

# Introduction to financial statements

## The Accounting Cycle:

1. Transaction Analysis: Verifying Debit-Credit Parties.
2. Journal entries (Journalizing).
3. Ledger Accounts Balanced off (Posting).
4. Preparing Trail Balance (before making Adjustments).
5. Preparing Year-end Adjustments.
6. Preparing Trail Balance Adjusted (After making Adjustments).
7. Preparing Financial statements.

## First: Transaction Analysis depending on Accounting Equation:

### Accounting Equation:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

### Examples of Assets Accounts:



#### Long-term Assets (Fixed Assets):

- \* Land.
- \* Building.
- \* Equipment.
- \* Vehicles.
- \* Furniture.

#### Current Assets (Short-term Assets):

- \* Inventory.
- \* Accounts receivable.
- \* Notes receivable.
- \* Cash.
- \* Prepaid expenses.
- \* Accrued revenue.

### Examples of Liability Accounts:

- \* Accounts Payable.
- \* Notes Payable.
- \* Loan.
- \* Accrued Expenses.
- \* Unearned Revenue.

### Examples of Equity Accounts:

- \* Capital.
- \* (+) Revenue.
- \* (-) Expenses.
- \* (-) Withdrawals.

**Very Important Rule:**

**\*\* Each Business transaction must be analyzed into 2 Parties: (Debit – Credit). Accounting equation must remain in balance after each transaction\*\*.**

**Example (1):**

**on May 1, Sara established Travel Agency. The following transactions were completed during the month:**

1. Invested L.E 10,000 cash to start the agency.
2. Paid L.E 400 cash for May office rent.
3. Purchased office equipment for L.E 2,500 cash.
4. Incurred L.E 300 of advertising costs on account.
5. Paid L.E 500 cash for office supplies.
6. Earned L.E. 9,500 for services rendered: L.E 3000 cash is received from customers.
7. Withdrew L.E 200 cash for personal use.
8. Paid amount due in transaction (4).
9. Paid employee's salaries L.E 2,200 in cash.
10. Received L.E 4,000 in cash from customers who have previously been billed in transaction 6.

**Required:** Prepare accounting Equation, and show the effect of transactions.

**Solution:**

**Accounting Equation:**

**Assets = Liabilities + Equity**

T. N	Assets				Liabilities	Owner's Equity
	Cash	Acc. R	Supplies	Equipment	Acc. P	Capital
1	+10.000	-	-	-	-	+10.000
<b>Balance:</b>	<b>10.000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>+10.000</b>
2	- 400	-	-	-	-	-400 (Rent Ex.)
<b>Balance:</b>	<b>+ 9600</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>+ 9600</b>
3	- 2500	-	-	+ 2500	-	+ 9600
<b>Balance:</b>	<b>+7100</b>	<b>-</b>	<b>-</b>	<b>+2500</b>	<b>-</b>	<b>+9600</b>
4	-	-	-	-	+ 300	-300 (Adv. Ex.)
<b>Balance:</b>	<b>+7100</b>	<b>-</b>	<b>-</b>	<b>+2500</b>	<b>+300</b>	<b>+ 9300</b>
5	-500	-	+500	-	-	-
<b>Balance:</b>	<b>+ 6600</b>	<b>-</b>	<b>+500</b>	<b>+2500</b>	<b>+300</b>	<b>+9300</b>
6	+ 3000	+6500	-	-	-	+ 9500 (Ser. Re.)
<b>Balance:</b>	<b>+9600</b>	<b>+6500</b>	<b>+500</b>	<b>+2500</b>	<b>+300</b>	<b>+18800</b>
7	-200	-	-	-	-	- 200 (Withdr.)
<b>Balance:</b>	<b>+9400</b>	<b>+6500</b>	<b>+500</b>	<b>+2500</b>	<b>+300</b>	<b>+18600</b>
8	-300	-	-	-	-300	-
<b>Balance:</b>	<b>+9100</b>	<b>+6500</b>	<b>+500</b>	<b>+2500</b>	<b>-</b>	<b>+18600</b>
9	- 2200	-	-	-	-	- 2200 (Sal. Ex.)
<b>Balance:</b>	<b>+6900</b>	<b>+6500</b>	<b>+500</b>	<b>+2500</b>	<b>-</b>	<b>+16400</b>
10	+4000	-4000	-	-	-	-
<b>Balance:</b>	<b>+10900</b>	<b>+2500</b>	<b>+500</b>	<b>+2500</b>	<b>-</b>	<b>+16400</b>
<b>F. Balance:</b>	<b>16400</b>				<b>16400</b>	

### **Example (2):**

Osama opened a law office, on July 1, 2010. On July 31, the balance sheet showed cash L.E 5,000, Accounts Receivable 1,500, Supplies L.E 500, Office Equipment L.E 6,000, Accounts Payable L.E 4,200, and Osama Capital L.E 8,800. During August the following transactions occurred:

1. Collected cash L.E 1,200 of accounts receivables.
2. Paid L.E 2,800 cash on Accounts payable.
3. Earned revenue of L.E 8,000 of which L.E 3,000 is collected in cash, and the balance is due in September.
4. Purchased additional office equipment for L.E 2,000 paying L.E 400 in cash, and the balance on account.
5. Paid in cash: salaries L.E 2,500, rent for August L.E 900, and advertising expenses L.E 400.
6. Withdrew L.E 700 in cash for personal use.
7. Received a Loan of L.E. 1,500 from Egypt bank in Cash.
8. Incurred utility expenses for month on account L.E 220.

### **Required:**

Prepare a tabular analysis of the August transactions beginning with July 31 balances.

### **Solution:**

T. N	Assets				Liabilities		Owner's Equity
	Cash	Acc. R	Supplies	Equipment	Loans	Acc. P.	Capital
<b>31, July Balance.</b>	<b>5000</b>	<b>1500</b>	<b>500</b>	<b>6000</b>		<b>4200</b>	<b>8800</b>
1	1200	-1200	-	-		-	-
<b>Balance:</b>	<b>6200</b>	<b>300</b>	<b>500</b>	<b>6000</b>		<b>4200</b>	<b>8800</b>
2	-2800					-2800	
<b>Balance:</b>	<b>3400</b>	<b>300</b>	<b>500</b>	<b>6000</b>		<b>1400</b>	<b>8800</b>
3	3000	5000					8000 (Rev.)
<b>Balance:</b>	<b>6400</b>	<b>5300</b>	<b>500</b>	<b>6000</b>		<b>1400</b>	<b>16800</b>
4	-400			2000		1600	
<b>Balance:</b>	<b>6000</b>	<b>5300</b>	<b>500</b>	<b>8000</b>		<b>3000</b>	<b>16800</b>
5	-2500 -900 -400						-2500 (Sal. Ex) -900(Rent Ex.) -400(Adv. Ex.)
<b>Balance:</b>	<b>2200</b>	<b>5300</b>	<b>500</b>	<b>8000</b>		<b>3000</b>	<b>13000</b>
6	-700						-700 (Withd.)
<b>Balance:</b>	<b>1500</b>	<b>5300</b>	<b>500</b>	<b>8000</b>		<b>3000</b>	<b>12300</b>
7	1500				1500		
<b>Balance:</b>	<b>3000</b>	<b>5300</b>	<b>500</b>	<b>8000</b>	<b>1500</b>	<b>3000</b>	<b>12300</b>
8						220	-(220 U. Ex.)
<b>Balance:</b>	<b>3000</b>	<b>5300</b>	<b>500</b>	<b>8000</b>	<b>1500</b>	<b>3220</b>	<b>12080</b>
<b>F. Balance:</b>	<b>16800</b>				<b>16800</b>		

## How to Prepare Financial Statement?

The main Three types of financial statement are:

- \* Income statement.
- \* Balance Sheet.
- \* Owner's Equity statement.

### \*\*The Income statement:

Revenues:		_____
Less (-):		
Expenses:		(-----)
<b>Net Profit (or Net Loss)</b>		_____

### \*\*Owner's Equity Statement:

Capital:		***
(+)		
Investment	*	
Net Income	*	**
(-)		
Withdrawals	(*)	
Net Loss	(*)	(**)
<b>Capital</b>		*

**\*\*Balance Sheet:**

Assets:		Liabilities:	**
Long- term Assets	**		
(+)			
Current Assets	*		
		Owner's equity:	
		Capital (from O.E statement)	*
<b>Total Assets</b>	<b>***</b>	<b>Total Liabilities &amp; Owner's equity</b>	<b>***</b>

**\*\*Back to Example (2), and Prepare the main three financial statement:**

**Solution:**

**\*\*The Income statement:**

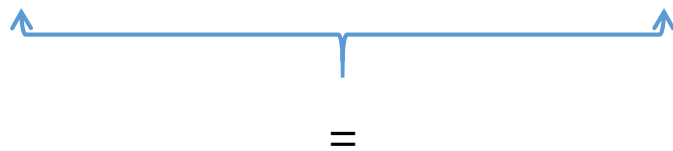
<b>Revenues</b>		<b>8000</b>
Less (-):		
<b>Expenses:</b>		
(Salaries Ex.)	2500	
(Rent Ex.)	900	
(Advertising Ex.)	400	
(Utility Ex.)	220	<b>(4020)</b>
<b>Net Profit</b>		<b>3980</b>

**\*\*Owner's Equity Statement:**

Capital:		8800
(+)		
Net Income	3980	
(-)		
Withdrawals	(700)	
		3280
<b>Osama Capital</b>		<b>12080</b>

**\*\*Balance Sheet:**

<b>Assets:</b>		<b>Liabilities:</b>	
<b><u>Long- term Assets:</u></b>		Accounts Payable	3220
Equipment	8000	Loans	1500
(+)		<b>Total Liabilities</b>	<b>4720</b>
<b><u>Current Assets:</u></b>		<b><u>Owner's equity:</u></b>	
Cash	3000	Osama Capital	12080
Accounts Receivable	5300	(From O.E. Statement)	
Supplies	500		
<b>Total Assets</b>	<b>16800</b>	<b>Total Liabilities &amp; Owner's equi</b>	<b>16800</b>



## Terminology:

Transaction Analysis	تحليل العمليات
Debit party	الطرف المدين
Credit party	الطرف الدائن
Journal entries	قيود اليومية
Journalizing	التقيد في دفتر اليومية
Ledger Accounts	الحسابات في دفتر الأستاذ
Posting	الترحيل إلى دفتر الأستاذ
Trail Balance	ميزان المراجعة
Adjustments	التسويات الجردية
Accounting Equation	معادلة الميزانية
assets	أصول
Long-term Assets (Fixed Assets)	أصول ثابتة
Land.	أراضي
Building.	مباني
Equipment.	آلات ومعدات
Vehicles.	وسائل نقل
furniture	أثاث وتجهيزات
Current Assets (Short-term Assets):	أصول متداولة
Inventory.	المخزون (البضاعة)
Accounts receivable.	المدينون
Notes receivable.	أوراق القبض
Cash.	النقدية
Prepaid expenses.	مصروفات مدفوعة مقدماً
Accrued revenue	إيرادات مستحقة
Liabilities	التزامات
Accounts Payable.	الدائنون
Notes Payable.	أوراق الدفع
Loan.	قروض
Accrued Expenses.	مصروفات مستحقة

Unearned Revenue.	إيرادات محصلة مقدماً
Owner's Equity	حقوق الملكية
Capital.	رأس المال
Revenue.	الإيرادات
Expenses.	المصروفات
Withdrawals	المسحوبات
remain in balance	تظل متوازنة
Invest	استثمر
Incur	تكبد - تحمل
on account	على الحساب
office supplies	معدات مكتبية (أصل)
Render services	يقدم خدمات
Withdrew	سحب
due	المستحق (يُستحق)
employee's salaries	مرتبات الموظفين
Who have previously been billed	الذين تم الدفع لهم مسبقاً بفاتورة (على الحساب)
balance sheet	قائمة المركز المالي (الميزانية العمومية)
Collected	حصّل
Earned revenue	اكتسب إيراداً (حقق إيراداً)
Purchased	اشترى
Balance	الرصيد - المتبقي
tabular analysis	جدول تحليلي (تحليل جدولي)
Net Income	صافي الربح
Net Loss	صافي الخسارة
Utility	مصروفات مهمات (مياه - كهرباء - غاز)