Basics of Accounting

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I. INTRODUCTION

This book presents basics of accounting for beginners. The starting process is to understand what is accounting and what is hiding under Accounting Equation concept. Afterwards Accounting Cycle and detailed description of its each step is presented and supported by practical examples in order you understand basics and have an opportunity to practice gained knowledge.

II. ACCOUNTING EQUATION BASICS

The basis of accounting is **Accounting Equation**. It is necessary to understand its meaning to be able identifying how transactions impact this equation and financial position of the entity.

Properties (can be material, immaterial, monetary) owned by the entity are called **assets**. All the assets of the entity are financed by different means either owner's means, which are called **equity**, either means provided by the creditors, called **liabilities**. These means of finance are claims of the financers to the assets of the entity. Therefore value of the assets in any entity must be equal to the sum of equity and liabilities creating an equation:

Assets = **Owners' equity** + **Liabilities**

Upon analyzing business transactions all the time it is required to identify how they impact each part of this equation, i.e. how they impact assets, equity or liabilities.

Examples below provide analysis of the basic types of transactions and their impact on the equation.

1st transaction: One shareholder establishes a company, which will provide copying services. The shareholder invests 15000$ in cash opening entity's bank account and transferring cash into this bank account. The impact of this transaction on the equation is provided below, i.e. cash (assets) increases by 15000$ and share capital (owners' equity) increases by 15000$, as investment is made from the own means of the shareholder.

Assets		Owners' equity
Cash	=	Share capital
15000		15000

2nd transaction: the entity acquires copying equipment for 8000$ paying in cash from its bank account. As a result cash decreases by 8000$ and equipment increases by 8000$. Before reflecting an impact of this transaction on the equation, please note, that the equation starts from the figures transferred after the previous transaction was reflected, i.e. opening cash balance is 15000$ and opening owners' equity balance is 15000$. This is done after each transaction is reflected. Please pay attention to the fact, that in this case owners' equity does not change, as only structure of the assets has changed, i.e. cash was exchanged into equipment. After reflecting impact of this transaction on the equation, you can see that the equation still remains, i.e. cash plus equipment is equal to the owners' equity, which is a must. If there is no equation, a mistake upon reflecting a particular transaction in the equation was made.

	Assets			Owners' equity
	Cash	Equipment		Share capital
Σ	**15000**		=	**15000**
2	(8000)	8000		
Σ	**7000**	**8000**		**15000**

3rd transaction: inventory is purchased to provide services. Price of inventory is 900$, the acquisition is made on credit, i.e. the suppliers will be paid after 30 days. In this case there is a change, i.e. increase, in assets (inventory) by 900$. As the entity does not pay cash at once, but remains liable for the inventory liabilities of the entity increase, i.e. accounts payable increase by 900$. Again we have an equation.

	Assets				Liabilities	Owners' equity
	Cash	Equipment	Inventory		Accounts payable	Share capital
Σ	**7000**	**8000**		=		**15000**
3			900		900	
Σ	**7000**	**8000**	**900**		**900**	**15000**
	15900			=	**15900**	

4th transaction: part of the accounts payable, i.e. 500$ was paid from the bank account to suppliers of inventory. In this case liabilities of the entity changed, i.e. decreased by 500$, as cash amounting to 500$ was paid to the suppliers, causing decrease in assets.

	Assets				Liabilities	Owners' equity
	Cash	Equipment	Inventory		Accounts payable	Share capital
Σ	**7000**	**8000**	**900**	=	**900**	**15000**
4	(500)				(500)	
Σ	**6500**	**8000**	**900**		**400**	**15000**
	15400			=	**15400**	

5th transaction: services for 6000$ were provided to customers, who paid in cash. In this case the company receives income for the services provided. Income represents increase in the owners' equity, as it belongs to the owners. Therefore as a result of this transaction the owners' equity increases by 6000$ and assets (cash) increase by 6000$, as customers pay in cash.

	Assets				Liabilities	Owners' equity
	Cash	Equipment	Inventory		Accounts payable	Share capital
Σ	**6500**	**8000**	**900**	=	**400**	**15000**
5	6000					6000
Σ	**12500**	**8000**	**900**		**400**	**21000**
	21400			=	**21400**	

6th transaction: inventory used to provide services (220$) was expensed, i.e. written off. In this case the company incurs expenses. Contrary to income, which causes an increase in the owners' equity, expenses cause decrease in the owners' equity. Therefore there is a decrease in inventory by 220$ and decrease in the owners' equity by 220$. Once again after reflecting this transaction, there is an equation, i.e. assets are equal to the sum of liabilities and owners' equity.

	Assets				Liabilities	Owners' equity
	Cash	Equipment	Inventory		Accounts payable	Share capital
Σ	**12500**	**8000**	**900**	=	**400**	**21000**
6			(220)			(220)
Σ	**12500**	**8000**	**680**		**400**	**20780**
	21180			=	**21180**	

In order to have a full picture of all the transactions, below you can find **a summary**. The summary shows an impact of each transaction on the accounting equation and at the end there is a balance, i.e. equation between the assets and sum of the liabilities and the owners' equity.

	Assets				Liabilities	Owners' equity
	Cash	Equipment	Inventory		Accounts payable	Share capital
1	15000					15000
2	(8000)	8000				
3			900	=	900	
4	(500)				(500)	
5	6000					6000
6			(220)			(220)
Σ	**12500**	**8000**	**680**		**400**	**20780**
	21180			=	**21180**	

II.1. LEARNING EXAMPLE

Further through all the learning process the below company called **Alfa** will be used. The following transactions occurred during June 2007 in Alfa:

1. June 1, 2007: Alfa was established to provide copying services and sell stationery. Invest own capital in cash to Alfa's bank account – 20000$ and take a loan from bank in the name of Alfa – 15000$

2. June 2, 2007: Alfa acquired fixed assets: equipment – 19000$; current assets: inventory (for sale) – 5000$. Part of total acquisition price was paid in cash – 4000$, remaining part to be paid after 30 days

3. June 3, 2007: Alfa acquired office supplies for cash – 2500$

4. June 4, 2007: Alfa paid in cash for office insurance, insurance period - one year, insurance price 1500$

5. June 5, 2007: Alfa partly paid suppliers by cash for the equipment and inventory acquired on June 2, 2007 – 3500$

6. June 15, 2007: Alfa provided copying services to customers – 7000$. 5000$ was received in cash, remaining part to be received after 30 days

7. June 19, 2007: Alfa sold all stationery for cash, sales price – 6500$

8. June 21, 2007: customers, which acquired copying services on June 15, 2007 paid partly their debt – 1000$

Below there is an analysis how these transactions impact accounting equation.

1st transaction results increase in cash by 35000$ (investment of the shareholder and a loan from bank), increase in the owners' equity (share capital) by 20000$ and increase in liabilities (loan) by 15000$.

	Assets		Liabilities	Owners' equity
	Cash	=	Loan	Share capital
1	35000		15000	20000
35000		=	**35000**	

2nd transaction results increase in equipment by 19000$, inventory 5000$, decrease in cash by 4000$, as part of the acquisition price was paid in cash, and increase in liabilities (accounts payable) by 20000$ (total acquisition price 19000$+5000$ minus paid in cash 4000$).

	Assets				Liabilities		Owners' equity
	Cash	Inventory	Equipment		Acc. payable	Loan	Share capital
Σ	**35000**			=		**15000**	**20000**
2	(4000)	5000	19000		20000		
Σ	**31000**	**5000**	**19000**		**20000**	**15000**	**20000**
55000				=	**55000**		

3rd transaction results increase in office supplies (assets) by 2500$ and decrease in cash by 2500$ as all the acquisition price of the office supplies was paid in cash.

	Assets					Liabilities		Owners' equity
	Cash	Supplies	Inventory	Equipment		Acc. payable	Loan	Share capital
Σ	**31000**		**5000**	**19000**	=	**20000**	**15000**	**20000**
3	(2500)	2500						
Σ	**28500**	**2500**	**5000**	**19000**		**20000**	**15000**	**20000**
55000					=	**55000**		

4th transaction results increase in prepaid expenses (insurance) by 1500$. **Prepaid expenses** represent certain expenses which are paid in advance and which will be incurred in the future. As an example is insurance, for which Alfa pays in advance for the whole year and these expenses actually will be incurred through the whole year. As Alfa paid for insurance in cash, there is a decrease in cash by 1500$.

	Assets						Liabilities		Owners' equity
	Prepaid expenses	Cash	Supplies	Inventory	Equipment	=	Acc. payable	Loan	Share capital
Σ		**28500**	**2500**	**5000**	**19000**		**20000**	**15000**	**20000**
4	1500	(1500)							
Σ	**1500**	**27000**	**2500**	**5000**	**19000**		**20000**	**15000**	**20000**
55000						=	**55000**		

5th transaction results decrease in cash by 3500$ and decrease in liabilities (accounts payable) by 3500$, as Alfa paid part of its debt to the suppliers of the equipment and inventory acquired on June 2, 2007.

	Assets					=	Liabilities		Owners' equity
	Prepaid expenses	Cash	Supplies	Inventory	Equipment		Acc. payable	Loan	Share capital
Σ	**1500**	**27000**	**2500**	**5000**	**19000**		**20000**	**15000**	**20000**
5		(3500)					(3500)		
Σ	**1500**	**23500**	**2500**	**5000**	**19000**		**16500**	**15000**	**20000**
	51500					=	**51500**		

6th transaction results increase in owners' equity by 7000$, as Alfa earned income, which as it was mentioned above belongs to the owners. Also there is an increase in cash by 5000$ and in accounts receivable, i.e. debt from customers, by 2000$ (income 7000$ minus cash received 5000$). Debt from customers or accounts receivable represent assets, as these are rights of Alfa to claim cash from the customers for the services provided.

	Assets						=	Liabilities		Owners' equity	
	Prepaid expenses	Cash	Acc. receivable	Supplies	Inventory	Equip-ment		Acc. payable	Loan	Share capital	Income/ expenses
Σ	**1500**	**23500**		**2500**	**5000**	**19000**		**16500**	**15000**	**20000**	
6		5000	2000								7000
Σ	**1500**	**28500**	**2000**	**2500**	**5000**	**19000**		**16500**	**15000**	**20000**	**7000**
	58500						=	**58500**			

7th transaction. This transaction is more complicated that the above described, as there are two parts: ***1st part:*** sale of inventory represent income amounting to 6500$, which results increase in cash by 6500$ and increase in owners' equity by 6500$. ***2nd part:*** Alfa sold all inventory, which was acquired on June 2, 2007. The cost of this inventory amounting to 5000$ represents expenses incurred, i.e. cost of inventory sold. Therefore upon selling this inventory there is a decrease in inventory by 5000$ and decrease in owners' equity by 5000$. In total Alfa earned 1500$ profit on the sale of inventory, i.e. sales income (6500$) minus cost (5000$)

	Assets						=	Liabilities		Owners' equity	
	Prepaid expenses	Cash	Acc. receivable	Supplies	Inventory	Equip-ment		Acc. payable	Loan	Share capital	Income/ expenses
Σ	**1500**	**28500**	**2000**	**2500**	**5000**	**19000**		**16500**	**15000**	**20000**	**7000**
7		6500									6500
7					(5000)						(5000)
Σ	**1500**	**35000**	**2000**	**2500**	**0**	**19000**		**16500**	**15000**	**20000**	**8500**
	60000						=	**60000**			

8th transaction results increase in cash by 1000$ and decrease in account receivable, i.e. debt from customers decreases as they paid their debt.

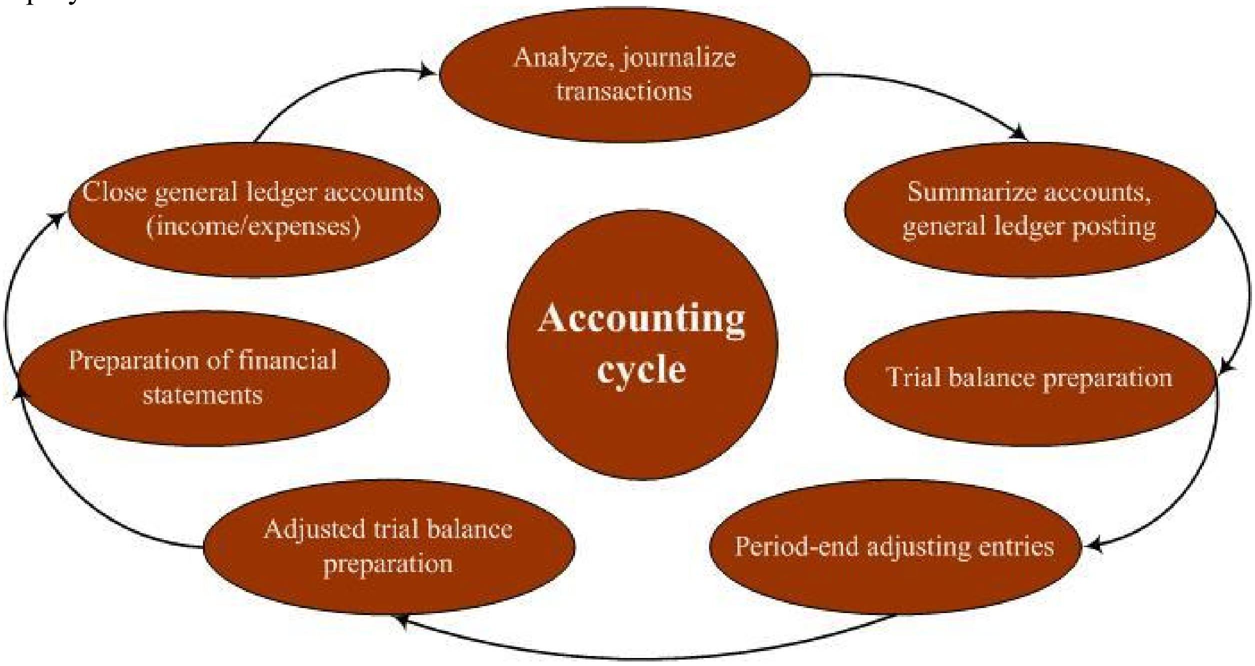
	Assets						=	Liabilities		Owners' equity	
	Prepaid expenses	Cash	Acc. receivable	Supplies	Inventory	Equip-ment	=	Acc. payable	Loan	Share capital	Income/ expenses
Σ	**1500**	**35000**	**2000**	**2500**	**5000**	**19000**		**16500**	**15000**	**20000**	**7000**
8		1000	(1000)								
Σ	**1500**	**36000**	**1000**	**2500**	**0**	**19000**		**16500**	**15000**	**20000**	**8500**
60000							=	**60000**			

And finally there is a summary of all the transactions, indicating that at the end there is an equation between assets and sum of liabilities and owners' equity.

	Assets						=	Liabilities		Owners' equity	
	Prepaid expenses	Cash	Acc. receivable	Supplies	Inventory	Equip-ment		Acc. payable	Loan	Share capital	Income/ expenses
1		35000							15000	20000	
2		(4000)			5000	19000		20000			
3		(2500)		2500			=				
4	1500	(1500)									
5		(3500)						(3500)			
6		5000	2000								7000
7		6500									6500
7					(5000)						(5000)
8		1000	(1000)								
Σ	**1500**	**36000**	**1000**	**2500**	**0**	**19000**		**16500**	**15000**	**20000**	**8500**
60000							=	**60000**			

III. ACCOUNTING CYCLE

The scheme below presents steps of the **Accounting Cycle**. Accounting Cycle is a certain process of analyzing, summarizing and recording transactions, which have an impact on the financial position of a business (company) in order to prepare financial statements and have an accurate and timely accounting data based on which interested parties (owners, creditors, suppliers, customers, employees, governmental institutions and other) can judge on the results the business has achieved during a particular period of time, on the assets the business possesses and on the financial means used to finance these assets, i.e. liabilities and owners' equity.



1. ANALYZE AND JOURNALIZE TRANSACTIONS

The purpose of accounting is to record each item, which appears in the financial statements separately in order to be able to trace it back if required. Type of record used for the purpose of recording individual transactions is called an account. Simplest form of account has three parts:

1. Title, containing name of the account

2. Space of increase in the amount of item in monetary terms

3. Space of decrease in the amount of item in monetary terms

Simplistic form of the account is T-form, therefore they are called T-accounts. Left side is called **Debit** side and right side is called **Credit** side. It is important to remember that every business transaction affects minimum of two accounts. Process when upon an accounting for a particular business transaction one account is debited and another account is credited is called **double entry accounting.**

Recalling basic accounting equation and examples of changes as a result of different transactions double entry is logical, as despite any change in parts of accounting equation after recording a particular business transaction must result in a balance, i.e. equation between the assets and sum of liabilities and equity.

Title	
Left side	**Right side**
Debit D	Credit C

Let’s take as an example transaction, when one shareholder establishes a company which will provide documents copying services. The shareholder invests 15000$ cash by opening entity’s bank account and transferring cash into bank account.

First step of recording a transaction is **journalizing**, i.e. recording of the transaction into the **general journal**. Simple illustration:

D Cash 15000
    C Equity (share capital) 15000

Data from the general journal is transferred to the accounts and this process is called as **posting**.

D	Cash	D
15000		

D	Share capital	D
		15000

Referring back to the accounting equation, when assets equal to liabilities plus equity and taking into account that left side is debit and right side is credit, final balance in assets accounts must be on debit (left) side and final balance in equity and liabilities accounts must be on credit (right) side.

Assets			Liabilities			Owners’ equity	
Debit for increases	**Credit** for decreases	=	**Debit** for decreases	**Credit** for increases	+	**Debit** for decreases	**Credit** for increases

The above were balance sheet accounts.

Analyzing income statement accounts, important to remember that income and expenses are related to equity, i.e. income increases equity and expenses decrease equity. Therefore increase in income is accounted under credit side, increase in expenses is accounted under debit side.

Expenses	
Debit for increases	**Credit** for decreases

Income	
Debit for decreases	**Credit** for increases

Balances in income and expenses accounts are equal to zero, as these figures are accounted for a period and as it will be in detail presented later are closed at the end of each period and are transferred to retained earning balance sheet account which is a part of equity, i.e. belongs to the shareholders.

Usually you can find single all purpose two column journal. Before a transaction is entered into the journal it should be analyzed:

1. determine whether the asset, liability, equity, income or expenses affected;

2. determine whether asset, liability, equity, income or expenses affected in increased or decreased

3. determine whether such increase/decrease to be recorder as debit or credit

Going back to the transaction taken as an example, when one shareholder establishes a company which will provide document copying services and the shareholder invests 15000$ cash by opening entity's bank account and transferring cash into bank account, the general journal entry is a follows:

No	Date		Description	Post acc.	D	C
1	June, 2007	2	Cash		15000	
			Share capital			15000
			Share capital formation			

In column "No" number of transaction is indicated, further date of transaction is written. In the 3rd column "Description" it is indicated which accounts are affected, i.e. debited and credited and short description of transaction is provided. Column "Post acc." Is required for general ledger posting which is discussed in further stages of accounting cycle, i.e. in this column number of account in general ledger is indicated. Further in column "D" amount of the debit is indicated and in the column "C" amount of credit is indicated. **Important!** debit must be equal to credit.

Group of accounts for a particular entity is called a **general ledger**. Separate accounts are set up for separate items of financial statements.

The following main parts are included into the financial statements:

Assets – any physical thing (tangible) or right (intangible) that has a monetary value. Divided into current assets (cash and other assets that may reasonably be expected to realized in cash or sold or used within period less or equal to one year. Examples: inventory, cash, accounts receivable, prepaid expenses) and long-term assets (used by the entity for a period longer that one year. Examples: long-term investments, fixed assets, intangible long-term assets).

Liabilities – debts owned to outsiders, i.e. creditors. Divided into current liabilities, which are due within one year (accounts payable, salaries payable, taxes payable, interest payable) and long-term liabilities which are due after one year.

Equity – residual claim against assets of business after total liabilities are deducted. Included share capital (financial means invested by the shareholders, retained earnings – net income retained in the business)

Income – gross increase in equity as a result of receiving income (sales of goods, provision of services)

Expenses – costs consumed in the process of earning income

Depending on the type of business different entities require different set of accounts. A listing of accounts in the ledger is called **chart of accounts**. It is quite convenient that separate accounts or group of accounts correspond to the items in the financial statements.

1.1. Learning example

Let's come back to Alfa learning example presented when analyzing impact of transactions on accounting equation. The following transactions occurred during June 2007 in Alfa:

1. June 1, 2007: Alfa was established to provide copying services and sell stationery. Invest own capital in cash to Alfa's bank account – 20000$ and take a loan from bank in the name of Alfa – 15000$

2. June 2, 2007: Alfa acquired fixed assets: equipment – 19000$; current assets: inventory (for sale) – 5000$. Part of total acquisition price was paid in cash – 4000$, remaining part to be paid after 30 days

3. June 3, 2007: Alfa acquired office supplies for cash – 2500$

4. June 4, 2007: Alfa paid in cash for office insurance, insurance period - one year, insurance price 1500$

5. June 5, 2007: Alfa partly paid suppliers by cash for the equipment and inventory acquired on June 2, 2007 – 3500$

6. June 15, 2007: Alfa provided copying services to customers – 7000$. 5000$ was received in cash, remaining part to be received after 30 days

7. June 19, 2007: Alfa sold all stationery for cash, sales price – 6500$

8. June 21, 2007: customers, which acquired copying services on June 15, 2007 paid partly their debt – 1000$

No	Date		Description	Post acc.	D	C
1	June, 2007	1	Cash		15000	
			Loan			15000
			Share capital			20000
			Alfa establishment			
2	June, 2007	2	Equipment		19000	
			Inventory		5000	
			Cash			4000
			Accounts payable			20000
			Equipment, inventory acquisition			
3	June, 2007	3	Office supplies		2500	
			Cash			2500
			Office supplies acquisition			
4	June, 2007	4	Prepaid expenses		1500	
			Cash			1500
			Pay for insurance in advance			
5	June, 2007	5	Accounts payable		3500	
			Cash			3500
			Partial payment to suppliers			
6	June, 2007	15	Cash		5000	
			Accounts receivable		2000	
			Income			7000
			Provision of copying services			
7	June, 2007	19	Cash		6500	
			Income			6500
			Expenses (cost of goods sold)		5000	
			Inventory			5000
			Sale of inventory			
8	June, 2007	21	Cash		1000	
			Accounts receivable			1000
			Partial receipt of cash from customers			

2. GENERAL LEDGER POSTING

It was already mentioned that from general journal accounting entries are posted to accounts. This process is called posting to general ledger (G/L). Going back to an example transaction, when one shareholder establishes a company which will provide documents copying services and invests 15000$ cash by opening entity's bank account and transferring cash into bank account the general journal entry was as indicated below. From general journal each entry is posted to a corresponding general ledger account. In this examples there are two accounts used: cash (assets) and share capital (owner's equity).

Each general ledger account has a name and number, date of transaction is indicated when posting the entry from general journal. In columns "D" and "C" changes in the account during a particular period are posted and after each change the balance of the account is calculated in the column "Balance" under debit or credit. Each general ledger account is similar to T account. For example in "Cash account No. 11", which belong to the assets side of accounting equation, increase in cash is depicted under debit side and decrease in cash – under credit side. Balance in cash account must be under debit side. A mistake was made if after calculating a balance in general ledger "Cash account" balance is under credit. In "Share capital account No. 30", which belongs to the owners' equity side of accounting equation, increase in share capital is depicted under credit side and decrease in share capital – under debit side. Balance in share capital account must be under credit side. A mistake was made if after calculating a balance in general ledger "Share capital account" balance is under debit side.

Also each general ledger account indicated opening balance of the account at the beginning of the period. In the example below "Cash account" has 0 debit balance at the beginning of June and "Share capital account" has 0 credit balance at the beginning of June.

General journal page 10						
No	**Date**		**Description**	**Post acc.**	**D**	**C**
1	June, 2007	2	Cash	11	15000	
			Share capital	30		15000
			Share capital formation			

G/L account Cash						**Account No 11**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	2	Share capital formation	10	15000		15000	

G/L account Share capital						**Account No 30**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance					0
	2	Share capital formation	10		15000		15000

In this example you can see that 15000$ from general journal was posted to general ledger account "Cash No. 11" in "D" column, as there was an increase in cash upon investment of cash into the company. Balance in this account after this transaction equals to 15000$ under debit side.

Also 15000$ from general journal was posted to general ledger account "Share capital No. 30" in "C" column, as there was an increase in share capital while establishing the company and investing cash into it. This shows that cash belongs to the shareholder. Balance in this account after this transaction equals to 15000$ under credit side.

2.1. Learning example

Coming back to the company Alfa, which transactions were already journalized, next step is to make a posting of those transactions into the general ledger.

1st transaction, June 1, 2007: Establish company to provide copying services and sell stationery. Invest own capital in cash to bank account – 20000$ and take a loan from bank – 15000$. In this transaction three accounts Cash, Loan, Share capital are used. As this is a first transaction all these accounts have 0 balances as of June 1. As Cash account belongs to assets category (left side of accounting equation), the balance of this account is always on the debit side. As Loan account belongs to liabilities category (right side of accounting equation) and Share capital account belongs to owners' equity category (right side of accounting equation), the balance of these accounts is always on the credit side.

As a result of the 1st transaction there was an increase in cash by 35000$, therefore from general journal this amount is posted to Cash account No. 11 debit turnover column and balance in Cash account after this transaction equals to 35000$ (debit side). Correspondingly share capital increase by 20000$, which is from general journal posted to Share capital account No. 30 credit turnover column and balance in Share capital account after this transaction equals to 20000$ (credit side), loan increased by 15000$, which is from general journal posted to Loan account No. 40 credit turnover column and balance in Loan account after this transaction equals to 15000$ (credit side).

General journal						**Page 10**
No	**Date**		**Description**	**Post acc.**	**D**	**C**
1	June, 2007	1	Cash		35000	
			Loan			15000
			Share capital			20000
			Alfa establishment			

G/L account Cash						**Account No 11**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	

G/L account Share capital						**Account No 30**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance					0
	1	Alfa establishment	10		20000		20000

G/L account Loan						**Account No 40**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance					0
	1	Alfa establishment	10		15000		15000

2nd transaction, June 2, 2007: Acquire fixed assets: equipment – 19000$; current assets: inventory (for sale) – 5000$. Part paid in cash – 4000$, remaining part will be paid after 30 days.

Four accounts are used in this transaction: Equipment (assets), Inventory (assets), Cash (assets) and Accounts payable (liabilities).

As a result of the 2nd transaction there was an increase in equipment by 19000$. This amount is posted to Equipment account No.17 debit turnover column.

Please note that this account is used for the first time, therefore it has 0 debit balance as of June 1.

After the transaction is posted, balance in this account equals to 19000$ (debit side, as equipment belongs to assets category on the left side of accounting equation). Also there was an increase in inventory by 5000$. This amount is posted to Inventory account No.16 debit turnover column.

Please note that this account is used for the first time, therefore it has 0 debit balance as of June 1. After the transaction is posted, balance in this account equals to 5000$ (debit side, as inventory belongs to assets category on the left side of accounting equation).

Further there was a decrease in cash by 4000$, as part of the equipment and inventory acquisition price was paid in cash. This amount is posted to Cash account No. 11 credit turnover column.

Please note that this account was already used when posting 1st transaction, therefore it already has 35000$ debit balance as of June 2.

After the transaction is posted, balance in this account equals to 31000$ (35000-4000, debit side, as cash belongs to assets category on the left side of accounting equation).

The remaining acquisition price of equipment and inventory, i.e. 19000+5000-4000=20000$ will be paid later, therefore Alfa remains liable to suppliers, which results increase in accounts payable – liabilities by 20000$. This amount is posted to Account payable No.41 credit turnover column.

Please note that this account is used for the first time, therefore it has 0 credit balance as of June 1.

After the transaction is posted, balance in this account equals to 20000$ (credit side, as accounts payable belongs to liabilities category on the right side of accounting equation).

General journal						Page 10
2	June, 2007	2	Equipment		19000	
			Inventory		5000	
			Cash			4000
			Accounts payable			20000
			Equipment, inventory acquisition			

G/L account Equipment						Account No 17	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	2	Equipment, inventory acquisition	10	19000		19000	

G/L account Inventory						Account No 16	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	2	Equipment, inventory acquisition	10	5000		5000	

G/L account Cash						Account No 11	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	
	2	Equipment, inventory acquisition	10		4000	31000	

G/L account Accounts payable						Account No 41	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance					0
	2	Equipment, inventory acquisition	10		20000		20000

3rd transaction June 3, 2007: Acquire office supplies for cash – 2500$. Two accounts are used in this transaction: Office supplies (assets), Cash (assets).

As a result of the 3rd transaction there was an increase in office supplies by 2500$. This amount is posted to Office supplies account No.15 debit turnover column. Please note that this account is used for the first time, therefore it has 0 debit balance as of June 1. After the transaction is posted, balance in this account equals to 2500$ (debit side, as office supplies belong to assets category on the left side of accounting equation).

Also there was a decrease in cash by 2500$, as office supplies acquisition was paid by cash. This amount is posted to Cash account No. 11 credit turnover column. Please note that this account was already used when posting 1st and 2nd transactions, therefore it already has 31000$ debit balance as of June 3. After the transaction is posted, balance in this account equals to 28500$ (31000-2500, debit side, as cash belongs to assets category on the left side of accounting equation).

General journal						Page 10
3	June, 2007	3	Office supplies		2500	
			Cash			2500
			Office supplies acquisition			

G/L account Office supplies						Account No 15	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	3	Office supplies acquisition	10	2500		2500	

G/L account Cash						Account No 11	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	
	2	Equipment, inventory acquisition	10		4000	31000	
	3	Office supplies acquisition	10		2500	28500	

4th transaction June 4, 2007: pay in cash for office insurance, period one year – 1500$.

Two accounts are used in this transaction: Prepaid expenses (assets), Cash (assets).

As a result of the 4th transaction there was an increase in prepaid expenses by 1500$. This amount is posted to Prepaid expenses account No.10 debit turnover column.

Please note that this account is used for the first time, therefore it has 0 debit balance as of June 1.

After the transaction is posted, balance in this account equals to 1500$ (debit side, as prepaid expenses belong to assets category on the left side of accounting equation).

Also there was a decrease in cash by 1500$, as prepaid expenses were paid by cash. This amount is posted to Cash account No. 11 credit turnover column.

Please note that this account was already used when posting previous transactions, therefore it already has 28500$ debit balance as of June 4.

After the transaction is posted, balance in this account equals to 27000$ (28500-1500, debit side, as cash belongs to assets category on the left side of accounting equation).

General journal						Page 10
4	June, 2007	4	Prepaid expenses		1500	
			Cash			1500
			Pay for insurance in advance			

G/L account Prepaid expenses						Account No 10	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	4	Pay for insurance in advance	10	1500		1500	

G/L account Cash						Account No 11	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	
	2	Equipment, inventory acquisition	10		4000	31000	
	3	Office supplies acquisition	10		2500	28500	
	4	Pay for insurance in advance	10		1500	27000	

5th transaction June 5, 2007: Partly pay suppliers for equipment and inventory acquired – 3500$.

Two accounts are used in this transaction: Accounts payable (liabilities), Cash (assets).

As a result of the 5th transaction there was a decrease in accounts payable by 3500$. This amount is posted to Accounts payable account No.41 debit turnover column.

Please note that this account was already used when posting 2nd transaction, therefore it has 20000$ credit balance as of June 5.

After the transaction is posted, balance in this account equals to 16500$ (credit side, as accounts payable belong to liabilities category on the right side of accounting equation).

Also there was a decrease in cash by 3500$, as accounts payable were paid by cash. This amount is posted to Cash account No. 11 credit turnover column.

Please note that this account was already used when posting previous transactions, therefore it already has 27000$ debit balance as of June 5.

After the transaction is posted, balance in this account equals to 23500$ (27000-3500, debit side, as cash belongs to assets category on the left side of accounting equation).

General journal						Page 10
5	June, 2007	5	Accounts payable		3500	
			Cash			3500
			Partial payment to suppliers			

G/L account Accounts payable						Account No 41	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance					0
	2	Equipment, inventory acquisition	10		20000		20000
	3	Partial payment to suppliers	10	3500			16500

G/L account Cash						Account No 11	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	
	2	Equipment, inventory acquisition	10		4000	31000	
	3	Office supplies acquisition	10		2500	28500	
	4	Pay for insurance in advance	10		1500	27000	
	5	Partial payment to suppliers	10		3500	23500	

6th transaction, June 15: Provide copying services to customers – 7000$. 5000$ paid in cash, remaining part will be paid after 30 days.

Three accounts are used in this transaction: Cash (assets), Accounts receivable (assets), Income (increase owners' equity).

As a result of the 6th there was an increase in cash by 500$, as part of income was receive in cash. This amount is posted to Cash account No. 11 debit turnover column.

Please note that this account was already used when posting previous transactions, therefore it already has 23500$ debit balance as of June 5.

After the transaction is posted, balance in this account equals to 28500$ (23500+5000, debit side, as cash belongs to assets category on the left side of accounting equation).

Also there was an increase in accounts receivable by 2000$ (remaining part of income will be paid later, therefore customer owe Alfa 7000-5000=2000). This amount is posted to Accounts receivable account No.14 debit turnover column.

Please note that this account is used for the first time, therefore it has 0 debit balance as of June 1.

After the transaction is posted, balance in this account equals to 2000$ (debit side, as accounts receivable belong to assets category on the left side of accounting equation).

Further there was an increase in income by 7000$. This amount is posted to Income account No. 50 credit turnover column. Opening balance of income account is always equal to 0 (the reason will be explained in later stages of accounting cycle).

After the transaction is posted, temporary balance in this account equals to 7000$ (credit side, as income belongs to owners' equity on the right side of accounting equation).

General journal						**Page 10**
6	June, 2007	15	Cash		5000	
			Accounts receivable		2000	
			Income			7000
			Provision of copying services			

G/L account Cash						**Account No 11**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	
	2	Equipment, inventory acquisition	10		4000	31000	
	3	Office supplies acquisition	10		2500	28500	
	4	Pay for insurance in advance	10		1500	27000	
	5	Partial payment to suppliers	10		3500	23500	
	15	Provision of copying services	10	5000		28500	

G/L account Accounts receivable						**Account No 14**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	15	Provision of copying services	10	2000		2000	

G/L account Income						**Account No 50**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance					0
	15	Provision of copying services	10		7000		7000

7th transaction, June 19, 2007: Sell all stationery for cash, sales price – 6500$. Four accounts are used in this transaction: Cash (assets), Income (increase owners' equity), Inventory (assets), Expenses (decrease in owners' equity).

As a result of the 7th transaction there was an increase in cash by 6500$, as income was receive in cash. This amount is posted to Cash account No. 11 debit turnover column.

Please note that this account was already used when posting previous transactions, therefore it already has 28500$ debit balance as of June 15. After the transaction is posted, balance in this account equals to 35000$ (28500+6500, debit side, as cash belongs to assets category on the left side of accounting equation).

Further there was an increase in income by 6500$. This amount is posted to Income account No. 50 credit turnover column. Opening balance of income account is always equal to 0 (the reason will be explained in later stages of accounting cycle).

After the previous transaction there are already 7000$ in this account.

After this transaction is posted, temporary balance in this account equals to 13500$ (credit side, as income belongs to owners' equity on the right side of accounting equation).

As all inventory acquired previously was sold, there is a decrease in inventory cost by 5000$ (acquisition price of all inventory). This amount is posted to Inventory account No.16 credit turnover column.

Please note that this account was used previously, therefore it has 5000$ debit balance as of June 2.

After the transaction is posted, balance in this account equals to 0$ (debit side, as inventory belong to assets category on the left side of accounting equation) and the entire inventory was sold.

Cost of inventory sold represents expenses of Alfa. 5000$ (inventory cost) is posted to Expenses account No.60. Opening balance of expenses account is always equal to 0 (the reason will be explained in later stages of accounting cycle).

After this transaction is posted, temporary balance in this account equals to 5000$ (debit side, as expenses belongs to owners' equity on the right side of accounting equation, decreasing owners' equity).

General journal						Page 10
7	June, 2007	19	Cash		6500	
			Income			6500
			Expenses (cost of goods sold)		5000	
			Inventory			5000
			Sale of inventory			

G/L account Cash						Account No 11	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	
	2	Equipment, inventory acquisition	10		4000	31000	
	3	Office supplies acquisition	10		2500	28500	
	4	Pay for insurance in advance	10		1500	27000	
	5	Partial payment to suppliers	10		3500	23500	
	15	Provision of copying services	10	5000		28500	
	19	Sale of inventory	10	6500		35000	

G/L account Income						Account No 50	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance					0
	15	Provision of copying services	10		7000		7000
	19	Sale of inventory	10		6500		13500

G/L account Inventory						Account No 16	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	2	Equipment, inventory acquisition	10	5000		5000	
	19	Sale of inventory	10		5000	0	

G/L account Expenses						Account No 60	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	19	Provision of copying services	10	5000		5000	

8th transaction June 21, 2007: Copying services customers paid partly their debt – 1000$. Two accounts are used in this transaction: Cash (assets), Accounts receivable (assets).

As a result of 8th transaction there was an increase in cash by 1000$, as accounts receivable were covered by cash. This amount is posted to Cash account No. 11 debit turnover column.

Please note that this account was already used when posting previous transactions, therefore it already has 35000$ debit balance as of June 19. After the transaction is posted, balance in this account equals to 36000$ (36000+1000, debit side, as cash belongs to assets category on the left side of accounting equation).

As a result of the 8th transaction there was a decrease in accounts receivable by 1000$. This amount is posted to Accounts receivable account No.14 debit turnover column.

Please note that this account was already used when posting 6th transaction, therefore it has 2000$ debit balance as of June 15. After the transaction is posted, balance in this account equals to 1000$ (debit side, as accounts receivable belong to assets category on the left side of accounting equation).

General journal						Page 10
			Sale of inventory			
8	June, 2007	21	Cash		1000	
			Accounts receivable			1000
			Partial receipt of cash from customers			

G/L account Cash						Account No 11	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	1	Alfa establishment	10	35000		35000	
	2	Equipment, inventory acquisition	10		4000	31000	
	3	Office supplies acquisition	10		2500	28500	
	4	Pay for insurance in advance	10		1500	27000	
	5	Partial payment to suppliers	10		3500	23500	
	15	Provision of copying services	10	5000		28500	
	19	Sale of inventory	10	6500		35000	
	21	Partial receipt of cash from customers	10	1000		36000	

G/L account Accounts receivable						Account No 14	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance				0	
	15	Provision of copying services	10	2000		2000	
	21	Partial receipt of cash from customers	10		1000	1000	

3. TRIAL BALANCE PREPARATION

Trial balance is a summary (in a table form) of all general ledger accounts, used to check whether posting from general journal to general ledger was correctly done and whether balances in accounts with debit balance are equal to balances in accounts with credit balances. Please note that trial balance is not a financial statement, it is a working table to be used to prepare financial statements.

In order to prepare trial balance of Alfa as of June 30, 2007 each general ledger account used to account for transactions performed in Alfa during June, 2007 are reviewed and balances from these accounts are included into the table, which layout is presented below. First column of this table includes name of the account, second column- number of the account, third column – debit accounts balances, fourth column – credit accounts balances. Total amounts in debit and credit columns are calculated and **MUST** be equal. In case there is no equation, mistakes were done when journalizing transactions, or when posting from general journal to general ledger.

There is also an example, how balance from the Accounts receivable account No. 14 is transferred to the trial balance.

Trial balance - June 30, 2007			
Item	**G/L account**	**D**	**C**
Prepaid expenses	10	1500	
Cash	11	36000	
Accounts receivable	14	1000	
Office supplies	15	2500	
Inventory	16	0	
Equipment	17	19000	
Accounts payable	41		16500
Loan	40		15000
Share capital	30		20000
Income	50		13500
Expenses	60	5000	
Balance		**65000**	**65000**

G/L account Accounts receivable						**Account No 14**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	15	Provision of copying services	10	2000		2000	
	21	Partial receipt of cash from customers	10		1000	1000	

Prepared Alfa's trail balance as of June 30, 2007 indicates posting from general journal to general ledger was done correctly, as debit and credit amounts are equal.

4. PERIOD END ADJUSTING ENTRIES

Usually after transactions which occurred during a particular month were journalized and posted from general journal to general ledger, certain accounting data and facts are still not accounted for. This is done at the end of each period, when such data is fully available and all facts are known.

Usually period end adjusting entries are related to the following accounting data and facts:

1. Calculation and accounting for depreciation of fixed assets

Usually when fixed assets are acquired, the company intends to use in the activities them for the period longer that one year. Therefore the cost value of these assets is included into the balance sheet of the company. As the assets are being used, their value decreases and such decrease must be included into the expenses. Each item of the fixed asset has useful life during which the asset can be used, therefore cost value of the asset must be included into the expenses in equal parts during that useful life. For example: the company on June 1, 2007 acquires furniture, which has useful life of 4 years. Cost value of the furniture is 4800$. During June only the following general journal entry would be done:

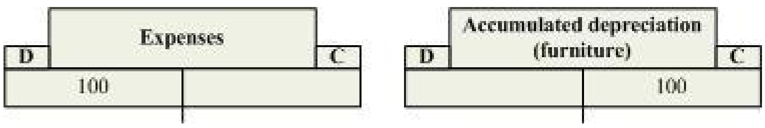
D Furniture 4800$ C Cash or Accounts payable (if not paid by cash) 4800$

At the end of June it is necessary to account for the depreciation of furniture. Monthly depreciation amount is calculated as follows: 4800$/4 years=1200$ - annual depreciation amount. 1200$/12 months=100$ - monthly depreciation amount.

To account for depreciation the following general journal entry is made: D Expenses 100$ C Accumulated depreciation (furniture) 100$

Please not that for depreciation purposes separate account is used, i.e. furniture cost value is not directly decreased, but is accounted for in the contrary account – accumulated depreciation, which balance is always on credit side thus decreasing the value of the assets.

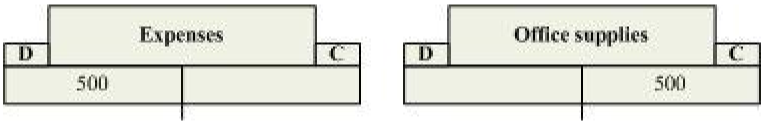
Posting this transaction into general ledger can be depicted by posting into T accounts:



2. Estimation of current assets (stationery, office supplies) consumed and accounting for consumption

Usually during a current period (for example - month) the company in its activities consumes certain stationery and office supplies. At the end of period cost value of such items consumed is estimated and included into the expenses, decreasing value of stationery or office supplies. Example: assume that during a particular month the company consumed office supplies, cost value of which is 500$. The following general journal entry is done: D Expenses 500$ C Office supplies 500$

Posting this transaction into general ledger can be depicted by posting into T accounts (please note that T accounts include only this particular transaction, without information on the opening balances and other transactions posted into the accounts):

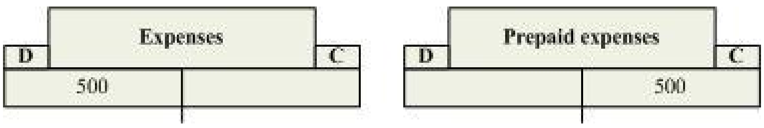


3. Estimation of prepaid expenses (insurance, subscription) amount used during the period

In case the company pays for certain expenses in advance, i.e. usually insurance and subscription is paid in advance, the amounts paid are accounted for as assets and at the end of the period only actual amount of expenses incurred is included into the expenses. For example: on June 1 the company paid in advance for insurance, amount 3000$, insurance period is 6 months. General journal entry to account for prepaid insurance was as follows: D Prepaid expenses 3000$ C Cash 3000$

At the end of June it is necessary to estimate actual amount of insurance expenses incurred, i.e. 1 month passed and 1/6 of the insurance amount (3000/6=500$) to be included into the expenses. General journal entry is: D Expenses 500$ C Prepaid expenses 500$

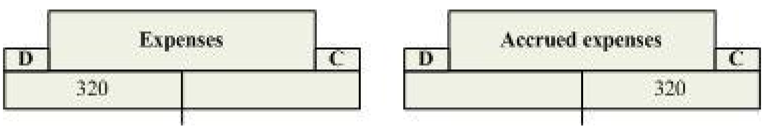
Posting this transaction into general ledger can be depicted by posting into T accounts (please note that T accounts include only this particular transaction, without information on the opening balances and other transactions posted into the accounts):



4. Accounting for additional expenses incurred for the period

Usually at the end of month not all the invoices for particular long-term services are received, i.e. for telecommunication services, utilities, and these invoices are received within first days of the next month. However as the amount of such expenses is know, it must be accrued (accounted for) in that particular period in order to follow the matching principle. For example, invoice for utilities services provided in June, was received on 3rd of July, value of services is 320$. To account for this transaction the following general journal entry to be made: D Expenses 320$ C Accrued expenses 320$

Posting this transaction into general ledger can be depicted by posting into T accounts (please note that T accounts include only this particular transaction, without information on the opening balances and other transactions posted into the accounts):

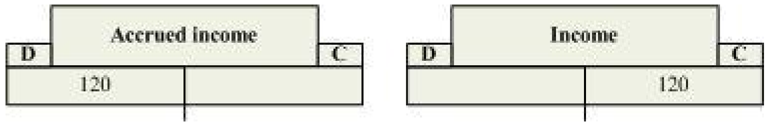


5. Accounting for additional income earned for the period

Also at the end of period certain income can be earned, but not yet invoices issued. Such income must be included into the income of that period in which they were earned. For example: in June the company provided services for 120$, however the invoice was issued only in the beginning of July. To account for this income, the following general journal entry to be made: D Accrued income (assets) 120$ C Income (owners' equity) 120$

Accrued income is accounted under assets side, as after the invoice will be issued the company will have a right to claim cash from the customers.

Posting this transaction into general ledger can be depicted by posting into T accounts (please note that T accounts include only this particular transaction, without information on the opening balances and other transactions posted into the accounts):



4.1. Learning example

Coming back to the operations of Alfa during June 2007, additional information is provided:

1. Fixed assets are used in the activities for 5 years.

2. On June 1, 2007 one employee was hired with a monthly salary of 1500$, which is paid on 2nd of the next month.

3. Telephone expenses for one month starting from June 1, 2007 amount to 350$, invoice is received on the 5th of the next month.

4. On June 30, 2007 it was estimated that during June office supplies costing 450$ were consumed in the activities of the company.

This information must be accounted as period-end adjustments. General journal entries are skipped, however in practice at first all the data and facts must be included into the general journal. Accounting for this additional information is done by posting it directly to general ledger. The explanations are as follows:

1. **Depreciation:** Alfa has equipment with cost value of 19000$. Annual depreciation is 19000$/5years=3800$. As we have only one month – June, monthly depreciation is 3800$/12 months=317$. To account for this transaction: D Expenses account No. 60 - 317$ C Accumulated depreciation account No.17/1 - 317$

2. **Salary:** Salary represents expenses and liability as of end of June, 2007, as it will be paid only next month. To account for this transaction: D Expenses account No. 60 – 1500$ C Salaries payable account No. 43 – 1500$

3. **Telephone expenses:** Telephone expenses are related to June, therefore must be included into June expenses. To account for this transaction: D Expenses account No. 60 – 350$ C Accrued expenses account No. 42 – 350$

4. **Consumption of office supplies:** Consumption of office supplies decrease value of supplies, as they are expensed. To account for this transaction: D Expenses account No. 60 – 450$ C Office supplies account No. 15 – 450$.

All these entries are booked into the general ledger as depicted below.

G/L account Expenses						**Account No 60**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	19	Provision of copying services	10	5000		5000	
	30	Account for depreciation	11	317		5317	
	30	Account for salaries	11	1500		6817	
	30	Account for accrued expenses	11	350		7167	
	30	Account for consumption of office supplies	11	450		7617	

G/L account Accumulated depreciation						**Account No 17/1**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	0
	30	Account for depreciation	11		317		317

G/L account Salaries payable						**Account No 43**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	0
	30	Account for salaries	11		1500		1500

G/L account Accrued expenses						**Account No 42**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	0
	30	Account for accrued expenses	11		350		350

G/L account Office supplies						**Account No 15**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	3	Office supplies acquisition	10	2500		2500	
	30	Account for consumption of office supplies	10		450	2050	

5. ADJUSTED TRIAL BALANCE PREPARATION

After all period-end adjusting entries are posted to general journal and general ledger, these adjustments can be reflected in the adjusted trial balance, which will be used to prepare financial statements.

Adjusted trial balance of Alfa is provided below. Its form is the same as the form of trial balance, in addition having columns for adjustments (debit and credit) and final balances of all accounts indicated in the column adjusted trial balance.

	Trial balance - June 30, 2007			Adjustments		Adjusted trial balance	
Item	**G/L account**	**D**	**C**	**D**	**C**	**D**	**C**
Prepaid expenses	10	1500				1500	
Cash	11	36000				36000	
Accounts receivable	14	1000				1000	
Office supplies	15	2500			450	2050	
Inventory	16	0				0	
Equipment	17	19000				19000	
Accounts payable	41		16500				16500
Loan	40		15000				15000
Share capital	30		20000				20000
Income	50		13500				13500
Expenses	60	5000		2617= (317+ 1500+ 350+450)		7617	
Accumulated depreciation	17/1				317		317
Salaries payable	43				1500		1500
Accrued expenses	42				350		350
Balance		**65000**	**65000**	**2617**	**2617**	**67167**	**67167**

6. PREPARATION OF FINANCIAL STATEMENTS

The main financial statements are balance sheet and income statement.

Balance sheet indicates structure of the assets belonging to the company and financial means used to finance these assets at a particular point of time.

For example: balance sheet as of December 31, 2006 indicated structure of the assets and how they are finances on December 31, 2006.

Balance sheet is made on the basis of accounting equation, i.e. assets are equal to the sum of liabilities and owners' equity.

The assets side includes current and long-term assets.

Liabilities and owners' equity side includes current and long-term liabilities, owners' equity consisting of share capital, retained earnings, i.e. net profit earned and retained in the business.

Income statement indicates income earned and expenses incurred by the company for a particular period of time.

For example: income statement for the year 2006 indicated, what income was earned and what expenses were incurred by the company during the year 2006. Difference between all income and all expenses is called net profit for the year.

Starting point of preparing financial statements is adjusted trial balance, which includes list of all general ledger accounts with the balances in those accounts.

Worth to notice several important points:

1. Accumulated depreciation account has a credit balance. As it was explained earlier this account is contrary to the fixed assets account, in Alfa's case Equipment account. In the balance sheet on the assets' side difference between cost of fixed assets and accumulated depreciation, called **net book value**, is indicated

2. Balances of income and expenses are included into the income statement

3. Net profit retained in the business (5883$) from income statement is transferred to the balance sheet under owners' equity part

Adjusted trial balance - June 30, 2007			
Item	**G/L account**	**D**	**C**
Prepaid expenses	10	1500	
Cash	11	36000	
Accounts receivable	14	1000	
Office supplies	15	2050	
Inventory	16	0	
Equipment	17	19000	
Accounts payable	41		16500
Loan	40		15000
Share capital	30		20000
Income	50		13500
Expenses	60	7617	
Accumulated depreciation	17/1		317
Salaries payable	43		1500
Accrued expenses	42		350
Balance		**67167**	**67167**

Balance sheet as of June 30, 2007	
Assets	
Prepaid expenses	1500
Cash	36000
Accounts receivable	1000
Office supplies	2050
Inventory	0
Equipment, cost	19000
Accumulated depreciation	(317)
Equipment, net book value	18683
Total assets	**59233**
Liabilities and owners' equity	
Liabilities	
Accrued expenses	350
Salaries payable	1500
Accounts payable	16500
Loan	15000
Total liabilities	***33350***
Owners' equity	
Share capital	20000
Retained earnings	5883
Total owners' equity	***25883***
Total liabilities and owners' equity	**59233**

Income statement for June 2007	
Income	13500
Expenses	(7617)
Net profit for June	**5883**

7. CLOSING GENERAL LEDGER ACCOUNTS

It was already mentioned that income statement indicates income earned and expenses incurred for the particular period. Therefore at the end of each period income and expenses accounts are closed and must have 0 balance. These accounts will be used in the next period to account income and expenses for that period.

Closing of income and expenses accounts is done by transferring balances in these accounts to a balance sheet account called Retained earnings used to accumulate net profit retained in the business and belonging to the owners.

Balance in the Retained earnings account might be either on credit side (in case income exceed expenses, which means the company earned profit for the period), or on debit side (in case income is less than expenses, which means the company incurred loss for the period).

Below closing of expenses account is presented. Closing is done by crediting expenses account with the balance in this account accumulated for the whole period, i.e. 7617$. This amount is transferred to Retained earnings account No. 31 debit turnover side. After this operation, balance in retained earnings account equals to 7617$ on the debit side.

G/L account Expenses						**Account No 60**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance				0	
	19	Provision of copying services	10	5000		5000	
	30	Account for depreciation	11	317		5317	
	30	Account for salaries	11	1500		6817	
	30	Account for accrued expenses	11	350		7167	
	30	Account for consumption of office supplies	11	450		7617	
	30	Closing account to retained earnings	11		7617	0	

G/L account Retained earnings						**Account No 31**	
Date		**Description**	**Post ref.**	**D**	**C**	**Balance**	
						D	**C**
June, 2007	1	Balance					0
	30	Closing expenses account		7617		7617	

Further closing of income account is presented. Closing is done by debiting income account with the balance in this account accumulated for the whole period, i.e. 13500$. This amount is transferred to Retained earnings account No. 31 credit turnover side. After this operation, balance in retained earnings account equals to 5883$ on the credit side. This means that Alfa earned profit in June equal to 5883$, which you can also see in the income statement which was prepared earlier.

G/L account Income						Account No 50	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance					0
	15	Provision of copying services	10		7000		7000
	19	Sale of inventory	10		6500		13500
	30	Closing account to retained earnings		13500			0

G/L account Retained earnings						Account No 31	
Date		Description	Post ref.	D	C	Balance	
						D	C
June, 2007	1	Balance					0
	30	Closing expenses account		7617		7617	
	30	Closing income account			13500		5883

IV. Further Reading

More detailed reading can be found on the site www.bookkeeping-financial-accounting-resources.com/accounting-books.html