanation	F	Debit	Credit	Balance
Sept. 18	Partial settlement of account due to Cruz Furniture	J-1		P 3,250	P 3,250

G. ALAJAR, Capital

Account No. 31

Date	Explanation	F	Debit	Credit	Balance
Sept. 1	Initial investment	J-1		P25,200	P25,200

G. ALAJAR, Personal

Account No. 32

Date	Explanation	F	Debit	Credit	Balance
Sept. 25	Drawing account	J-1	P 750		P 750

SERVICE INCOME

Account No.41

Date	Explanation	F	Debit	Credit	Balance
Sept. 5	Service rendered on account to R. Gil	J-1		P 1,200	P 1,200
9	Service rendered	J-1		2,200	3,400
28	Service rendered	J-1		2,500	5,900

ADVERTISING EXPENSE

Account No. 51

Date	Explanation	F	Debit	Credit	Balance
Sept. 2	Newspaper advertising	J-1	P 250		P 250

SALARIES AND WAGES

Account No. 52

Date	Explanation	F	Debit	Credit	Balance
Sept. 15	Wages of the shop helper -1st half	J-1	P 450		P 450
30	Wages of the shop helper- 2nd half	J-1	450		900

UTILITY EXPENSE

Account No. 53

Date	Explanation	F	Debit	Credit	Balance
Sept. 30	Monthly utility	J-1	P 150		P 150

RENT EXPENSE

Account No. 54

Date	Explanation	F	Debit	Credit	Balance
Sept. 30	Monthly rental	J-1	P 1,000		P 1,000

PREPARATION OF TRIAL BALANCE

TRIAL BALANCE

A trial balance is a list of accounts with open balances in the general ledger. It proves the equality of the debits and the credits in the general ledger.

ILLUSTRATION

Sure Repair Shop			
Trial Balance			
September 30, 2012			
Accounts	Debit	Credit	
Cash	P 900		
Notes Receivable	1,200		
Repair Tools	1,200		
Repair Supplies	1,500		
Furniture and Fixtures	6,500		
Service Truck	20,000		
Notes Payable		P 3,250	
G. Alajar, capital		25,200	
G. Alajar, personal	750		
Service Income		5,900	
Advertising Expense	250		
Salaries and Wages Expense	900		
Utility Expense	150		
Rent Expense	<u>1,000</u>		
Total	P34,350	P34,350	

ERRORS IN TRIAL BALANCE

If the totals of the debit and credit sides of a trial balance are not equal, an existence of error or more is possible. The causes of errors are the following:

1. Posting an item twice.
2. Posting to the wrong side of the account.
3. Omission of posting.
4. Wrong footings to the ledger.
5. Wrong transferring of account from the ledger to the trial balance.

The following procedure may be followed to locate errors:

1. Re-add the debits and credits of the trial balance.
2. Get the difference between the two totals.
 - a. If the difference is a digit of one, i.e., P10, P100, P1,000, etc., the error may be in the addition or subtraction. Check the footings of the debit and credit in that case. If the error is not located, the posting in the ledger should be verified.
 - b. If the difference is an even number, divide the number by 2. The quotient arrived at may be omitted in the trial balance or an account may be erroneously transferred on the wrong side of the trial balance. For this type of trial balance, scan the postings in the general ledger. If the amount is found, verify if the posting is correct or not.
 - c. If the difference is multiple by 9, the error may be due to transposition, that is, the order of the figure is reversed. Such as 57 is written as 75, or 119 as 191.
 - d. If the difference is divisible by 9, this indicates misplacements. For example P100 is written as P10 or P2,500 as P250.

CORRECTION OF ERRORS

Erasures in the record are not advisable because they destroy the neatness of work. Instead the following ways may be applied to correct errors committed:

1. Using correcting journal entries; or
2. Drawing a single line through the wrong item or amount and writing immediately above the cancelled item or amount the correct one.
 - a. If the difference is a digit of one, i.e., P10, P100, P1,000, etc., the error may be in the addition or subtraction. Check the footings of the debit and credit in that case. If the error is not located, the posting in the ledger should be verified.
 - b. If the difference is an even number, divide the number by 2. The quotient arrived at may be omitted in the trial balance or an account may be erroneously transferred on the wrong side of the trial balance. For this type of trial balance, scan the postings in the general ledger. If the amount is found, verify if the posting is correct or not.
 - c. If the difference is multiple by 9, the error may be due to transposition, that is, the order of the figure is reversed. Such as 57 is written as 75, or 119 as 191.
 - d. If the difference is divisible by 9, this indicates misplacements. For example P100 is written as P10 or P2,500 as P250.

THE ADJUSTING PROCESS

INTRODUCTION

Accounting period is any length of time in which the life of the business is divided. Such time may either be a monthly period, quarterly period or a year.

At the end of each accounting period, financial reports are prepared to show the results of the business operations. Such reports which always include the income statement and the balance sheet should reflect the revenues realized and expenses incurred and a fairly measure of the assets, liabilities and owner's equity. Normally at the end of each accounting period, there are several accounts that need to be adjusted.

ADJUSTING ENTRIES

Adjustments are premeditated part of the accounting cycle. Adjusting entries are recorded at the end of accounting period to bring the accounts up to date. Accounts should be adjusted due to passage of time and obsolete characteristics of property that need to be considered to accurately record the account.

PURPOSE OF ADJUSTING ENTRIES

1. To reflect the proper amounts of revenue realized and expenses incurred during a period.
2. To show a fairly measure of the assets, liabilities and owner's equity.

TWO TYPES OF ACCOUNTING METHOD:

1. Cash Method
2. Accrual Method

CASH METHOD vs ACCRUAL METHOD

Cash method income is recorded only when the cash is received and expenses are recorded when cash are paid.

Accrual method on the other hand, recognizes income when recorded goods are delivered or services are rendered to customers, and the expenses are recognized when incurred. The accrual method is commonly used method because it gives precise results when used in the normal operation of the business.

ACCOUNTS THAT NEED TO BE ADJUSTED:

1. Prepaid Expenses or Deferred Expenses – expenses paid in advance but have to be used or consumed the next accounting period. At the time of payment, the account is an asset and as it is used it becomes an expense.
2. Unearned Income /Unearned Revenue / Deferred Revenue – revenues already received in advance and to be earned the next accounting period.
3. Accrued Expenses – expenses already incurred but will be paid the next accounting period.
4. Accrued Income / Accrued Revenue – income already earned but the payment will be received the next accounting period.
5. Provision for bad debts
6. Provision for depreciation

ADJUSTMENT FOR PREPAID EXPENSES

Prepaid expenses are expenses paid in advance but have to be used or consumed the next accounting period. At the time of payment, the account is an asset and as it is used it becomes an expense.

There are two methods to be used: the asset method and the expense method.

1. Asset Method. Under this method, the original entry made is charged to an asset account.

Example

On November 1 of the current year, C. Santos paid P3,000 for a three month rental of the office space.

Original Entry			Adjusting Entry		
Nov. 1	Prepaid Rent	P3,000	Dec. 31	Rent Expense	P2,000
	Cash	P3,000		Prepaid Rent	P2,000

Analysis

The P3,000 which was paid in November 1 is for a three month rental of the space, November, December and January. As of December 31, the end of the accounting period, only P2,000 have already been incurred, so that portion is an expenses and the remaining P1,000 is still prepaid until January 31 of the following accounting period.

2. Expense Method. Under this method, expense account is charged when payment is made.

Using the same example, the following are the entries made:

Original Entry			Adjusting Entry		
Nov. 1	Rent Expense	P3,000	Dec. 31	Prepaid Rent	P2,000
	Cash	P3,000		Rent Expense	P2,000

Analysis

The rental payment of P3,000 is paid for the months of November, December and January. As of December 31, only P2,000 or for two months rental have been incurred. The remaining P1,000 is still prepaid until January 31 of the next accounting period.

ADJUSTMENT FOR UNEARNED INCOME / UNEARNED REVENUE / DEFERRED REVENUES

arises when payment is received before goods are delivered or before services are rendered. Are income received in advance before services have been rendered and before goods are delivered.

There are two methods to be used: the income method and the liability method.

1. Income Method. Under this method, income account is credited when cash is received.

Example

On November 1 of the current year, the business received P3,000 cash from the tenant of the vacant space of the store

		Original Entry			Adjusting Entry
Nov. 1	Cash	P3,000	Dec. 31	Rent Income	P2,000
	Rent Income	P3,000		Unearned Rent	P2,000

Analysis

The business received from a tenant a P3,000 cash advance rentals for the months of November, December and January. As of December 31, only two months rental or P2,000 are already earned. The remaining P1,000 is still unearned until January 31 of the following accounting period.

2. Liability Method. Under this method, a liability account is credited upon receipt of cash.

		Original Entry			Adjusting Entry
Nov. 1	Cash	P3,000	Dec. 31	Unearned Rent	P2,000
	Unearned Rent	P3,000		Rent Income	P2,000

Analysis

As of December 31, the two month rentals or P2,000 are already earned. Only P1,000 or the rental for the month of January is still unearned.

ACCRUAL OF EXPENSES

Accrued expenses are those expenses already incurred during the period but are not yet paid or recorded.

At the end of the accounting period, the income statement should reflect such expense and the balance sheet should reflect a liability account. The adjusting entry to record accrual of expenses is debit the expense account and credit the liability account.

Example

Office employees are paid every two weeks. On December 31, five days' salaries of an employees for P400 per day have accrued.

Adjusting Entry:

Date	Account Titles and Explanation	F	Debit	Credit
Dec. 31	Salaries Expense		P2,000	
	Accrued Salaries			P2,000
	Five-day accrued salaries of an employee for P400 per day.			

ACCRUAL OF INCOME

Accrued Income arises when goods have been delivered or services have been rendered but no amount of payment have been collected or if there is payment, such collection is not yet recorded.

In order to avoid understatement of income and asset, an adjusting entry is needed at the end of the period.

The entry to adjust accrual of income is to debit the asset account and credit the income account.

Example

A tenant, who occupies the right side of the shop space, is two months in arrears as of the balance sheet date. His monthly rental is P5,000 per month.

Adjusting Entry:

Date	Account Titles and Explanation	F	Debit	Credit
Dec. 31	Accrued Rent Income		P10,000	
	Rent Income			P10,000
	Two months arrears of the tenant for P5,000 per month			

PROVISION FOR BAD DEBTS

Usually, most business firms extend credits to attract more customers and to sell more goods. However, not all credits extended are good or collectible. For a reason or another, a certain percentage of these collectibles are not collected. For this reason, the business should provide for such losses for non-collection of credits. This loss from uncollectible accounts is called bad debts. Bad debts is nominal account which must be shown in the income statement at the end of the accounting period.

The entry to adjust bad debts is as follows:

Bad Debts Expense	P500	
Estimated Uncollectible Account		P500

Bad debts or Loss from Bad Debts is debited to show a decrease in proprietorship account due to estimated loss.

Estimated Uncollectible Account or Allowance for Bad Debts which is a valuation account is credited because it is a deduction from an asset account, Account Receivable. In the balance sheet presentation, Estimated Uncollectible Account is deducted from Accounts Receivable to show the net book value or the net realizable value of the accounts receivable

Illustration

Accounts Receivable	P7,000
Less: Allowance for Uncollectible Account	500
Net Realizable Value	P6,500

There are several methods of estimating the probable losses from bad debts:

1. Increasing the accumulated allowance for bad debts by a certain percentage of the accounts receivable.
2. Increasing the accumulated allowance for bad debts to a certain percentage of the accounts receivable.

Illustration

The following accounts are shown in the pre-adjusted trial balance of Mr. Rodriguez as of December 31, 19_

	Debit	Credit
Accounts Receivable	P7,000	
Allowance for Bad Debts		P500

1. Allowance for Bad Debts by a Certain Percentage of Accounts Receivable

Computation:

$$\text{Bad Debt estimate} = P7,000 \times .10 = P700$$

Adjusting Entry

Bad Debts	P700	
Allowance for Bad Debts		P700
To increase the allowance for bad debts by 10% of the accounts receivable		

Balance Sheet Presentation

Accounts Receivable	P7,000	
Less: Allowance for Bad Debts	1,200	P5,800

2. Allowance for Bad Debts to a Certain Percentage of Accounts Receivable

Computation:

$$\text{Bad Debt estimate} = P7,000 \times .10 = P700$$

$$P700 - P500 = P200$$

Adjusting Entry

Bad Debts	P200	
Allowance for Bad Debts		P200
To increase the allowance for bad debts to 10% of the accounts receivable		

Balance Sheet Presentation

Accounts Receivable	P7,000	
Less: Allowance for Bad Debts	700	P6,300

PROVISION FOR DEPRECIATION

Asset which are relatively permanent in nature are fixed assets. They are used by the business in its operation and not intended for sale. The value of these assets, except land decreases as time passes by due to the following reasons:

1. wear and tear from operations.
2. inadequacy and obsolescence

An asset is said to be inadequate for the business if there is business expansion and the asset can no longer fulfil the needs of the business.

If it said to be obsolete in the introduction of new models or inventions and the business desires to replace the old asset with a new one.

The cost of the fixed asset is allocated to the number of its useful life. Depreciation is the portion of the cost of the asset which is already used or consumed.

There are several methods of depreciating assets such as the straight-line method of depreciation. The following formula is used to compute depreciation:

$$D = \frac{C - S}{N}$$

Where: D is the depreciation

C is the original cost which includes the invoice price less discount plus other cost incurred before the use of the asset such as freight and installation.

S is the salvage or scrap value. This is the amount wherein the asset can be sold after its useful life.

N is the number of estimated useful life

THE PREPARATION OF WORKSHEET

INTRODUCTION:

Accounting period is any length in which the life of the business is divided. Such time may either be monthly period, quarterly period or a year.

At the end of each accounting period, financial reports are prepared to show the results of the business operations. Such reports which always include the statement of comprehensive income and the statement of financial position should reflect the revenues realized and expenses incurred and a fairly measure of the assets, liabilities and owner's equity.

THE WORKSHEET

A worksheet is prepared to facilitate the presentation of adjusting entries, financial statements, and closing entries. It is prepared before the construction of financial statements and before the adjusting entries are entered in the journal and posted.

The following steps are taken in preparing a worksheet:

1. Write the heading of the heading of the worksheet at the top of the paper with the following information:

Name of the Business
Worksheet
For the period _____, 19_____

2. Provide the following columns in the worksheet

Account Titles	Trial Balance		Adjustments		Adjusted T.B.		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit

ILLUSTRATION NO. 2: COMPLETE ILLUSTRATION ADJUSTING ENTRIES, ADJUSTED TRIAL BALANCE AND WORKSHEET

Sure Repair Shop
Trial Balance
September 30, 19_

Accounts	Debit	Credit
Cash	P 900	
Accounts Receivable – M. Soriano	1,200	
Repair Tools	1,200	
Repair Supplies	1,500	
Furniture and Fixtures	6,500	
Service Truck	20,000	
Notes Payable		P 3,250
G Alajar, capital		25,200
G Alajar, drawing	750	
Service Income		5,900
Advertising Expense	250	
Salaries and Wages	900	
Utility Expense	150	
Rent Expense	1,000	
	34,350	34,350

On December 31, the end of the accounting period, the following data were taken:

1. An actual count of repair supplies showed a balance of P850.
2. Repair tools are depreciated at 10% per annum.
3. Furniture and Fixtures are estimated to have a useful life of 5 years while service ruck has a useful life of 10 years.
4. A 10% interest has accrued on the note payable.
5. Of the income received, P900 is applicable to the next accounting period.
6. Accrual of expenses: salaries and wages P250; rent P500.
7. The balance of the advertising expense account represents payment for five months.

Adjusting Journal Entries

1. Repair supplies used P650
 Repair supplies P650
 (P1,500 – P850 = P650)
2. Depreciation – repair tools 120
 Accumulated depreciation – repair tools 120
 (P1,200 x .10 = P120)
3. a. Depreciation – furniture and fixtures 433
 Accumulated depreciation – furniture and fixtures 433
 (P6,500 / 5 = P1,300/year) (P1,300 x 1/3 = P433)
- b. Depreciation – service truck 666
 Accumulated depreciation – service truck 666
 (P20,000 / 10 = P2,000/year) (P2,000 x 1/3 = P666)

Both furniture and fixtures and service truck were purchased on September of the current year.

4. Interest expense 325
 Accrued interest expense 325
 (P3,250 x .10 = P325)
5. Service Income 900
 Unearned Service Income 900
6. Salaries and wages 250
 Accrued salaries and wages 250
- b. Rent expense 500
 Accrued rent expense 500
7. Prepaid advertising 50
 Advertising 50
 (P250 / 5 = P50/month) (50 x 4 = P200 from Sept. to Dec.) (P250 – P200 = P50)

SURE REPAIR SHOP Worksheet For the four-month Period Ending December 31, 19__

Account	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	900				900				900	
Accounts										
Receivable-M. Soriano	1,200				1,200				1,200	
Repair Tools	1,200				1,200				1,200	
Repair Supplies	1,500			650	850				850	
Furniture & Fixture	6,500				6,500				6,500	
Service Truck	20,000								20,000	
Notes Payable		3,250								3,250
G Alajar, capital		25,200								25,200
G Alajar, drawing	750								750	
Service Income		5,900	900			5,000	5,000	5,000		
Advertising	250			50	200		200			
Salaries and Wages	900		250		1,150		1,150			
Utility expense	150				150		150			
Rent expense	1,000		500		1,500		1,500			
Total	34,350	34,350								

Repair Supplies Used			650		650					
Depreciation – repair tools			120		120					
Accumulated depreciation – repair tools				120		120				120
Depreciation – furniture & fixtures			433		433					
Accumulated depreciation- furniture & fixtures				433		433				433
Depreciation – service truck			666		666					
Accumulated depreciation – service truck				666		666				666
Interest expense			325		325					
Accrued interest expense				325		325				325
Unearned service income				900		900				900
Accrued salaries & wages				250		250				250
Accrued rent expense				500		500				500
Prepaid advertising			50		50				50	
			3,894	3,894	36,644	36,644	5,194	5,000	31,450	31,644
Net Loss								194	194	
							5,194	5,194	31,644	31,644

FINANCIAL STATEMENTS

Nature of Financial Statements

After the accounts have been adjusted and worksheet has been constructed, financial statements are prepared. There are two basic accounting statements: the income statements which contains the income and expense accounts, shows the results of business operation. The balance sheet contains the assets, liabilities and proprietorship of the business. It shows the financial condition of the business.

From the worksheet, the income statement can be prepared by referring to the income statement columns and the balance sheet can be prepared from the balance sheet columns of the worksheet.

The income statement has two forms: the multiple step form and the single step form. The single step form is commonly used by service concern. In this form, all expenses incurred are deducted from the income earned in order to obtain the net income of the period.

Income Statement – Single Step Form (Net Loss): Illustration

Sure Repair Shop
Income Statement
For the four-month Period Ending December 31, 19_

Service Income		P5,000
Less: Advertising expense	P 200	
Salaries and Wages expense	1,150	
Utility expense	150	
Rent expense	1,500	
Repair supplies used	650	
Depreciation – repair tools	120	
Depreciation – furniture and fixtures	433	
Depreciation – service truck	666	
Interest expense	<u>325</u>	<u>5,194</u>
Net Loss		(P 194)

The balance sheet has two forms also. The report form and the account form. In the report form, the assets, liabilities and owner's equity sections are in vertical order while in the account form, the assets are on the left side and liabilities and owner's equity are on the right side.

BALANCE SHEET – Account Form (Net Loss): Illustration
ACCOUNT FORM

Sure Repair Shop
Balance Sheet
As of December 31, 19_

Assets		Liabilities	
Current:			
Cash	P 900	Notes Payable	P3,250
Accounts Receivable-M. Soriano	1,200	Accrued Interest Expense	325
Repair Supplies	850	Accrued Salaries and Wages	250
Prepaid Advertising	<u>50</u>	Accrued Rent Expense	500
Total current assets	P 3,000	Unearned Service Income	<u>900</u>
		Total Liabilities	P5,225
Properties and Equipment:			
Repair Tools	P1,200	Owner's Equity	
Less: Accumulated depreciation	<u>120</u> P1,080	G. Alajar, capital	P25,200
Furniture and Fixtures	P6,500	Less: G. Alajar, drawing	<u>750</u>
Less: Accumulated depreciation	<u>433</u> 1,067	Net Capital	P24,450
Service Truck	P20,000	Less: Net Loss	<u>194</u> <u>24,256</u>
Less: Accumulated depreciation	<u>666</u> <u>19,344</u>		
Total Properties and Equipment	<u>26,481</u>		
Total Assets	P29,481	Total Liabilities & Owner's Equity	P29,481

REPORT FORM

Sure Repair Shop
Balance Sheet
As of December 31, 19_

Assets			
Current Assets			
Cash		P	900
Accounts Receivable-M. Soriano			1,200
Repair Supplies			850
Prepaid Advertising			<u>50</u>
Total current assets		P	3,000
Properties and Equipment:			
Repair Tools		P1,200	
Less: Accumulated depreciation	P120		<u>1,080</u>
Furniture and Fixtures		P6,500	
Less: Accumulated depreciation	<u>666</u>		<u>19,344</u>
Total Properties and Equipment			P26,481
Total Assets			P29,481
Liabilities			
Notes Payable		P3,250	
Accrued Interest Expense			325
Accrued Salaries and Wages			250
Accrued Rent Expense			500
Unearned Service Income			<u>900</u>
Total Liabilities			P5,225
Owner's Equity			
G. Alajar, capital		P25,200	
Less: G. Alajar, drawing			<u>750</u>
Net Capital			P24,450
Less: Net Loss			<u>194</u>
			P24,256
Total Liabilities & Owner's Equity			P29,481

ASSESSMENT NO. 1 : MULTIPLE CHOICE

NAME:	SCORE:
SECTION:	DATE:

Direction: Write your answer for each item in the space provided before the statement.

- _____ 1. Debits
- a. increase both assets and liabilities

- b. decrease both assets and liabilities
 - c. increase assets and decrease liabilities
 - d. decrease assets and increase liabilities
- _____ 2. A revenue account is:
- a. is increased by debits
 - b. is decreased by credits
 - c. has a normal balance of debit
 - d. is increased by credits
- _____ 3. Accounts that normally have debit balances are:
- a. assets, expenses and revenues
 - b. assets, expenses and owner's equity
 - c. assets, liabilities and owner's drawing
 - d. assets, owner's drawing and expenses
- _____ 4. Which of the following is not part of the recording process:
- a. analysing transactions
 - b. preparing a trial balance
 - c. entering transactions in a journal
 - d. posting transactions
- _____ 5. A ledger
- a. contains only asset and liability account
 - b. shows account in alphabetical order
 - c. is a collection of the entire group
 - d. is a book of original entry
- _____ 6. Posting
- a. normally occurs before journalizing'
 - b. transfer ledger transactions
 - c. is an optional step in the recording process'
 - d. transfer journal entries to ledger account
- _____ 7. Which of the following statement about a journal is false?
- a. It is not a book of original entry
 - b. It provides a chronological record of transactions
 - c. It helps locate errors because the debit and credit column for each entry can be readily compared.
 - d. It discloses in one place the complete effect of a transaction
- _____ 8. Debits and credit
- a. Increase assets and decrease in liabilities
 - b. Decrease both assets and liabilities
 - c. Decrease assets and increase liabilities
 - d. Increase both assets and liabilities
- _____ 9. Which of the following pertains to trial balance
- a. Proves that all that all transactions have been recorded
 - b. Will not balance if a correct journal entry is posted twice
 - c. Proves mathematical accuracy of journalized transactions.
 - d. It is a list of accounts accuracy of journalized transactions
- _____ 10. All of the following are false about the process of posting except for
- a. Transferring of entries from ledgers to the journal
 - b. Reconciling entries from journal to ledger
 - c. Reconciling items from ledger to journal
 - d. Transferring of entries from ledgers to the journal

ASSESSMENT NO. 2 : TRUE OR FALSE

NAME:	SCORE:
SECTION:	DATE:

Direction: In the space provided before the statement, write TRUE if the statement is correct or FALSE if the statement is incorrect.

- _____ 1. The recording process of accounting covers the verification of the accuracy and orderly of source documents.
- _____ 2. Recording the journal is chronologically arranged.
- _____ 3. Only those economic activities that will increase or decrease any of the accounting elements are recorded in the books of accounts.
- _____ 4. To credit an account is to record the value received in a business transactions.
- _____ 5. The posting process in the books of accounts is also referred to as journalizing.
- _____ 6. The accounting records written in the journal are called “ journal entries “,
- _____ 7. A journal entry has total debit equal to the total credit.
- _____ 8. A simple journal entry has only one debit account and one credit account.
- . _____ 9. The posting on the post-reference column of the general journal will indicate that the peso value of an account was already posted to its respective account in the general ledger.
- _____ 10. The general ledger is the source of the balances to be listed in the trial balance.

ASSESSMENT NO. 3 : TRUE OR FALSE

NAME:	SCORE:
SECTION:	DATE:

TRUE OR FALSE. In the space provided before the statement, write TRUE if the statement is correct or FALSE if the statement is incorrect.

- _____ 1. Accounting is the medium of communication through which financial information is furnished to different parties for decision making.
- _____ 2. To evaluate the operating performance of the business, the decision maker has to look at its balance sheet.
- _____ 3. The financial condition of the business is reported in its balance sheet.
- _____ 4. The business is profitable if its revenue is higher than its expenses.
- _____ 5. Cash is a real account, and accounts receivable is a nominal account.
- _____ 6. Expenses incurred to generate revenue are nominal account.
- _____ 7. An account is an accounting device use to record increase and decrease in specific accounting element.
- _____ 8. A chart of account is a listing of all the account names or titles use to record the economic activity of the business.
- _____ 9. An item to be considered as asset of the business must be owned by the business.
- _____ 10. The normal balance of an account payable is a debit amount.

ASSESSMENT NO. 4 : TRUE OR FALSE

NAME:	SCORE:
SECTION:	DATE:

TRUE OR FALSE. In the space provided before the statement, write TRUE if the statement is correct or FALSE if the statement is incorrect.

- _____ 1. The normal balance of an asset account is credit
- _____ 2. The general ledger is a book of original entry.
- _____ 3. The purchase of office equipment on account will increase the liability account
- _____ 4. Journalizing is the first step in accounting cycle.
- _____ 5 The additional investment by the owner will increase the asset account.
- _____ 6. Payment of business expenses will increase the equity account.
- _____ 7. The financial statements are prepared after the adjusting entries have been posted.
- _____ 8. Rendering of services on account will decrease the equity account
- _____ 9. The balance sheet shows all the nominal accounts.
- _____ 10. Payment of accounts payable will increase the liability account.

ASSESSMENT NO. 5 : APPLICATION OF DEBIT AND CREDIT

NAME:	SCORE:
SECTION:	DATE:

Direction: Indicate in each independent case whether the account is to be debited (Dr.) or to be credited (Cr.) .

1. _____ decrease in cash
2. _____ increase in owner's drawing account
3. _____ increase in accounts payable
4. _____ decrease in owner's equity
5. _____ decrease in prepaid insurance
6. _____ decrease in unearned income
7. _____ increase in rent income
8. _____ increase in office equipment
9. _____ decrease in accounts receivable
10. _____ decrease in unpaid salaries

ASSESSMENT NO.5:

NAME:	SCORE:
SECTION:	DATE: