People's Democratic Republic of Algeria

Ministry of Higher Education and Scientific Research

University of FERHAT ABBAS - Setif 1

Faculty of Economics, Commerce and Management

الجمهورية الجزائرية الديمقراطية الشعبية

وزارة التعليم العالي والبحث العلمي

جامعة فرحات عباس – سطيف 1

كلية العلوم الاقتصادية والتجارية وعلوم التسيير

Pedagogical Publication in:

FINANCIAL ACCOUNTING 1

Intended for: First-year students in Economics, Commerce and Management

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Contents of the Pedagogical Publication

Brief Contents

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Course Description

Introduction:

This pedagogical publication was prepared for the benefit of first-year students in basic education at the Faculty of Economics, Commerce, and Management. Reliance was made to a large extent on the Syllabus of Financial Accounting I, with some modifications being made that were believed to be more appropriate to ensure the logical and smooth sequence of the axes of financial accounting in its first part.

1. Course Description of Financial Accounting 1

Course title	Financial Accounting 01
Education unit	Basic
Balance	06
Parameter	03
Time study per week	3 hours of lectures + 1.5 hours of tutorials
Target level	First year of basic education
Required Prerequisites	Some basic knowledge in mathematics
Learning methods followed	Traditional in-person classes and distance learning
Assessment method	Continuous assessment and examinations

2. Learning Objectives:

- **Primary objective:**

Understand the most important basics in financial accounting, which allows for further in-depth study later in the major of accounting.

- **Sub-objectives:**

  At the end of this course, students must acquire:
  - ✓ **Knowledge:** understand and interpret accounting concepts, principles, and rules;
  - ✓ **Cognition**: analyze transactions, record accounts in accounting books, and prepare financial statements;
  - ✓ **Communication skills**: develop communication skills within a team and cooperate to solve problems.

3. Course Contents:

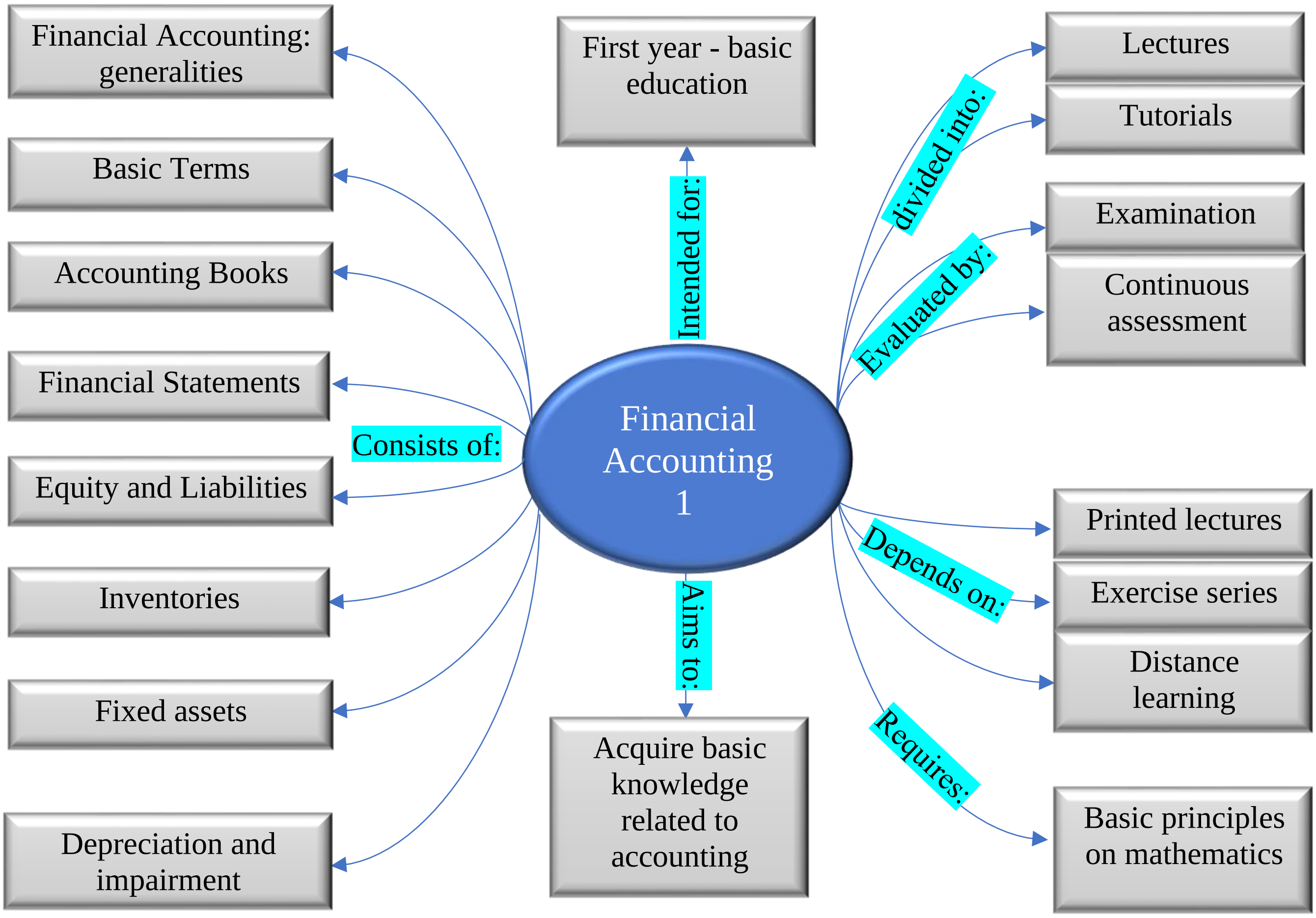
Chapter 01: Financial Accounting: Definition, Importance, and Principles	01 week
Chapter 02: Basic Accounting Terms	01 week
Chapter 03: Accounting Books	03 weeks
Chapter 04: Financial Statements	01 week
Chapter 05: Class 1 - Equity and Liabilities	02 weeks
Chapter 06: Class 3 – Inventories and Work in progress	03 weeks
Chapter 07: Class 2 - Fixed assets	01 week
Chapter 08: Depreciation and Impairment Loss	02 weeks
Total	**14 weeks**

4. Plans to Improve the Course of Financial Accounting 1:

- ✓ Continuous modification of content as a result of new research and references in this field;
- ✓ Focusing on using accounting software as one of the most important means of acquiring skills;
- ✓ Preparing and publishing an electronic version on the e-learning platform (Moodle) to give students more flexibility and interaction;
- ✓ Enhancing feedback related to this course and then revising it constantly to get a better version;

✓ Develop a database of questions and answers and make it available to students to help them better practice and understand the course.

5. Mind Map of the Course of Financial Accounting 1:



CHAPTER ONE:

FINANCIAL ACCOUNTING: DEFINITION, IMPORTANCE, AND PRINCIPLES

Chapter 01:
Financial Accounting: Definition, Importance, and Principles

Learning Objectives:

After completing this chapter, students should be able to:

LO1: Understand the meaning of financial accounting, economic event, and economic entity;

LO2: Identify the importance and purposes of financial accounting;

LO3: Explain accounting assumptions and principles.

Chapter contents:

1. **Branches and origins of accounting**
2. **What is financial accounting?**
3. **Who practices accounting?**
4. **Users of financial information**
5. **Why is financial accounting so important?**
6. **Accounting assumptions and principles**
7. **Bank of questions and exercises**

Introduction

In the first-year common core of Economics, Commerce and Management, students receive lessons in financial accounting, although not all of them aim to be accountants in the future. In fact, there is often an unavoidable need for accounting information everywhere. For example, if someone wants to run his own business, he needs to know how it is performing. He likely wants answers to questions like:

- ✓ Is his business making any profit?
- ✓ Has he got enough money to pay his bills?
- ✓ Who owes him money?
- ✓ How much is his business worth?

Financial accounting provides comprehensive answers to all these questions and more. In fact, it provides information about the whole entity situation in the form of numbers, and anyone who seeks to understand what is financially happening in this entity must be able to understand these numbers.

Branches and origins of accounting

1- Branches of accounting:

There are several types of accounting that have different uses and are subject to certain rules, the most important of which can be mentioned as follows:

- **Financial accounting:** the Algerian Financial Accounting System defines financial accounting as: “It is a system for organizing financial information. This system allows basic data to be entered, classified, evaluated, recorded, and presented in financial statements that reflect a faithful representation of the entity’s financial position, performance, and treasury at the end of the financial year.”
- **Cost Accounting:** it is a managerial accounting process that involves recording, analyzing, and reporting an entity's costs over a specific period of time (a week, a month, or a quarter of a year) in order to evaluate goods or services. Cost accounting is an internal process used only by internal users that aims to help

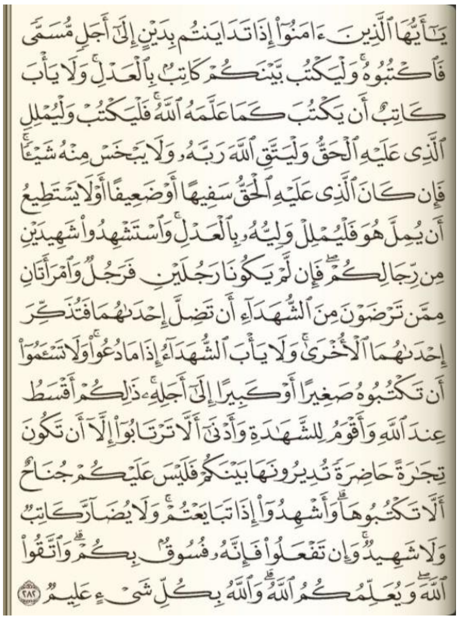
make decisions related to determining the selling price, identifying ways to reduce spending, resorting to internal subcontracting, investing, etc.

- **National Accounts:** simply refer to the value of all the transactions that take place within an economy. The national accounts compile all economic agents within a year or more. They aim to provide information related to the country's economic performance. They provide indicators about the level of national consumption, production, or investment, in addition to the indicator known as the Gross Domestic Product (GDP), which summarizes all these data.
- **Government Accounting:** as its name indicates, it relates to non-economic public entities, that is, institutions of an administrative nature: the ministry, the municipality, regional bodies, and other public institutions. Government accounting is based on recording the transactions carried out as well as following up and auditing the implementation of approved budgets.

2- A brief history of accounting:

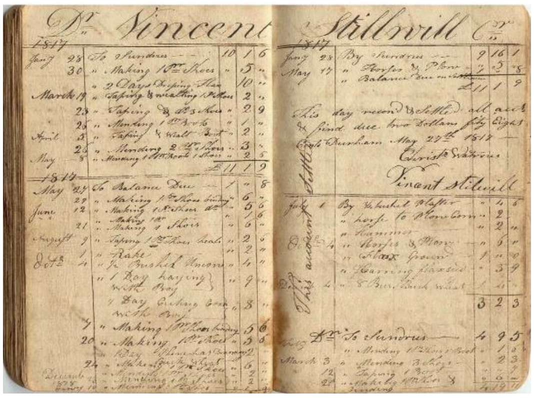
Many people think that accounting is a modern technique. In fact, it is difficult to pinpoint exactly when accounting appeared. It can be said that it appeared with the beginning of humans doing agriculture and storing crops. Around 2000 BC, the Code of Hammurabi required Babylonian merchants to prepare reports on their transactions. This type of accounting was primitive and limited to recording expenses and revenues when they occurred.

For its part, Islamic civilization contributed to the development of knowledge in various fields, as accounting received a share of this development. Islam obliges financial traders to write down the debt and state its term, no matter how small or large it is, as God Almighty says, "**O you who have believed, when you contract a debt for a specified term, write it down**" (Surah Al-Baqarah 282). This is legislation requiring the recording of rights and obligations, and it is one of the bases on which accounting is based, which requires the provision of documents that justify the occurrence of transactions. The Prophet, may God bless him and grant him peace, entrusted the task of collecting zakat and alms to trusted persons, and ordered that the funds collected and disbursed be recorded. Then accounting developed significantly in the Umayyad and Abbasid eras, where all financial transactions were recorded based on documents in gross, discount, and net, and the accounts and inventory were also reviewed at the end of each period.


يَٰٓأَيُّهَا ٱلَّذِينَ ءَامَنُوٓاْ إِذَا تَدَايَنتُم بِدَيۡنٍ إِلَىٰٓ أَجَلٖ مُّسَمّٗى
فَٱكۡتُبُوهُۚ وَلۡيَكۡتُب بَّيۡنَكُمۡ كَاتِبُۢ بِٱلۡعَدۡلِۚ وَلَا يَأۡبَ
كَاتِبٌ أَن يَكۡتُبَ كَمَا عَلَّمَهُ ٱللَّهُۚ فَلۡيَكۡتُبۡ وَلۡيُمۡلِلِ
ٱلَّذِي عَلَيۡهِ ٱلۡحَقُّ وَلۡيَتَّقِ ٱللَّهَ رَبَّهُۥ وَلَا يَبۡخَسۡ مِنۡهُ شَيۡـٔٗاۚ
فَإِن كَانَ ٱلَّذِي عَلَيۡهِ ٱلۡحَقُّ سَفِيهًا أَوۡ ضَعِيفًا أَوۡ لَا يَسۡتَطِيعُ
أَن يُمِلَّ هُوَ فَلۡيُمۡلِلۡ وَلِيُّهُۥ بِٱلۡعَدۡلِۚ وَٱسۡتَشۡهِدُواْ شَهِيدَيۡنِ
مِن رِّجَالِكُمۡۖ فَإِن لَّمۡ يَكُونَا رَجُلَيۡنِ فَرَجُلٞ وَٱمۡرَأَتَانِ
مِمَّن تَرۡضَوۡنَ مِنَ ٱلشُّهَدَآءِ أَن تَضِلَّ إِحۡدَىٰهُمَا فَتُذَكِّرَ
إِحۡدَىٰهُمَا ٱلۡأُخۡرَىٰۚ وَلَا يَأۡبَ ٱلشُّهَدَآءُ إِذَا مَا دُعُواْۚ وَلَا تَسۡـَٔمُوٓاْ
أَن تَكۡتُبُوهُ صَغِيرًا أَوۡ كَبِيرًا إِلَىٰٓ أَجَلِهِۦۚ ذَٰلِكُمۡ أَقۡسَطُ
عِندَ ٱللَّهِ وَأَقۡوَمُ لِلشَّهَٰدَةِ وَأَدۡنَىٰٓ أَلَّا تَرۡتَابُوٓاْ إِلَّآ أَن تَكُونَ
تِجَٰرَةً حَاضِرَةٗ تُدِيرُونَهَا بَيۡنَكُمۡ فَلَيۡسَ عَلَيۡكُمۡ جُنَاحٌ
أَلَّا تَكۡتُبُوهَاۗ وَأَشۡهِدُوٓاْ إِذَا تَبَايَعۡتُمۡۚ وَلَا يُضَآرَّ كَاتِبٞ
وَلَا شَهِيدٞۚ وَإِن تَفۡعَلُواْ فَإِنَّهُۥ فُسُوقُۢ بِكُمۡۗ وَٱتَّقُواْ
ٱللَّهَۖ وَيُعَلِّمُكُمُ ٱللَّهُۗ وَٱللَّهُ بِكُلِّ شَيۡءٍ عَلِيمٞ ٢٨٢

Surah Al-Baqarah 282

Then, with the development of trade and credit, a method was developed that allowed the tracking of the cash treasury and other elements of an entity's wealth. This development can be observed in the records of major Italian merchants in the 14^{th} century AD. This practice preceded theoretical writing because the first and most famous book in accounting did not appear in Venice until 1494. This book is entitled "Tractatus", written by the mathematician Luca Pacioli, who is often considered the "Father of Accounting," and thus the rule called "double entry" appeared, which means that any transaction carried out by the entity is recorded twice:



https://www.business-case-analysis.com/double-entry-system.html

- Once, in order to determine what the resource is,
- Again, in order to determine what the use is.

The changes that came later concerned secondary points such as the accounting treatment of special transactions or the formalities that had to be respected. Later, with economic development and market openness, the need for an international accounting system increased to facilitate the reading and comparison of accounting information in different countries, which helps investors make appropriate decisions. This is what led to the emergence of the International Accounting Standards, which unified accounting concepts and principles in 1973.

As for Algeria, accounting development essentially began since its independence in 1962, when it implemented the General Accounting Plan of 1957, which it inherited from French colonialism, as part of filling the legal vacuum that followed the National Independence. However, in 1969, Algeria had to establish an accounting scheme that was compatible with the socialist economic orientation adopted by the government, as the General Accounting Plan was expressly designed to be compatible with the free economy (capitalism). As a result, the National Accounting Plan was released in 1975 and went into force on January 1, 1976.

In late 1998, the Ministry of Finance entrusted the National Accounting Council with the task of preparing a new accounting system that is consistent with the International Accounting Standards on the one hand and with national requirements on the other. These efforts culminated in the issuance of the Financial Accounting System on November 25, 2007 in the Official Gazette, which entered into force on January 1, 2010 and is still in effect to this day.

What is Financial Accounting?

1- Definition of financial accounting

Accounting is the process of measuring, recording, summarizing, and communicating an entity's economic activity in the form of financial information about position and performance, which is used as a basis for decision-making.

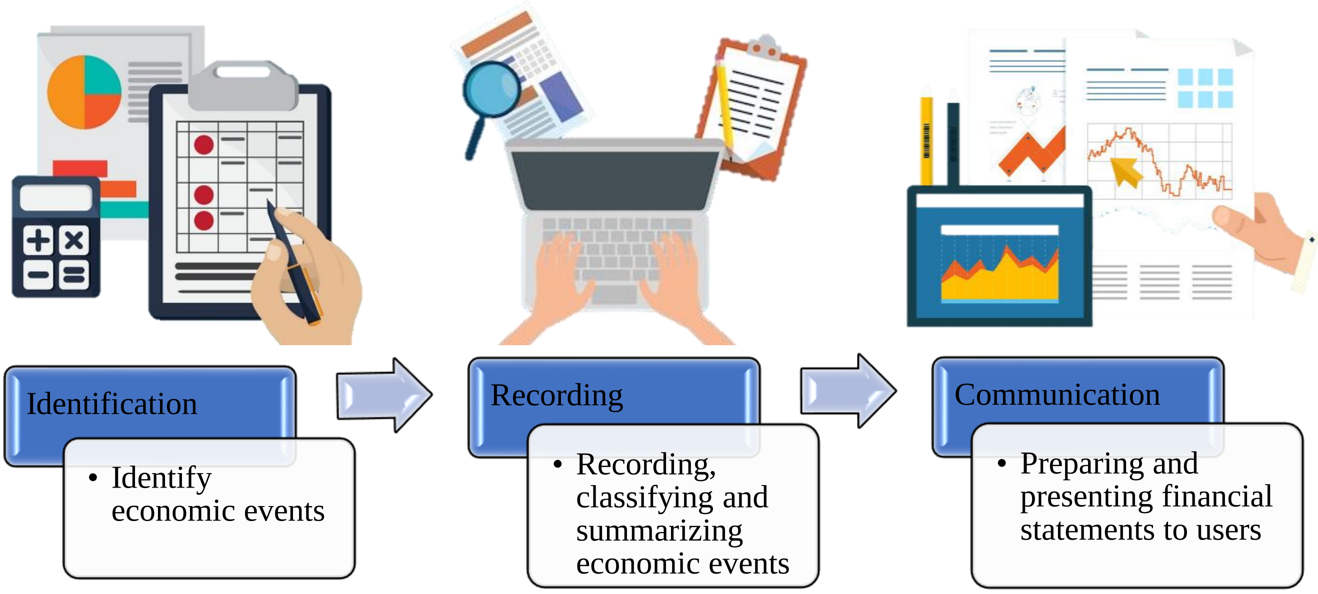
It can be said that financial accounting is an information system that identifies and records transactions in accounting books, presents information in financial statements about the entity's wealth and position during a specific period, and communicates this information to the concerned parties. Therefore, accounting is based on three basic activities, as follows:

1- As a starting point, economic events related to the entity's business are identified. Examples of economic events include purchasing goods, paying bills, withdrawing from a bank account, etc.

2- Once economic events are identified, those events are recorded in order to form a memory of economic events. The recording is in organized books in the chronological order of events that can be measured in monetary units. At this stage, economic events are also classified and summarized.

3- Finally, information resulting from similar transactions is presented in aggregate. For example, all sales transactions during a certain period of time are collected and presented as a single amount. The collected information is communicated to interested users through reports that are called financial statements.

The three activities of financial accounting



Financial accounting is different from bookkeeping. Bookkeeping simply means recording economic events. Therefore, bookkeeping is a part of financial accounting.

2- Terms related to financial accounting

- **Accounting transaction (economic event):** It is an event related to the economic entity; it has a specific date and can be measured monetarily.
- **Economic entity:** It is an entity with a name and legal responsibility that carries out an economic activity that may be:

✓ Commerce
✓ Industry
✓ Agriculture
✓ Services
✓ ……

An economic entity can also be classified according to its ownership into:

✓ Proprietorship (owned by one person)
✓ Company (owned by more than one person).

- **Financial information:** information appearing in the financial statements in an organized and summarized form (tables) helps those interested parties judge the entity's position. These financial statements (which will be studied later) are as follows:

✓ balance sheet;

- ✓ income statement;
- ✓ Statement of cash flows;
- ✓ Statement of changes in equity;
- ✓ Notes to the financial statements.

- **The Financial Accounting System (FAS):** is the approved accounting reference that contains all principles and rules that regulate financial accounting in Algeria.

Who practices accounting?

Accounting is also considered a profession. It is regulated by the legal bodies authorized to do so through laws, legislation, and the legal reference represented by the Financial Accounting System. Financial accounting can be practiced by:

1. Accountant:

The accountant is the person who performs the accounting profession in an entity. He may hold the position of an official in the entity or an employee. Large entities usually need a team of accountants in order to carry out accounting activities.

2. Chartered accountant:

The certificate of chartered accountant is granted after a bachelor's degree or its equivalent in finance and accounting, followed by at least two years of professional internship and success in the final exam organized by the University of Algiers. The holder of the chartered accountant certificate can practice his profession independently (a freelance profession) or as an employee of an entity as a chief accountant or financial manager.

3. Auditor:

There is usually confusion between the chartered accountant and the auditor. While the task of the chartered accountant is to accompany and advise, the auditor monitors the entity's accounts and ensures that they honestly reflect the financial position. The chartered accountant is usually an auditor, but he cannot hold both missions at the same time for one entity. In fact, the auditor must be independent in order to be able to audit the accounts, as he is appointed by the shareholders of the entity, in order to review and ensure the accuracy of financial statements and the respect of accounting principles and rules.

Users of financial information

Users of financial information can be divided into two basic categories:

1- **Internal users**: They are both management and workers/employees of an entity.

2- **External users**: shareholders/owners, banks, suppliers, tax authorities, customers, and anyone interested in the entity's position from the public.

Users of the financial information of the entity

Why is Financial Accounting so Important?

The goal of accounting is to make sense of the regular financial transactions that an entity may come across. It handles the never-ending flood of documents that typically follows each financial transaction. Examples of this paperwork include supplier invoices for goods the entity has purchased. Accounting continuously gathers data from every financial transaction and keeps it in a database.

- If any trader were asked about the importance of accounting, the answer would most likely be preparing tax declarations. This answer is correct but incomplete. Indeed, accounting allows calculating the basis of taxes and social contributions and also allows specifying:

✓ Profit that is subject to tax on profits or income;

✓ Turnover that is subject to the value-added tax (VAT);

✓ Wages that are subject to social contributions...

- However, the role of accounting is greater because it is used to provide information about the financial position of an entity to many interested parties in the form of summary tables and information, namely the financial statements, which consist of:

- ✓ The balance sheet that displays the entity's position at the date of account closing;
- ✓ The income statement that explains the composition of the income by tracking the entity's activities during the financial year;
- ✓ Notes provide all the complementary information necessary to understand the financial statements.

- Analysis of financial statements allows judging the entity's position, i.e., evaluating performance, level of activity, and cash flows. This information is important for decision-making for:
  - ✓ The bank that verifies the entity's ability to repay before granting the loan;
  - ✓ The supplier, who also verifies the entity's ability to pay before postponing the payment date;
  - ✓ The investor who compares risks and returns before investing his money in the entity;
  - ✓ Managers who work to ensure the good performance of the entity;
  - ✓ Employee representatives who are interested in the position of the entity before entering into possible negotiations about wages.
- Finally, it can be said that accounting is similar to a genetic fingerprint. In fact, source documents and accounting books are a recognized evidential tool in courts and tax authorities when a dispute occurs with a customer, supplier, or tax inspector.

Accounting assumptions and principles

Financial accounting is based on many assumptions and principles that have arisen and been formed over time, which explain methods and procedures applied to process transactions in a way that ensures the consistency of an entity's records and statements.

1- Accounting assumptions:

- ✓ **Accrual Basis:** According to this assumption, transactions are recorded in accounting books when they occur. In other words, accrual basis is a method that allows an entity to record expenses as they are incurred and revenues as they are earned, regardless of when relevant cash flows occur.
- ✓ **Going concern:** it states that the entity is financially stable enough to continue in business and will remain in operation for the foreseeable future. It also means that the entity does not intend to, or expect to be forced to, liquidate its business.

2- Accounting principles:

- ✓ **Periodicity (time period):** since the going concern is one of the accounting assumptions based on the fact that the life of the entity continues indefinitely, it is illogical for the owner to wait until the end of the entity's life to know the net income achieved by his capital. Therefore, financial information can be reported within certain regular periods of time. According to the Financial Accounting System, an entity consistently reports its financial information on an annual basis, starting on 01/01/N and ending on 12/31/N.
- ✓ **Matching Principle:** states that expenses incurred during a period should relate to revenues earned during the same period. That means, revenues and expenses are matched on the income statement for one period of time. For example, if an entity buys a building that will last for many years, it couldn't write off the cost of that building all at once. Instead, it records depreciation expenses over the building's estimated useful life. Thus, the entity has matched the cost of the building with the benefits it produces over the course of years.
- ✓ **Economic Entity:** requires that the entity's activities be maintained apart from those of the owner. In order to assess an entity's performance and financial position accurately, it is important to not blur an entity's transactions with personal transactions or those of other entities.
- ✓ **Monetary Unit:** states that business transactions should only be recorded if they can be expressed in terms of a currency. In other words, non-quantifiable information should not be recorded. For instance, the financial statements should not include customer satisfaction, despite it being crucial information required by interested parties. As per the guidelines provided in the Financial Accounting System, all transactions are recorded in the country's monetary unit, the Algerian Dinar (DZD).
- ✓ **Conservatism:** states that gains should be recorded only if their earning is certain, but all potential losses, even those with a slim probability of incurrence, are to be recognized. The main idea behind the conservative principle is to recognize liabilities and expenses as soon as possible when the outcome is uncertain, but to recognize revenues and assets only once they are assured of being received.
- ✓ **Consistency:** refers to applying the same accounting principles and procedures from year to year within an entity. In other words, once an entity chooses one accounting method, it must use it consistently from then on.
- ✓ **Historical Cost:** dictates that entities record assets at their own cost. This is true not only at the time the asset is purchased but also over the time the asset is held.

- ✓ **Non-compensation:** This principle states that all aspects of an entity's performance, whether positive or negative, are to be reported. In other words, an offset between assets and liabilities in the balance sheet or between expense and revenue items in the income statement is not permitted unless it is imposed within the Financial Accounting System.
- ✓ **Substance over Form:** is an accounting principle utilized to ensure that financial statements provide a full and relevant representation of transactions and events. This means that the financial statements will convey the overall financial reality of the entity (economic substance) rather than simply reporting the legal record of transactions (form). Often, the economic substance and legal form are the same for a transaction, but when they reflect differences, recording it based on the legal form may not give a fair representation of this transaction.
- ✓ **Materiality:** is related to the significance of information within an entity's financial statements. It determines that all items that are reasonably likely to impact decision-making must be recorded or reported in detail in financial statements. A transaction or business decision is considered "material" to the entity if it is significant enough to be reported to investors or other users of the financial statements.

3- Qualitative Characteristics of Financial Information

- ✓ **Relevance**: it means that information provides a confirmatory value, which verifies or adjusts previous expectations, and a predictive value, which aids in providing accurate expectations about the future. It also needs to be timely, meaning that decision-makers need to have access to it before it loses its ability to impact decisions.
- ✓ **Faithful Representation (Credibility):** means that information accurately depicts what really happened. A depiction that is complete (meaning that all the information that a user needs to understand the economic phenomena is included), neutral (meaning that the representation is unbiased; it's neither overly optimistic nor overly pessimistic), and free from error.
- ✓ **Comparability:** when different entities apply the same accounting principles, that ensures the consistent presentation of financial information across different entities and different periods and enables users of financial statements to make accurate comparisons and make informed decisions.
- ✓ **Understandability:** Information has the quality of being understandable if it is presented in a clear and concise manner, so that reasonably informed users of financial statements can interpret it and understand it easily.

Bank of questions and exercises

1- Questions:

1. **Categorize the following tasks into the three activities of accounting (identification, recording, or communication):**
   a) Adjustment of accounts at the end of the year.
   b) Preparing financial statements.
   c) Reporting information in a standard format.
   d) Selecting transactions relevant to the entity.
   e) Summarizing accounting transactions.
   f) Analyzing and interpreting financial information.
   g) Classifying economic events.
   h) Keeping a systematic chronological diary of events.
   i) Measuring events in monetary units.
2. **Which of the following events cannot be recorded in accounting?**
   a) Purchase equipment on account (to be paid later).
   b) Termination of an employee.
   c) Borrowing a bank loan.
   d) Paying wages to employees.
   e) Death of the manager.
   f) Purchase supplies in cash.
   g) Discussing product design with potential customers.
3. **Categorize the following users of financial statements as internal and external users:**
   a) Investors
   b) Production manager
   c) Statistics agencies
   d) Customers
   e) Storekeeper
   f) Labor unions
   g) Insurance funds
   h) Marketing manager
   i) Tax Inspectorate
4. **Which of the following sentences about accounting assumptions is true?**
   a) The basic assumptions are the same as the accounting principles.
   b) The assumption of accrual basic states that there must be a certain unit of measurement.

c) The assumption of going concern allows for accounting for employee morale.
d) The assumption of going concern means that the entity's liquidation date is not definite.

5. **The historical cost principle states that:**
   a) The activities of the entity must remain separate and distinct from those of its owner.
   b) Assets should be initially recorded at cost and adjusted when their market value changes.
   c) Assets must be recorded at their cost.
   d) Only transactions that can be expressed in monetary terms are recorded.
6. **An entity may only report activities in the financial statements that are specifically related to the entity's transactions and not those that affect the owner personally. Which of the following is consistent with the previous statement?**
   a) The principle of economic entity
   b) The assumption of going concern
   c) The assumption of periodicity
   d) The principle of monetary measurement
7. **Entities can provide useful information in shorter periods of time, such as years, according to:**
   a) Substance over form
   b) Accrual basis assumption
   c) Time period principle
   d) Materiality principle
8. **Which of the following terms is used when assuming that expenses and revenues should be related to the same period?**
   a) Conservatism principle
   b) Matching principle
   c) Time period principle
   d) Going concern assumption
9. **Which of the following terms states that an entity must recognize revenue only when the product or service is provided?**
   a) Non compensation principle
   b) Matching principle
   c) Conservatism principle
   d) Accrual basis assumption

10. For each of the following cases, identify the date when revenue should be recognized.

a) The customer receives an item on April 3, and pays on April 24.
b) The customer pays cash for an item on April 15, and he receives it on April 24.
c) The customer orders an item on April 3, and receives it on April 15, then pays on April 24.

11. The proprietor, Ahmed, bought a new truck. The price mentioned in the advertisement was 50.000 DZD, but he bargained with the seller and negotiated a discount of 10.000 DZD, so he could buy it for 40.000 DZD; while the same model of truck is sold everywhere for 60.000 DZD. The truck should be recorded in accounting books at:

a) 60.000 DZD
b) 50.000 DZD
c) 40.000 DZD

12. ABC Company developed software for a customer. The customer agreed to a minimum price for the software of 20.000 DZD, but if the customer had no problems at all with the software for the first month, he would pay 25.000 DZD for the Company.

The Company must record the revenue earned at…………..DZD according to the……………………..principle.

2- Exercises:

Exercise 01:

The following situations involve accounting principles and assumptions:

1. ABC Company owns buildings that are substantially worth more than they originally cost. In an effort to provide more relevant information, the Company records the buildings at fair value in its reports.
2. ABC Company includes in its accounting books only transaction data that can be expressed in terms of money.
3. Ahmed, manager of ABC Company, records his personal phone bills as expenses of the Company.
4. ABC Company purchased land five years ago for 300.000 DZD. Even though the current market value of this land increases to 400.000 DZD, it continues to be reported at 300.000 DZD.
5. ABC Company imported a machine from abroad denominated in 2.000$ and recorded 2.000$ as value in accounting books;

6. ABC Company has paid a rent bill worth 50.000 DZD for two consecutive years (2022-2023). It recorded the full rent amount in the accounting books for the year 2022.
7. In 2022, ABC Company was applying a perpetual inventory method to track the movement of its inventories, and in the following year, it decided to change this method and rely on the periodic inventory method.

***Required*:**

Indicate if the accounting method used in each of the aforementioned cases was correct or not. If correct, list the principle or assumption that underpins the chosen method, and determine which principle or assumption has been broken if it is incorrect.

Exercise 02:

Alpha Company is an industrial enterprise. Here are some of the transactions it carried out during the years N-1, N, and N+1. The closing of accounts for this Company is on 12/31.

- 12/15/N-1: Sending sales invoice to the customer "Beta" on account (to be collected later);
- 12/20/N-1: Obtaining a loan from the People's Bank;
- 12/22/N-1: Purchasing supplies from the supplier "Gamma," who will send the invoice later on 01/05/N;
- 01/05/N: Receiving the purchase invoice from the supplier "Gamma"
- 01/15/N: Collecting the amount of the sales invoice dated 12/15/N-1 from the customer "Beta";
- 01/20/N: Payment of the first loan installment to the People's Bank;
- 02/02/N: Hiring a new employee;
- 02/28/N: Payment of wages to the new employee;
- 03/15/N: Sending goods to the customer "Beta" without an invoice;
- 03/21/N: Sending the sales invoice to the customer "Beta";
- 03/31/N: Determining worker productivity;
- 04/12/N: Sending a purchase order to the supplier "Gamma";
- 04/15/N: Receiving the purchase invoice and goods from the supplier "Gamma";
- 04/17/N: Payment for the supplier "Gamma";
- 05/05/N: Evaluation of the market shares of the Company and its competitors;
- 07/01/N: Payment of office rent for 12 months;

- 12/18/N: Estimating that there is a high probability of losing a lawsuit against a customer.
- 12/20/N: Expecting that the Company will increase sales by 5% because of the opening of a new market;
- 12/28/N: Sending a sales invoice and goods and collecting the amount from the customer "Beta";
- 01/05/N+1: Recovering part of the goods sold on 12/28/N from the customer.

Required:

1- What are the events that the Company must record during the year N?

2- What are the accounting principles and rules related to choosing what to record during the year N?

Exercise 03:

State the qualitative characteristics of financial information corresponding to the following cases:

1. Financial information is presented in tables in a clear and organized manner.
2. Financial information provides confirmatory value that adjusts previous expectations.
3. All the information that a user needs to understand economic phenomena is included.
4. Financial statements show any information that helps users make an informed decision.
5. Financial information is available in a timely manner before it loses value.
6. The information presented in the financial statements relates to two consecutive years and is based on the same methods.
7. Financial statements contain adequate and comprehensive explanations about the entity's position.

CHAPTER TWO:

BASIC ACCOUNTING TERMS

Chapter 02:

Basic Accounting Terms

Learning objectives:

After completing this chapter, students should be able to:

LO1: Identify flows and their types;

LO2: Determine the nature of accounts and their normal balances;

LO3: Understand the steps of the accounting cycle.

Chapter contents:

1. **Typology of flows**
2. **Accounts and double entry**
3. **The Chart of Accounts**
4. **The accounting cycle**
5. **Bank of questions and exercises**

Introduction

There are a large number of financial transactions going on in the entity, making it impossible to look at each and every transaction. In order to make sense of or understand what is happening in the entity, it is necessary to categorize and sort similar transactions into groups. In financial accounting, the term "account" is used to refer to a category or group. Any entity subject to the legal obligation to produce annual financial statements shall set up a chart of accounts in compliance with the regulation, i.e., the Financial Accounting System. This chart must be sufficiently detailed to allow the recording of all the entity's transactions. In this chapter, the following questions will be answered:

- ✓ What are the flow types linked to a transaction?
- ✓ What are the account types?
- ✓ How does each type of accounts function?
- ✓ From which documents and how?

Typology of Flows

1. Definition of flow

An economic flow is a quantity of goods, services, or money in motion between two economic actors. Every flow is characterized by direction and value. The direction of flow translates into the existence of an origin and a destination. The origin of the flow involves a resource, and the destination involves a use.

2. Types of flows

a) Real flows and financial flows

Real flows correspond to the movements of goods and services. They are described as real, unlike financial flows. Financial flows correspond to payment movements or payment commitments. Examples of real flows:

- ✓ flow of raw materials,
- ✓ flow of goods,
- ✓ flow of equipment,
- ✓ flow of services.

Examples of financial flows:

- ✓ payments,
- ✓ collections.

b) External flows and internal flows

External flows concern several economic agents. Internal flows concern only one economic agent. Examples of external flows:

- ✓ Purchases,
- ✓ Sales.

Examples of internal flows:

- ✓ Deposit of cash into the bank account,
- ✓ Movement of raw materials between stores and factories of the same entity.

c) Elements of flows

What needs to be specified for each flow is:

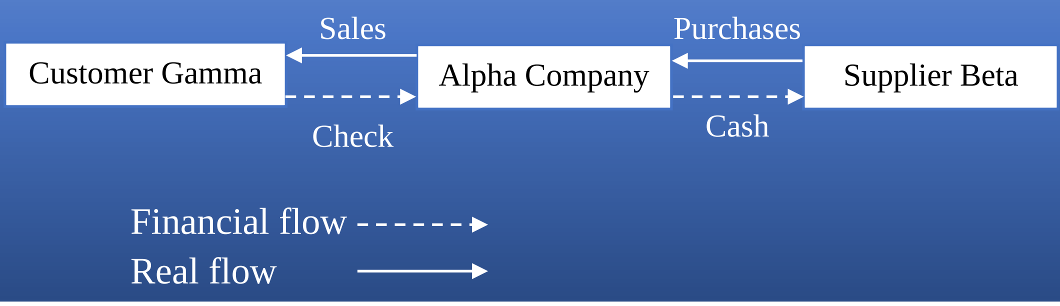
- ✓ The resource,
- ✓ The use,
- ✓ The nature of the flow (purchase, payment, sale, collection, etc.),
- ✓ The monetary measurement.

Example

Alpha Company carried out the following transactions:

- Sale of goods to the customer “Gamma” for 30.000 DZD collected by check.
- Purchase supplies from the supplier “Beta” worth 20.000 DZD paid in cash.

These transactions can be represented as follows:



Accounts and Double Entry

1. Accounts:

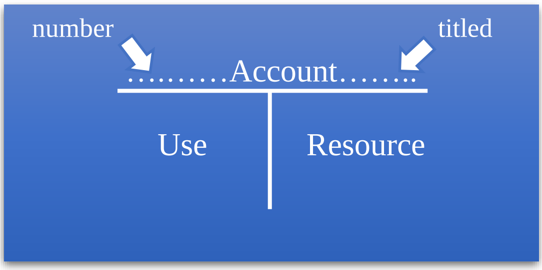
a) What is an account?

The account is the smallest classification unit used to record the flows arising from different transactions. Transactions of the same nature are grouped together in tables to represent these accounts.

For example, if an entity makes a sale, the amount in the account used to record revenue will increase. If an entity pays an electricity bill, the expense account will reflect the added cost to the entity. These various accounts help entities stay organized and aware of their spending and earning activities.

b) From flows to accounting transactions

All transactions must be recorded according to the double-entry principle. For each transaction, you must use at least two different accounts. One or more accounts for the incoming flow (use) and one or more for the outgoing flow (resource). For simplification, the account is presented in a T-shaped format.

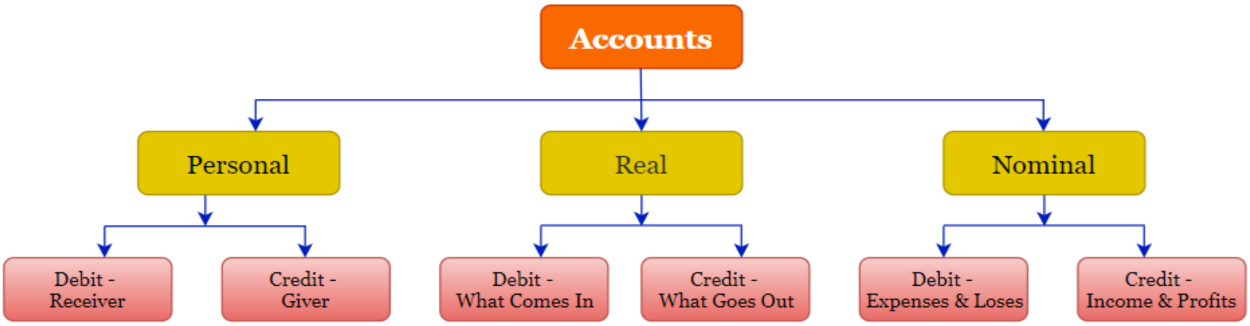


By convention, any resource is noted on the right side and any use on the left side. The right part of an account is called credit (records the resource), and the left part is called debit (records the use). The balance is debit when the total debit > total credit, and vice versa. The equality of the debit amount and the credit amount must always be verified. We then say that the writing is balanced.

Every record of a transaction must follow the golden rules of accounting. These rules apply to three types of accounts, as follows:

- **Real account**: an account that pertains to assets and liabilities.
  Golden Rule: Debit what comes into the business, and credit what goes out of the business.
- **Personal account:** includes all accounts related to individuals, firms, and associations.
  Golden Rule: Debit the receiver, and credit the giver.
- **Nominal account**: related to all income, expenses, losses, and profits.
  Golden Rule: Debit the expense or loss, and credit the income or profit.

Golden Rules of Accounting



2. The Double Entry Rule:

For every transaction observed, it must be double recorded, which is known as the double entry rule. Double entry is a bookkeeping method that states that every transaction has equal and opposite effects in at least two different accounts.

Any transaction resulting in real or financial flow carried out by the entity must be recorded in accounts. For accounts to be balanced, it is necessary that, for each transaction, one account at least be debited and another at least be credited according to the principle of double entry.

The Chart of Accounts

1. What is the Chart of Accounts?

The Chart of Accounts is a list of accounts that entities can use. In other words, it is a form of presenting the detailed nomenclature contained in the Financial Accounting System by standardizing and using these accounts on a regular basis, and it can be adapted at the level of each entity depending on its size and sector of activity.

2. Classification of accounts:

The Financial Accounting System requires all entities to apply a unified list of accounts and a classification plan. These accounts are classified by nature as follows:

Class 1 to 5: Balance Sheet Accounts	
Class 1:	Equity and Liability
Class 2:	Fixed Assets
Class 3:	Inventory and Work in Progress
Class 4:	Accounts Receivable and Payable
Class 5:	Cash and Financial Instruments
Class 6 to 7: Profit and Loss Accounts	
Class 6:	Expenses
Class 7:	Revenues

- **Class 1 to 5: Balance Sheet Accounts**

The balance sheet transactions are divided into five classes of accounts qualified as balance sheet accounts, as follows:

- **Class 1: Equity and Liabilities**

The accounts of class 1 include shareholders' equity, other funds, loans, and similar debts.

- **Class 2: Fixed Assets**

The accounts of class 2 include intangible fixed assets, tangible fixed assets, financial fixed assets, depreciation, and impairment losses of fixed assets.

- **Class 3: Inventory and Work in Progress**

For inventories and work in progress, there are two classification criteria:

✓ the physical nature of goods or the nature of service;
✓ the chronological order of the production cycle: consumable, work in progress, production, inventory for resale.

- **Class 4: Accounts Receivable and Payable**

The accounts of class 4 include those attached to third-party accounts and used to record either financing methods linked to debts and receivables, i.e., accounts payable and accounts receivable, or future debts and receivables relating to the financial year, i.e., accrued expenses and accrued income that include expenses and income recognized during the current year but related to the following years.

- **Class 5: Cash and Financial Instruments**

The accounts of class 5 record:

✓ transactions in cash, checks, and coupons;
✓ transactions involving financial intermediaries;
✓ marketable securities.

The balance sheet is divided into two parts: the uses appear on the left and are called **Assets**. The resources appear on the right and represent **Liabilities**. Assets include: Fixed assets (class 2), Non-cash current assets (class 3 + class 4), Cash assets (class 5). Liabilities contain: permanent financing (class 1), non-cash current liabilities (class 4), and cash liabilities (class 5).

- **Class 6 to 7: Profit and loss accounts**

The income statement transactions are divided into two classes of accounts qualified as profit and loss accounts and structured as follows:

- **Class 6: Expenses**

Expenses include accounts that summarize the outflow of money from an entity or the loss or wastage of the entity's resources (for example, money spent to purchase goods for resale, telephone, electricity, rent, and wages expenses). Class 6 includes accounts for recording, during the financial year, expenses by nature, including those relating to previous financial years, which are related to:

- ✓ Operating activities;
- ✓ Financial management;
- ✓ Exceptional transactions;
- ✓ Employee profit-sharing and income taxes.

- **Class 7: Revenues**

Revenues include accounts that summarize the inflow of money into an entity resulting from sales of inventories, services performed, and general operations (for example, sales, rent received, and commission received). Class 7 includes accounts for recording, during the financial year, income by nature, including those relating to previous financial years, which are related to:

- ✓ Operating activities;
- ✓ Financial management;
- ✓ Exceptional transactions;
- ✓ Transfers of expenses.

Expenses are classified by nature: operating expenses (Accounts 60 to 65), financial expenses (Account 66), and exceptional expenses (Account 67). The same classification applies for revenues.

3. Principles of the Chart of Accounts

The Financial Accounting System adopts one accounting coding principle using decimal classification for the seven classes of accounts. More detailed subdivision of accounts in the official nomenclature is permitted, provided that the order of account classification to be used in the new chart of accounts is respected. Each **main account** (2-digit numbers) can be divided into **divisional accounts** (3-digit numbers) and **sub-accounts** (accounts with 4 digits or more).

The main accounts of the balance sheet ending in 9 (Accounts 29, 39, 49, and 59) identify the depreciation and impairment of losses for each class. For divisional accounts and sub-accounts, the ending 9 makes it possible to identify operations with a nature contrary to those normally covered by the immediately higher-level account and classified in subdivisions ending in 0 to 8. In other words, these accounts represent a balance contrary to the nature of the original group to which they belong. Examples of these accounts: 409-Suppliers with a debit balance, 419- Customers with a credit balance, 519-Short term bank advances.

4. Functioning of Accounts

The following table summarizes the functioning of the four groups of accounts, which consist of balance sheet accounts (assets and liabilities) in addition to profit and loss accounts (expenses and revenues):

Asset + Expense accounts		Liability + Revenue accounts	
Debit	**Credit**	**Debit**	**Credit**
Increase +	Decrease -	Decrease -	Increase +

An asset account or an expense account increases on the debit side and decreases on the credit side. On the contrary, a liability account or revenue account increases on the credit side and decreases on the debit side.

Example

In March 2023, the transactions related to the account 53-Cash were as follows:

- March 1: the initial amount of the cash account is 10.000 DZD;
- March 5: collection of sales worth 30.000 DZD in cash;
- March 20: payment of purchases worth 5.000 DZD in cash.

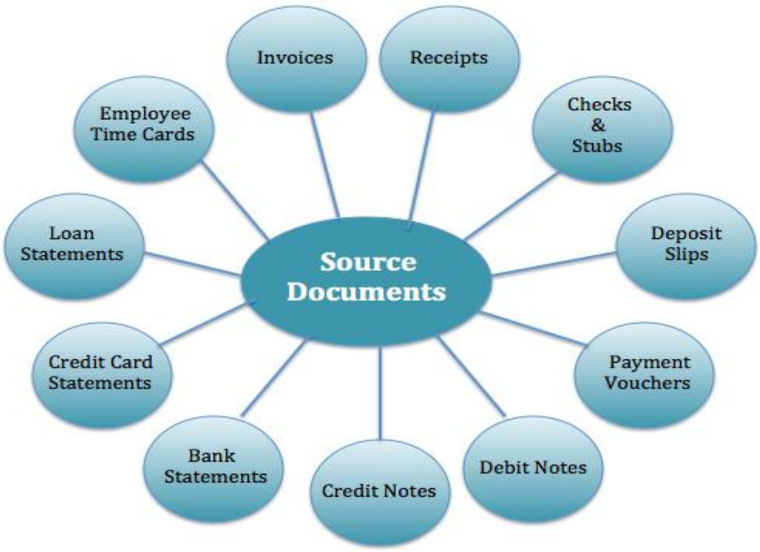
The account of cash looks like this:

Debit (Dr)	53/ Cash		Credit (Cr)
03/01 Opening Balance	*10.000*	*03/20 Purchases*	*5.000*
03/05 Sales	*30.000*	*Balance (Dr)*	*35.000*
Total	**40.000**	**Total**	**40.000**

The Accounting Cycle

The accounting cycle begins with recording every transaction individually and ends with a comprehensive report of the entity's activities for the designated period of time. Today, entities use software to automate the accounting cycle. This allows accountants to program cycle dates and receive automated reports. Typically, bookkeeping will involve some technical support, but the bookkeeper may be required to intervene in the accounting cycle at various levels. The accounting cycle can be divided into the following steps:

- **Step 1: Identification of transactions**



The first step in the accounting cycle is identifying transactions. Each transaction needs to be properly recorded in the entity's books, and every time an entity is involved in a transaction, a paper trail is generated. This paper trail is referred to as a source document. For example:

- ✓ Written checks to be cashed;
- ✓ Sales invoices delivered to customers;
- ✓ Bills received from suppliers;
- ✓ Recorded work hours on an employee's timesheet.

- **Step 2: Journalizing**

The second step in the cycle is the creation of journal entries for each transaction. According to the double-entry rule, each transaction has a debit side and an equal credit side.

- **Step 3: Posting**

Once a transaction is recorded as a journal entry, it should be posted in the general ledger. The general ledger provides a breakdown of all accounting activities by account.

- **Step 4: Preparation of Trial Balance**

At the end of the accounting period, a trial balance is prepared as the fourth step in the accounting cycle. The trial balance shows the balances in each account. The purpose of this step is to ensure that the total credit balances are equal to the total debit balances. This step can catch a lot of mistakes if those balances do not match up.

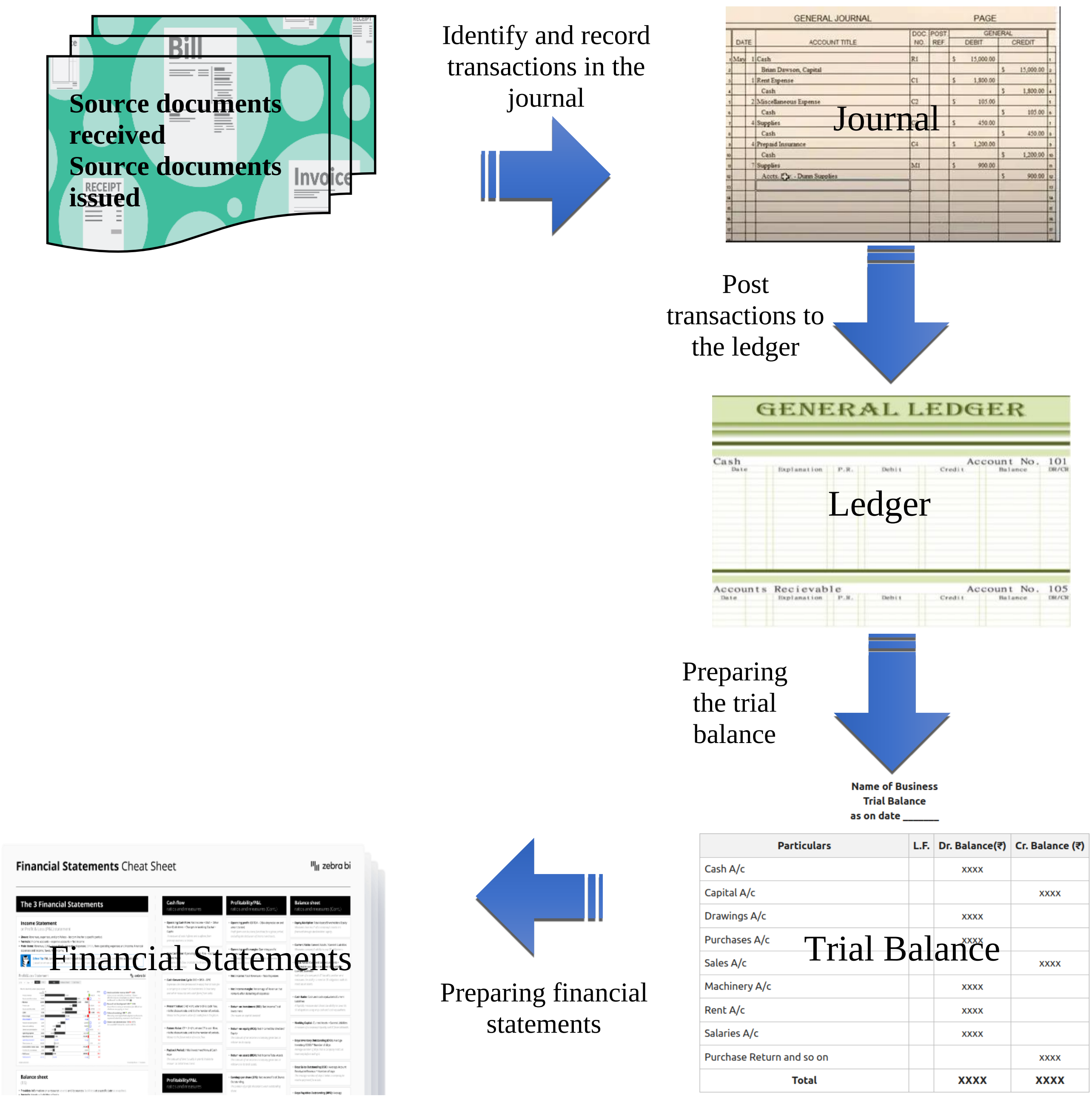
- **Step 5: Preparation of Financial Statements**

After the entity makes all adjusting entries, it then generates its financial statements. These statements will include an income statement, a balance sheet, a cash flow statement, a statement of changes in equity, and notes.

- **Step 6: Closing the Books**

Finally, the entity ends the accounting cycle by closing its books at the end of the specified closing date. The closing statements provide a report for analysis of performance over the period. After closing, the accounting cycle starts over again from the beginning with a new reporting period.

Steps of the accounting cycle



Bank of Questions and Exercises

1- Questions:

1. **Which of the following statements about the account is true?**
   a) In its simplest form, an account consists of two parts: debit and credit.
   b) In an account, the resource of the transaction appears on the debit side, and the use of the transaction appears on the credit side.
   c) The account is used to aggregate changes that occur in one component of assets, liabilities, expenses, or revenues.
   d) The debit total and the credit total of an account may be different.
2. **On the credit side of an account:**
   a) Assets and liabilities increase.
   b) Assets and liabilities decrease.
   c) Assets increase and liabilities decrease.
   d) Assets decrease and liabilities increase.
3. **A revenue account:**
   a) Increases in debit.
   b) Decreases in credit.
   c) Has a normal balance in debit.
   d) Increases in credit.
4. **Which of the following is not part of the recording process?**
   a) Analyzing financial statements.
   b) Preparing a trial balance.
   c) Entering transactions in the journal.
   d) Posting transactions.
5. **Posting is:**
   a) Normally done before journalizing.
   b) The transfer of ledger data to the journal.
   c) An optional step in the recording process.
   d) The transfer of journal entries to the ledger.
6. **Which of the following is not a source document?**
   a) Bank statement
   b) Income statement
   c) Insurance bill
   d) Ledger
   e) Cash receipt
   f) Trial balance
   g) Employee’s timesheet

h) Credit notes

7. **Order the following accounting tasks according to the accounting cycle:**

j) Posting debits and credits to the ledger;
k) Occurrence of economic events;
l) Entering information in the journal;
m) Preparing a trial balance;
n) Adjusting accounts at the end of the year;
o) Preparing financial statements;
p) Reporting information in a standard format;
q) Selecting transactions relevant to the entity;
r) Summarizing accounting transactions;
s) Analyzing and interpreting financial information;
t) Classifying economic events;
u) Keeping a systematic chronological diary of events;
v) Measuring events in a monetary unit.

2- Exercises:

Exercise 01:

- Al-Aqsa Company carried out the following transactions during the year 2023:

1. Borrowed an amount of 50.000 DZD from the bank;
2. Purchased a computer worth 25.000 DZD in cash;
3. Sold goods worth 4.500 DZD by check.
4. Hired a new employee.
5. Purchased office furniture for 19.000 DZD on account.
6. Paid 8.500 DZD to suppliers in cash.
7. Paid a salary of 25.000 DZD to the new employee by check.

Required:

Identify the resource and the use for each transaction mentioned above.

Exercise 02:

- Presented below are transactions related to ABC Company:

1. Deposited 2.000 DZD cash in the bank account;
2. Bought raw materials worth 4.000 DZD and other supplies worth 3.000 DZD, all on account;
3. Bought an industrial machine worth 10.000 DZD and a truck worth 5.000 DZD, all on account;
4. Rendered services to the customer at a value of 25.000 DZD collected in cash;
5. Paid 6.000 DZD to the supplier by check.

6. Sold finished goods worth 16.500 DZD; collected 10.000 DZD in cash; and kept the rest on account.
7. Paid rent bills of 7.000 DZD and repair bills of 5.000 DZD, all in cash.

***Required*:**

Prepare the T-account for each transaction.

Exercise 03:

- Some transactions of ABC Company in May 2023 were as follows:
- May 5: advertising expenses of 5.000 DZD paid in cash;
- May 9: 20.000 DZD in cash collected from customers;
- May 12: other supplies worth 10.000 DZD purchased on account.
- May 18: employee salaries of 17.000 DZD paid in cash;
- May 23: 16.000 DZD paid in cash to suppliers.
- May 26: performed services of 14.000 DZD in cash and 9.000 DZD on account.

Required:

Knowing that the opening balance of the cash account is 25.000 DZD, prepare the T-account for the cash account.

CHAPTER THREE:

ACCOUNTING BOOKS

Chapter 03:

Accounting Books

Learning objectives:

After completing this chapter, students should be able to:

LO1: Properly record entries in the journal;

LO2: Post accounts from the journal to the ledger;

LO3: Prepare the trial balance based on the ledger balances.

Chapter contents:

1. **Definition of accounting books**
2. **The Journal**
3. **The General ledger**
4. **The Trial balance**
5. **Bank of questions and exercises**

Introduction

When an entity has many customers and suppliers, it may be difficult to consolidate all of its sales and purchases into just one document. Keeping track of everything an entity does in records is essential because they are evidence of how money is exchanged, how regularly, and with whom. So, all assets, liabilities, revenues, and expenses are tracked in these records. As a general rule, the term "Accounting books" is usually used to describe these records. In this context, several questions can be asked:

- ✓ What are the most important accounting books in accounting?
- ✓ How can an entity record the movements of money to and from its business?
- ✓ How can a recording be transferred from one accounting book to another?

Definition of Accounting Books

1. What is an Accounting Book?

Accounting books include documents and records used for the preparation of financial statements. That means an accounting book is a register in which all the financial transactions of an entity are recorded in a chronological order. Each transaction is associated with accounts according to the Financial Accounting System. This latter defines the mandatory books for an economic entity:

1. The journal book,
2. The general ledger,
3. The inventory book.

Accounting books are maintained by a bookkeeper, who performs the routine bookkeeping task. Thanks to these books, it is possible to consult any transaction carried out by the entity. The generation of the entity's financial statements at the end of the financial year is made possible thanks to data from the accounting books, which appear as a reference in the event of an audit. Each line in these books relates to a source document.

2. Definition of Bookkeeping

Bookkeeping is the systematic recording of data related to an entity’s transactions. It encompasses both the technical and procedural aspects of accounting work, as well as the role of record-keeping. The bookkeeping process includes the following tasks:

- ✓ Detecting and tracking the entity’s transactions;
- ✓ Entering transactions in the journal;
- ✓ Posting in the ledger;
- ✓ Preparing the trial balance;
- ✓ Passing adjustment entries;
- ✓ Preparing the adjusted trial balance;
- ✓ Preparing the financial statements.

3. Obligations to Keep Accounting Books

The Financial Accounting System stipulates conditions for keeping accounting books, which are as follows:

- ✓ Any natural or legal person with the status of trader is required to keep mandatory accounting books.
- ✓ The journal and inventory book are kept according to the date (chronologically) and without leaving blank or any change of any kind (erasing, crossing out, etc.) or moving to the margin.
- ✓ The pages of these books are numbered and signed by the president of the court.
- ✓ Keeping accounts requires the keeping of source documents.
- ✓ The mandatory accounting books must be kept in their original form for 10 years.
- ✓ The accounting books can take the form of handwritten documents or electronic documents.

The Journal

1. Definition of the Journal Book

The purpose of the journal is to record, on a day-to-day basis, all accounting transactions as they occur in chronological sequence. It is written up from information recorded in source documents. The process of entering transactions into the journal is called journalizing. The journal is also known as the book of the original entry, where business transactions are recorded when they first happen. Any entry in the journal must contain the following information:

- ✓ The date of the transaction;
- ✓ The account or accounts that are debited and the amounts involved;
- ✓ The account or accounts that are credited and the amounts involved;
- ✓ A short description of the transaction and a reference to the source document.

The journal entry is recorded in the following format:

Dr. Account	Cr. Account	Financial Year	Debit	Credit
Debit account		____________Date____________ Debit account name (Use)	Debit amount	
	Credit account	Credit account name (Resource) Description (Document number, Name) For example, check No.…. or supplier name…		Credit amount

The Financial Accounting System specified the recording procedures that must be respected as follows:

- ✓ The entries are made according to the double-entry rule;
- ✓ Each entry indicates the date and the source document;
- ✓ The recordings are validated by a procedure prohibiting any subsequent modification or deletion.

Although it is possible to enter transaction data directly into accounts (the ledger) without using a journal, this latter is a necessary and obligatory book in the accounting cycle.

2. Three Steps in Journalizing

In practice, three basic steps are routinely used in the journalizing process:

- ✓ **Step 1:** Determine which accounts will be affected by the transaction.
- ✓ **Step 2:** For each of the accounts identified in Step 1, it must be determined whether these accounts represent assets, liabilities, expenses, or revenues.
- ✓ **Step 3:** For each of the accounts identified in Step 1, it must be determined whether these accounts are increasing or decreasing. The amounts in the relevant accounts must be recorded by applying the double-entry rule.

Example

- On July 17, ABC Company transferred an amount of 20.000 DZD from its bank account to cash. The journalizing of this transaction goes through the following steps:
- ✓ The accounts affected in this transaction are bank account and cash;
- ✓ The bank account and the cash are assets, so this transaction is affecting real accounts.
- ✓ The bank account decreased by 20.000 DZD (goes out), so it is recorded in credit, while the cash increased by 20.000 DZD (comes in), and is recorded on the debit side.
- ✓ The entry is recorded as follows:

Dr. A/c	**Cr. A/c**		**Debit**	**Credit**
		____________07/17____________		
53		Cash	20.000	
	512	Banks and current accounts		20.000
		Transfer of money (check No…)		

3. Types of Journal Entries

Some entries include only two accounts, one in debit and another in credit. An entry like this is called a **simple entry**. However, some transactions require more than two accounts for journalizing. An entry that requires three or more accounts is a **compound entry**. The following example explains how to record a simple entry and a compound entry in the journal.

Example

- On February 4, ABC Company bought furniture worth 10.000 DZD in cash.
- A simple entry is recorded as follows:

Dr. A/c	Cr. A/c		Debit	Credit
		02/04		
2184		Furniture	10.000	
	53	Cash		10.000
		Purchase furniture (invoice No…)		

- On May 6, ABC Company purchased a truck worth 600.000 DZD. It paid 240.000 DZD in cash and the remaining amount on account (to be paid later).
- A compound entry is recorded as follows:

Dr. No.	Cr. No.		Debit	Credit
		05/06		
2182		Transport equipment	600.000	
	404	Fixed asset supplier		240.000
	53	Cash		360.000
		Purchase truck (invoice No…)		

As a summary of the above, the recording process begins with transactions. Source documents, such as a sales slip, a check, a bill, or a cash register tape, provide evidence of transactions. These evidence are analyzed to determine transactions' effects on specific accounts and entered in the journal. Then, the journal entries are transferred to the designated accounts in the ledger.

The General Ledger

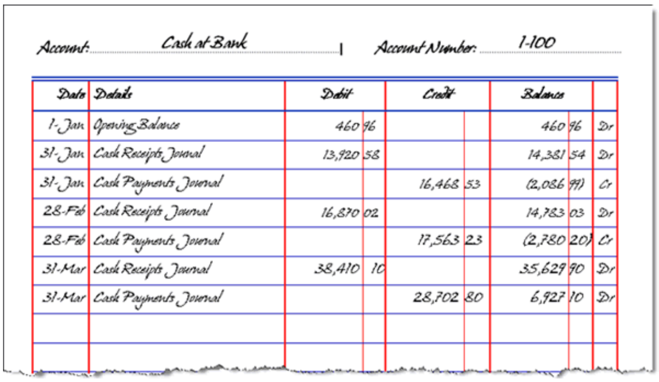
1. Definition of General Ledger

Another mandatory accounting book is the general ledger. The ledger is also known as the book of secondary entry or the principal book of accounts. It includes all the information that appears in the journal book but presents it differently. In the general ledger, movements are classified by accounts, so all the accounts (personal, real, and nominal) are in one place. It is necessary to use the Chart of Accounts and link each transaction to the corresponding accounts.

The ledger is prepared after the journal to categorize transactions based on the affected accounts. In an account, if the debit amounts exceed the credit amounts, it is called a debit balance. In the opposite case, there is a credit balance. Finally, the account must be balanced, where the total debits must equal the total credits.

2. Ledger Entry Formats

First, it is important to remember that the purpose of the accounting process is to summarize, record, and make sense of the thousands of transactions that occur in a specific period so financial reports can be produced. The general ledger receives, on a monthly basis, summarized information from the journal, which is itself the basic day-to-day record of transactions. At the end of the financial year, the general ledger then provides a final balance for each account, summarizing all the monthly journal postings. Therefore, ledger entries appear in the order of accounts compared to the journal's chronological order.


Account: Cash at Bank | Account Number: 1-100

Date	Details	Debit		Credit		Balance		
1-Jan	Opening Balance	460	96			460	96	Dr
31-Jan	Cash Receipts Journal	13,920	58			14,381	54	Dr
31-Jan	Cash Payments Journal			16,468	53	(2,086	99)	Cr
28-Feb	Cash Receipts Journal	16,870	02			14,783	03	Dr
28-Feb	Cash Payments Journal			17,563	23	(2,780	20)	Cr
31-Mar	Cash Receipts Journal	38,410	10			35,629	90	Dr
31-Mar	Cash Payments Journal			28,702	80	6,927	10	Dr

Explaining the purpose of the general ledger is perhaps difficult. One reason is that, in this age of computers and IT, the general ledger no longer has an easily identifiable physical form. In early times, a ledger would have taken the form of a book, hence the term "bookkeeping." The pages of the ledger would have been ruled into columns to facilitate neatness and discipline in writing. There were three columns for recording money: debit, credit, and balance. There was one page in the general ledger for each account, and typically there are many accounts, depending on the chart of accounts.

Today, the general ledger is a component of financial accounting software and exists in the form of an electronic database. The account would take one of the following formats:

1. Standard format of the account:

Date	Description	Reference	Debit	Credit
Total				

2. Simplified format of account (T-shaped format):

Debit	*Account*	*Credit*
Total		**Total**

Example

- In March 2020, the information related to the cash account movements was as follows:
  - ✓ March 1: the opening balance is 15.000 DZD;
  - ✓ March 7: purchasing goods worth 3.000 DZD in cash;
  - ✓ March 13: collecting 4.000 DZD in cash from the customer;
  - ✓ March 18: payment of phone bills of 2.000 DZD in cash;
  - ✓ March 26: Selling goods worth 5.000 DZD in cash.
- The standard format of cash account is as follows:

Date	Description	Dr	Cr
03\01	Opening balance	15.000	
03\07	Purchase goods		3.000
03\13	Collection from the customer	4.000	
03\18	Payment of phone bills		2.000
03\26	Sales of goods	5.000	
03\31	Ending balance (debit)		19.000
Total		**24.000**	**24.000**

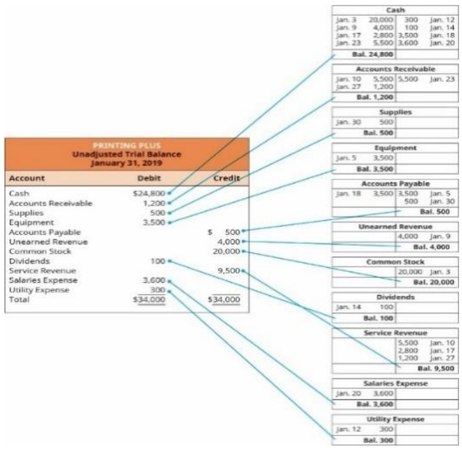
- The simplified format of cash account is as follows:

Dr		53/ Cash	Cr
03/01 Opening Balance	*15.000*	*03/07 Purchases*	*3.000*
03/13 Collection	*4.000*	*03/18 Payment*	*2.000*
03/26 Sales	*5.000*	*Balance (Dr)*	*19.000*
Total	**24.000**	**Total**	**24.000**

The third mandatory accounting book is the inventory book. It contains different information than the two stated above. It contains an inventory about all the assets and liabilities of the entity at the end of each year, and it also contains balance sheets and income statements.

The Trial Balance

1. Definition of Trial Balance



After classifying transactions into corresponding accounts in the ledger, it should be checked whether the accounts are balanced. This is where the trial balance comes into play. The trial balance is a list of ledger accounts, amounts, and balances prepared on a particular date. It contains account numbers, account names, debit and credit amounts, and balances. Once the information from the ledger is combined into the trial balance, it becomes easier for the accountant to detect imbalances between debits and credits. So, the trial balance is a concise and organized table that helps in eliminating inconsistency and proves to be a useful tool in keeping accounting books balanced.

2. Preparation of the Trial Balance

The process of drawing up a trial balance checks the arithmetic accuracy of the general ledger and whether all postings respect the rule of double-entry bookkeeping. This is usually done monthly, but the time interval between these checking procedures is arbitrary and depends on the policies and procedures of the entity. The steps for preparing the trial balance are as follows:

- ✓ **Step 1:** Calculate the debit and credit amounts and the balance of each ledger account.
- ✓ **Step 2:** List each account in the trial balance according to the order of the Chart of Accounts from Class 1 to Class 7, and put debit amounts, credit amounts, and balances in columns as appropriate.
- ✓ **Step 3:** Total the debit and credit columns. The totals of the amounts must be equal, and the same goes for the totals of the balances.

Trial Balance

12/31/N

Account	Account Name	Amounts		Balances	
		Debit	Credit	Debit	Credit
1xx	Class 1				
2xx	Class 2				
3xx	Class 3				
4xx	Class 4				
5xx	Class 5				
6xx	Class 6				
7xx	Class 7				
Total					

Even if the trial balance is found to be balanced, this does not mean that there are no errors. There may have been incorrect amounts entered on both sides of the journal or entries in the wrong accounts but on the right side. In addition, it is possible that transactions have been entirely omitted or entered twice. Therefore, some degree of comfort is afforded when totals of the trial balance are balanced, but there is no guarantee of correctness.

3. Unadjusted and Adjusted Trial Balance

The unadjusted trial balance and the adjusted trial balance are both integral parts of the accounting cycle, but they serve different purposes and are created at different times.

- **Unadjusted Trial Balance:**

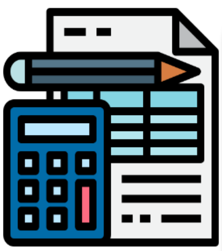
An unadjusted trial balance is a list of all the entity accounts that are set to have balances at the end of an accounting period before any adjusting entries are made. It's essentially a report that lists all account balances in the general ledger at a given point in time. The main purpose of an unadjusted trial balance is to ensure that the total of all debit balances equals the total of all credit balances, which should be the case in a correctly maintained double-entry system.

- **Adjusted Trial Balance:**

An adjusted trial balance is a list of all the account balances after the adjusting entries are made at the end of the financial year. Adjusting entries are generally accruals, outstanding and advances of revenue and expenses, as well as depreciation, impairments, and write-offs. These adjustments are made to provide a more accurate reflection of the financial position and performance of an entity in accordance with accounting assumptions and principles. The adjusted trial balance is used to prepare the financial statements.

DIFFERENCES	
Trial Balance	**Adjusted Trial Balance**
Prepared first	Prepared after trial balance
Doesn't include adjusted entries	Includes adjusted entries
Shows balance at particular point in time	Shows balances after adjusting entries

So, the key difference between the unadjusted trial balance and the adjusted trial balance is the timing and inclusion of adjusting entries. The unadjusted trial balance is created before adjusting entries are made, while the adjusted trial balance is created afterward.



Once the accounting books are balanced, it's time to create financial statements to better understand how the entity is performing. The most important of these statements are the balance sheet, which shows amounts the entity owns and owes to it and shareholders' equity; and the income statement, or profit and loss statement, that focuses on the revenues earned and expenses incurred by the entity in one year.

Bank of Questions and Exercises

1- Questions:

1. **Which of the following statements about the journal is true?**
a) It provides a chronological record of transactions.
b) It helps identify errors because the debit and credit amounts for each entry can be easily compared.
c) It is the book of secondary entry.
d) It reveals in one place the full effect of the transaction.
2. **Which of the following statements about the ledger is false?**
a) It contains accounts in alphabetical order.
b) It is a collection of the entire set of accounts maintained by the entity.
c) It is the original entry book.
d) It contains only asset and liability accounts.
3. **Trial balance:**
a) Provides the mathematical accuracy of the recorded transactions.
b) Is a list of accounts with their amounts and balances at a specific time.
c) Contains only expense and revenue accounts.
d) Proves that all transactions have been recorded.
4. **The trial balance will not be balanced if:**
a) A correct journal entry is posted twice.
b) An incorrect account is recorded in the journal.
c) Two sides of an entry in the journal are not equal.
d) Two accounts are incorrectly reversed in the journal.
5. **For each of the following accounts, indicate the effects on debit and credit and the normal balance of the account.**
a) Service provided.
b) Advertising Expense.
c) Accounts Payable.
d) Accounts Receivable.
e) Share Capital.
f) Cash.
6. **The trial balance of ABC Company had accounts with the following normal balances: Cash 5.000 DZD, Service provided 85.000 DZD, Salaries Expense 40.000 DZD, Industrial buildings 90.000 DZD, Loans from lending institutions 40.000 DZD, Rent Expense 14.000 DZD, Share Capital 100.000 DZD, Bank account 15.000 DZD, and Equipment 61.000 DZD.**
In preparing the trial balance, the total in the debit balance column is:

a) 310.000 DZD
b) 211.000 DZD
c) 225.000 DZD
d) 265.000 DZD

2- Exercises:

Exercise 01:

ABC Company has the following transactions during April 2020:

1. Purchased equipment worth 70.000 DZD on account.
2. Paid 5.000 DZD in cash as transport expenses of employees.
3. Sent an order to the supplier, Alpha Company, to purchase goods worth 25.000 DZD.
4. Purchased goods worth 25.000 DZD from the supplier Alpha on account.
5. Received 12.000 DZD by check from customers for services provided.
6. Paid 25.000 DZD to the supplier, Alpha Company, by check.

Required:

Record the above transactions in the journal.

Exercise 02:

Selected transactions are presented in the journal as follows:

Dr A/c	Cr A/c	Year 2020	Dr	Cr
		01/01/2020		
211		Land	50.000	
21311		Industrial buildings	30.000	
2154		Industrial machinery and equipment	25.000	
355		Finished goods	12.000	
512		Banks and current accounts	18.000	
53		Cash	5.000	
	101	Share capital		100.000
	1061	Legal reserve		1.200
	164	Loans from lending institutions		35.000
	401	Suppliers		3.800
		Record of the opening balance sheet		
		01		
53		Cash	2.000	
	512	Banks and current accounts		2.000
		Transfer from bank account to cash		
		02		
381		Purchases of raw materials and supplies	4.000	
382		Purchases of other supplies	2.200	
	401	Suppliers		6.200
		Purchase of raw materials and supplies on account		

		03		
2154		Industrial machinery and equipment	10.000	
2182		Transport equipment	5.000	
	404	Fixed asset suppliers		15.000
		Purchase of industrial machinery and transport equipment on account		
		04		
53		Cash	13.000	
	706	Other services		13.000
		Services provided in cash		
		05		
401		Suppliers	10.000	
	512	Banks and current accounts		10.000
		Payment of suppliers by check		
Total				

Required

Post the above entries to T-accounts and determine each account's ending balance.

Exercise 03:

A bookkeeper at ABC Company prepared the following trial balance with some mistakes only in the debit and credit balances:

ABC Company
Trial Balance
December 31, 2020

Account	Account Name	Amounts		Balances	
		Dr	Cr	Dr	Cr
101	Share capital		100.000		100.000
164	Loans from lending institutions		35.000		35.000
211	Land	50.000			50.000
21311	Administrative and commercial buildings	30.000		30.000	
2154	Industrial machinery and equipment	35.000			35.000
355	Finished goods	6.000		12.000	
401	Suppliers	10.000	10.000		
404	Fixed asset suppliers		10.000		15.000
411	Customers	7.500		14.500	
512	Banks and current accounts	28.000	12.000		15.000
53	Cash	20.000	12.000	10.000	
613	Rent	7.000		7.000	
623	Advertising, publications, public relations	5.000		5.000	

701	Sales of finished goods		19.500	16.500	
Total		**198.500**	**198.500**	**87.000**	**250.000**

Required

Prepare the correct trial balance, assuming all the debit and credit amounts are correct.

Exercise 04:

A list of transactions and events for an audit office in 2023 is as follows:

1. Deposited an amount of 140.000 DZD into the bank account to start exercise under an audit office;
2. Borrowed an amount of 150.000 DZD from a financial institution, the amount was deposited in the bank account;
3. Deposited an amount of 20.000 DZD into the cash account from the bank account;
4. Purchased a property at a cost of 75.000 DZD for the land and 175.000 DZD for the building. The full price was paid by bank check.
5. Purchased furniture from the supplier, ABC Company, at a cost of 60.000 DZD. The full price must be paid within 90 days.
6. Paid the insurance bill of 10.000 DZD by bank check.
7. Sent an invoice to the customer, Beta Company, for services provided worth 30.000 DZD. The office will receive the amount within 30 days.
8. Received a check from the client, Beta Company, for the services provided in transaction 7.
9. Paid the supplier, ABC Company, the due amount by check (transaction 5).
10. Received bills as follows: office rent: 25.000 DZD; gas: 4.000 DZD; electricity: 5.000 DZD; telephone/fax: 1.500 DZD.
11. Paid employee salaries of 5.000 DZD in cash.

Required:

a) Prepare the general journal.
b) Post the entries to T-accounts.
c) Prepare the trial balance on December 31, 2023.

CHAPTER FOUR:

FINANCIAL STATEMENTS

Chapter 04:

Financial Statements

Learning objectives:

After completing this chapter, students should be able to:

LO1: Distinguish between balance sheet accounts and profit and loss accounts;

LO2: Prepare the balance sheet and identify the profit or loss for the financial year;

LO3: Prepare the income statement by nature.

Chapter contents:

1. **Understanding Financial Statements**
2. **Balance sheet**
3. **Income statement**
4. **Bank of questions and exercises**

Introduction

Financial statements are one of the most important sources of reliable and audited financial data. Financial analysts rely on this data to analyze an entity's performance and predict the future direction of its development. Financial statements also provide interested parties, such as investors and creditors, with overall information in order to evaluate the entity's financial health and earnings potential. There are several questions related to this topic, including:

- ✓ What are the basic components of the balance sheet?
- ✓ How are the items arranged on the balance sheet?
- ✓ How can the income statement by nature be prepared?
- ✓ How is the profit or loss of the financial year calculated?

Understanding Financial Statements

1. Definition of financial statements

Financial statements are a set of documents that convey the activities of an entity and show the entity’s financial situation at a specific point in time. They include key data on what the entity owns and owes and how much money it has made and spent. Any entity falling within the scope of the Financial Accounting System must prepare financial statements annually, which include:

- ✓ A balance sheet that provides an overview of assets and liabilities as a snapshot in time.
- ✓ An income statement (or statement of profit and loss, P&L) that primarily summarizes the entity’s revenues and expenses during a particular period. Once expenses are subtracted from revenues, the statement produces an entity's net income (profit or loss of the financial year).
- ✓ A cash flow statement that shows how much money is coming in and going out of the entity. This statement tracks how an entity uses its cash to pay its debt obligations and fund its operating expenses and investments.
- ✓ A statement of changes in equity (or statement of retained earnings) that measures how equity moves through the entity throughout one year.
- ✓ Notes to the financial statement that disclose assumptions and accounting rules and methods used, provide additional information about the balance sheet and income statement, and help interpret and analyze financial statements.

2. Conditions of Financial Statement Preparation

The considerations to be taken into account for the preparation and presentation of financial statements arise from the conceptual framework of the

Financial Accounting System. Financial statements are the culmination of processing a lot of data and require simplification, synthesis, and structuring work. This information is collected, summarized, and structured through an aggregation presented in the financial statements in the form of sections and totals. The materiality principle determines the extent of this aggregation as well as the balance between the advantages provided to users by the dissemination of detailed information and the costs incurred to disclose and use this information.

Each of the components of the financial statements is clearly identified. The following information is mentioned precisely:

- Entity name, commercial name, and commercial register number of the entity presenting the financial statements;
- Nature of the financial statements (individual statements, consolidated statements, or combined statements);
- Closing date;
- Presentation currency and rounding level.
- Head office address, legal form, place of activity, and country of registration;
- Main activities and nature of transactions carried out;
- Name of the parent company and possibly name of the group to which the entity is attached;
- Average number of employees during the period.

The financial statements must be presented in the national currency. The amounts appearing in the financial statements may be rounded to the nearest thousand units. Financial statements must provide information for both the latest period and the prior period to make comparisons easier. For example, a financial statement covering January 1 to December 31, 2021, would include information for both 2021 and 2020. The notes to the financial statements contain comparative information in narrative, descriptive, and quantitative form.

Balance Sheet

1. Definition of Balance Sheet

The balance sheet is one of the key financial statements that entities generally produce on a yearly basis. The balance sheet is an important document that describes the financial health of an entity through its assets and liabilities. It provides a snapshot of an entity's owns and owes as of the date of publication. The date at the top of the balance sheet indicates when this snapshot was taken; this is generally the end of the annual reporting period. In general, the balance sheet shows the following components clearly:

a) Assets:

Assets are resources that an entity owns. The entity uses its assets to carry out activities such as production and sales. The common characteristic shared by all assets is the capacity to provide future services or economic benefits that eventually results in cash inflows (receipts). Accounts within this segment are listed from top to bottom in order of the degree of liquidity, which is the ease with which assets can be converted into cash. Assets are divided into non-current assets, which can be converted to cash in more than one year, and current assets, which can be converted to cash in one year or less.

Here is the general order of accounts within non-current assets:

Non-current or long-term assets	
Intangible fixed assets	Trademarks, patents, goodwill, intellectual property, and other intangible assets can't be physically touched but have future economic benefits for the entity.
Tangible fixed assets	Land, machinery, equipment, buildings, and other durable assets that have a physical substance.
Financial fixed assets	Securities that will not or cannot be liquidated in the next year.

Current assets include the following:

Current or short-term assets	
Inventory	Goods on hand intended to be sold, finished goods, work in progress that is not yet finished, or raw materials on hand that have yet to be consumed.

Accounts receivable And other debtors	Amounts of money owed to the entity by its customers for the sale of its goods and services, expenses paid in advance of when they are due, tax assets (distinguishing deferred taxes)
Cash and cash equivalents	Liquid assets, which may include cash on hand, bank accounts, treasury bills, certificates of deposit, and marketable securities.

b) Liabilities

Liabilities are claims against assets, that is, existing debts and obligations. Entities usually borrow money and purchase merchandise on credit. These economic activities result in payables of various sorts. A liability is any money that a company owes to outside parties. Items of liability are listed from top to bottom in order of maturity. According to the Financial Accounting System, liabilities include equity, which is the money attributable to the owners of an entity or its shareholders; non-current liabilities that are due at any point after one year; and current liabilities that are due within one year and are listed in order of their due date.

Equity contains the following items:

Equity	
Capital, reserves, and similar	Represents the amount of money that would be returned to shareholders if all of the assets were liquidated and all debts paid off, like issued capital, share capital, or sole proprietor's capital, premiums related to share capital, reserves, etc.
Retained earnings	Amounts of net earnings that were not paid to shareholders as dividends but were either reinvested in the entity or used to pay off debt.
Profit or loss	Profit of the financial year or loss of the financial year.

Non-current liabilities can include:

Non-current or long-term liabilities	
Long-term debts	They contain a variety of obligations, including non-voting shares, convertible debenture loans, loans from lending institutions, debts on finance lease contractors, and other loans that are due in their entirety in more than one year. Note that short-term portions of these debts are recorded as current liabilities.
Deferred tax liability	The amount of taxes that accrued but will not be paid for another year.
Other long-term debts	Including any interest and principal on bonds issued; pension fund liability refers to the money an entity is required to pay into its employees' retirement accounts; provisions for charges and liabilities; and revenue recognized in advance.

Current liability accounts might include:

Current or short-term liabilities	
Accounts payable	Invoices due as part of an entity's activities. This includes suppliers, notes payable, and utility bills.
Other creditors	Wages payable, dividends payable, customer prepayments, current portion of long-term debt, interest payable, tax liabilities (distinguishing deferred taxes);
negative cash and negative cash equivalents	Treasury facilities, overdraft.

2. Format of the Balance Sheet

The presentation of assets and liabilities in the body of the balance sheet highlights the distinction between current and non-current items. The balance sheet provides an overview of the state of an entity's finances at a given moment in time. It cannot give a sense of the trends playing out over a longer period on its own. For this reason, the balance sheet should be compared with those of previous periods. The format of the balance sheet (tabular form) is as follows:

Balance Sheet-Assets

The Financial year ended on 12/31/N

A/c	Assets	Financial year N			Financial year N-1
		Gross	Depreciation and impairment	Net	Net
	Non-current assets				
20	Intangible fixed assets				
21	Tangible fixed assets				
23	Fixed assets in progress				
26+27	Financial fixed assets				
	Total I				
	Current assets				
30-37	Inventory and work in progress				
41-48	Accounts receivable and related accounts				
50-54	Cash and cash equivalent				
	Total II				
Grand Total (I+II)					

Balance Sheet-Liabilities

The Financial year ended on 12/31/N

A/c	Liabilities	Financial year N	Financial year N-1
	Shareholders' equity		
10	Capital, reserves and similar		
11	Retaining earnings		
12	Profit or loss		
	Total I		
	Non-current liabilities		
16+17	Loans and financial debts		
133+155	Taxes (deferred and provisioned)		
229	Other non-current debts		
15+131 +132	Provisions and income recognized in advance		
	Total II		
	Current liabilities		
40	Accounts payable and related accounts		
41-48	Other creditors		
519	Negative cash and cash equivalent		
	Total III		
	Grand Total (I+II+III)		

3. The Basic Accounting Equation

The two basic elements of a business are what it owns and what it owes. Assets are the resources an entity owns, while owner's equity and liabilities are the claims against these resources. We can express the relationship between assets and liabilities as an equation. The balance sheet adheres to the following accounting equation, where assets on the one hand and liabilities on the other hand are balanced:

Assets = Liabilities

This relationship is the basic accounting equation. This formula is intuitive. That's because an entity must pay for all the things it owns (assets) by either borrowing money (taking on liabilities) or taking it from investors (issuing shareholders' equity).

Example

- The following elements constitute the assets and liabilities of the company "Al-Aqsa" as of January 1, 2020:

Reserves = 6.000 DZD; Industrial building = 10.000 DZD; Suppliers = 1.000 DZD; Equipment = 5.000 DZD; Bank loan = 4.000 DZD; Software = 4.000 DZD; Cash = 2.000 DZD; Finished goods = 2.000 DZD; Raw materials = 1.000 DZD; Customers = 3.000 DZD; Land = 20.000 DZD; Share capital = 40.000 DZD; Bank account = 4.000 DZD.

- The balance sheet is as follows:

A/c	Assets	Amount	A/c	Liabilities	Amount
	Non-current assets			**Equity**	
204	Software	4.000	101	Share capital	40.000
211	Land	20.000	106	Reserves	6.000
213	Industrial build	10.000		**Non-current liabilities**	
215	Equipment	5.000			
	Current assets		164	Bank loan	4.000
31	Raw materials	1.000		**Current assets**	
355	Finished goods	2.000	401	Suppliers	1.000
411	Customers	3.000			
512	Bank account	4.000			
53	Cash	2.000			
	Total	**51.000**		**Total**	**51.000**

- **Profit or loss of the financial year:**

  It is a profit/loss earned/incurred by the entity at the conclusion of the financial year after carrying out commercial, industrial, service activities, etc. It corresponds, in the balance sheet sense, to the difference between the total of assets and the total of liabilities.

Profit or Loss = **Assets** − **Liabilities**

- **The net financial position (NFP):**

  It is the net value of an entity's assets on a specific date. The net financial position is usually calculated after calculating the profit or loss. NFP may be calculated using one of the following equations:

NFP = **Assets** − **Debts**

Or:

NFP = **Equity** + **Profit or loss**

Example

- The following elements constitute the assets and liabilities of the company “Al-Aqsa” as of December 31, 2020:

Reserves = 8.000 DZD; Industrial building = 14.000 DZD; Suppliers = 3.000 DZD; Equipment = 10.000 DZD; Retaining earnings = 2.000 DZD; Software = 3.000 DZD; Cash = 5.000 DZD; Goods for resale = 7.000 DZD, Other supplies= 1.000 DZD; Customers = 3.000 DZD; Land = 30.000 DZD; Share capital = 40.000 DZD; Bank account = 7.000 DZD.

- **The profit or loss of the financial year** = (14.000 + 10.000 + 3.000 + 5.000 + 7.000 + 1.000 + 3.000 + 30.000 + 7.000) – (8.000 + 3.000 + 2.000 + 40.000) = 80.000 – 53.000 = **27.000 DZD** (Profit)
- **The net financial position** = (14.000 + 10.000 + 3.000 + 5.000 + 7.000 + 1.000 + 3.000 + 30.000 + 7.000) – 3.000 = 80.000 –3.000 = **77.000 DZD**

Or:

- **The net financial position** = (40.000 + 2.000 + 8.000) + 27.000 = **77.000DZD**

Income Statement

1. Definition of Income Statement

Unlike the balance sheet, the income statement covers a range of time, which is a year for annual financial statements. The income statement reports the success or profitability of the entity’s activities over a specific period of time. It provides an overview of expenses and revenues generated by the entity during the financial year. It shows, by difference, the profit or loss for the financial year. When revenues exceed expenses, net profit results. When expenses exceed revenues, a net loss results.

a) Revenues

Operating revenue is the revenue earned by selling an entity's goods or services. That means operating revenue is generated from the core business activities of an entity. Non-operating revenue is the income earned from non-core business activities. These revenues fall outside the primary business of the entity, for example: interest earned on cash in the bank, rent income from a property, and income from an advertisement display located on the entity's property. Other income is the revenue earned from other activities, such as gains from the sale of long-term assets such as land, vehicles, or a subsidiary.

b) Expenses

Primary expenses are incurred during the process of earning revenue from the primary activity of the business. They include the cost of goods sold, general and administrative expenses, depreciation and amortization, and research and development (R&D). Typical expenses include employee wages, sales commissions, and utilities such as electricity and transportation. Expenses that are linked to secondary activities include interest paid on loans or debt and losses from the sale of an asset.

2. Format of the Income Statement

The heading of the income statement identifies the entity, the type of statement, and the time covered by the income statement. The minimum information presented in this statement is as follows:

- ✓ Analysis of expenses by nature, making it possible to determine the following main management aggregates: gross margin, added value, gross operating surplus;
- ✓ Income from ordinary activities;
- ✓ Financial income and financial expenses;
- ✓ Payroll expenses;
- ✓ Taxes and other payments;
- ✓ Depreciation and impairment of losses relating to tangible assets;
- ✓ Depreciation and impairment of losses relating to intangible assets;
- ✓ Net income from ordinary activities;
- ✓ Extraordinary items (revenues and expenses);
- ✓ Net income for the period before distribution.

Income Statement
(By nature)
Period from………to………

	Financial year N	Financial year N-1
Turnover Changes in inventory of finished goods and work in progress Own work capitalized Operating grants		
I - PRODUCTION OF THE EXERCISE		
Consumed purchases External services and other consumption		
II - CONSUMPTION OF THE EXERCISE		
III-ADDED OPERATING VALUE (I - II)		
Payroll expenses Taxes, duties, and similar payments		
IV- GROSS OPERATING SURPLUS		
Other operating revenues Other operating expenses Depreciation, provisions, and impairment Reversal of impairment, and provisions		
V- OPERATING INCOME		
Financial revenues Financial expenses		
VI- FINANCIAL INCOME		
VII- ORDINARY INCOME BEFORE TAXES (V + VI)		
Taxes payable on ordinary income Deferred taxes (Variations) on ordinary income		
TOTAL INCOME FROM ORDINARY ACTIVITIES		
TOTAL EXPENSES OF ORDINARY ACTIVITIES		
VIII- NET INCOME FROM ORDINARY ACTIVITIES		
Extraordinary revenues Extraordinary expenses		
IX- EXTRAORDINARY INCOME		
X- PROFIT OR LOSS OF THE FINANCIAL YEAR		

Entities also have the option of presenting an income statement by function in the notes to the financial statements. They then use, in addition to a nomenclature of expense and revenue accounts by nature, a nomenclature of accounts by function adapted to their specificities and their needs.

Bank of Questions and Exercises

1- Questions:

1. **Which of the following statements is correct?**
    a. The changes in retained earnings over a certain period are summed up in the statement of changes in equity.
    b. The assets, liabilities, and equity of a given date are listed on the balance sheet.
    c. Revenues, expenses, equity changes, and net profits or net losses for a certain time are all shown on the income statement.
    d. Information regarding the cash inflows (receipts) and outflows (payments) for a given period is compiled in the statement of cash flows.
2. **On May 4, 2019, ABC Company bought an industrial machine for 50.000 DZD on account. This transaction will:**
    a. Affect the income statement only.
    b. Affect the balance sheet only.
    c. Affect the balance sheet and the income statement.
    d. Have no effect.
3. **Indicate whether each of the following items is an asset, liability, revenue, or expense:**
    a. Changes in work in progress of goods
    b. Income taxes
    c. Treasury and public agency accounts
    d. Prepaid expenses
    e. Social security
    f. Advertising, publications, and public relations
    g. Employee salaries
    h. Salaries payable
    i. Fixed asset suppliers
    j. Sales of finished goods
4. **In 2021, ABC Company's assets decreased by 60.000 DZD, and its debts decreased by 80.000 DZD. The net financial position is therefore:**
    a. increased by 20.000 DZD;
    b. decreased by 140.000 DZD;
    c. decreased by 20.000 DZD;
    d. increased by 140.000 DZD.

2- Exercises:

Exercise 01:

- Here are the assets and liabilities of the Company "Al-Quds" at January 1, 2020: Commercial building = 10.000 DZD; Share capital = 50.000 DZD; Goods for resale = 4.000 DZD; Transport equipment = 6.000 DZD; Cash = 4.000 DZD; Land = 20.000 DZD; Other supplies = 2.000 DZD; Customer = 1.000 DZD; Bank account = 8.000 DZD; Bank loan = 9.000 DZD; Suppliers = 6.000 DZD.
- During the year 2020, the Company carried out the following transactions:
  1. Obtained 4.000 DZD as a bank loan by check;
  2. Sold all the goods for resale for 8.000 DZD in cash;
  3. Purchased a truck worth 7.000 DZD by check;
  4. Paid of phone bills worth 1.000 DZD in cash;
  5. Deposited cash amount of 2.000 DZD in the bank account;
  6. Sent an order to the supplier to purchase raw materials worth 3.000 DZD.

Required:

- Prepare the beginning balance sheet for January 1, 2020.
- Determine the impact of each transaction during 2020 on the items of assets and liabilities.

Exercise 02:

- As of January 1, 2018, the items related to ABC Company are presented below: Rent Expenses = 11.000 DZD; Accounts Receivable = 9.000 DZD; Administrative buildings = 300.000 DZD; Bank loan = 70.000 DZD; Retaining earning = 5.000 DZD; Transport equipment = 50.000 DZD; Office equipment = 6.000 DZD; Furniture = 10.000 DZD; Goods for resale = 30.000 DZD; Land = 400.000 DZD; Cash = 8.000 DZD; Service Provided = 36.000 DZD; Salaries = 7.000 DZD; Notes Payable = 16.500 DZD; Bank account = 46.000 DZD; Trademarks = 10.000 DZD; Accounts Payable = 2.000; Share capital = 1.000.000 DZD.

Required

a) Prepare the balance sheet on December 31, 2018.

b) Determine the profit or loss for the financial year 2018.

c) Answer the following questions using the accounting equation:

   1. In 2019, if total assets increased by 70.000 DZD and total liabilities decreased by 80.000 DZD, what is the amount of profit or loss at the end of the year?
   2. In 2019, if total assets decreased by 50.000 DZD and equity increased by 12.000 DZD, what is the amount of the net financial position at the end of the year?

Exercise 03:

The items of expenses and revenues of ABC Company as of December 31, 2023, are listed below:

- ✓ Changes in inventory of goods = 40.000 DZD
- ✓ Own work capitalized of tangible fixed assets = 30.000 DZD
- ✓ Advertising, publications, and public relations = 10.000 DZD
- ✓ Employee salaries = 15.000 DZD
- ✓ Sales of finished goods = 55.000 DZD
- ✓ Agent commissions and fees = 24.000 DZD
- ✓ Capital gains on non-financial fixed assets = 3.000 DZD
- ✓ Operating reversal of impairment = 9.000 DZD
- ✓ Rent expenses = 8.000 DZD
- ✓ Service provided = 54.000 DZD
- ✓ Financial allowances given = 17.000 DZD
- ✓ Depreciation -fixed assets = 40.000 DZD
- ✓ Taxes = 20.000 DZD
- ✓ Sales of studies = 5.000 DZD

Required:

Prepare the income statement (by nature) on December 31, 2023.

CHAPTER FIVE:

CLASS 1 - EQUITY AND LIABILITIES

Chapter 05:

Class 1 - Equity and Liabilities

Learning objectives:

After completing this chapter, students should be able to:

LO1: Understand the functioning of accounts related to sole proprietorships;

LO2: Correctly record entries related to the steps of creating a company;

LO3: Record entries of the allocation of profit or loss of the financial year.

Chapter contents:

1. **Elements of Class 1**
2. **Accounting for sole proprietorships**
3. **Accounting for the creation of a company**
4. **Functioning of other accounts from Class 1**
5. **Bank of questions and exercises**

Introduction

The class of equity and liabilities is the first class in the Chart of Accounts. This class contains not only the elements of own shares but also the long-term sources of financing of the entity, including loans and debts related to equity interests. In this regard, several questions can be raised about this class, the most important of which are:

- ✓ What are the different types of entities?
- ✓ How can capital contributions be recorded in accounting?
- ✓ How is the profit or loss achieved by entities accounted for?

Elements of Class 1

The accounts of class 1 include:

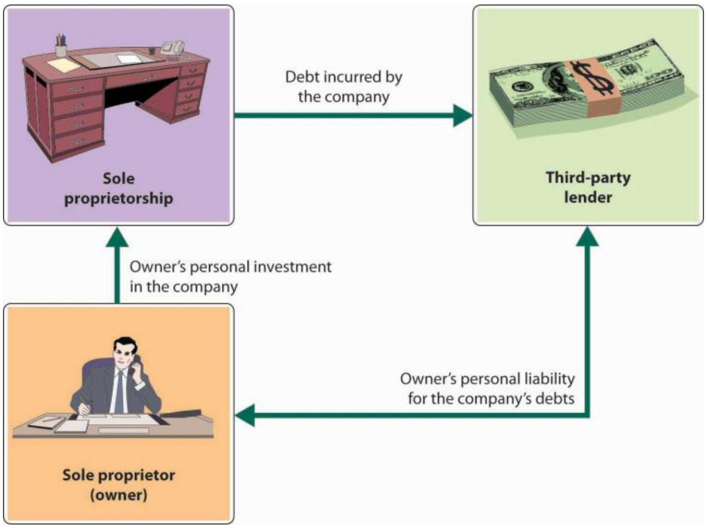
1. The shareholders' equity corresponds to contributions, allocations, and surpluses acquired by the entity. It brings together the resources made available to the entity on a definitive or conditional basis and certain resources of a lasting nature. Equity funds ensure the sustainability of activities and the development of new projects. Equity is the sum of:
   - ✓ Contributions: capital, premiums related to the capital,
   - ✓ Revaluation differences,
   - ✓ Differences in equity method,
   - ✓ Profits other than those for which a distribution decision has been made: reserves, retained earnings, profit for the financial year,
   - ✓ Losses: negative retained earnings, loss for the financial year,
2. Other own funds, which include the amount of non-voting shares issued, advances subject to conditions, and licensor's rights;
3. Provisions;
4. Loans and similar debts;
5. Debts related to equity interests;
6. Entities and joint venture intercompany accounts.

Depending on the entity's legal form, contributions and profits are recorded in different ways.

Accounting for Sole Proprietorships

1. Accounts for Use by the Sole Proprietor

Accounting for a sole proprietorship differs somewhat from the requirements for other types of entities. Often times, a proprietorship's transactions can overlap with those of a self-employed owner, since the owner is considered to be inseparable from the entity. However, independent records must be kept of the entity's activities and transactions in order to judge whether these transactions are profitable or not. There are some special accounts that are used to record transactions related to sole proprietorships, and it is necessary to know how they function:



- **Account 101- Sole proprietor's capital**: an individual enterprise does not have share capital like companies but individual capital, embedded in the overall assets of the sole proprietor or operator.
- **Account 108 -Sole proprietor account:** An owner of an individual entity is referred to as a sole proprietor. The sole proprietor account is used to record the proprietor's withdrawals and contributions for the entity.
- **Account 120 – Profit or loss of the financial year:** This account is used to record the income achieved by the entity at the end of each year. On the credit side, profits of the financial year are recorded in account 120, and on the debit side, losses of the fiscal year are recorded in account 129.

2. Functioning of Accounts of the Sole Proprietorship

- Account 101 is credited with:

✓ the value of the contributions of the sole proprietor at the beginning of the entity's activity;
✓ the value of the contributions of the sole proprietor during the entity's activity;
✓ the amount of profit of the financial year (account 120).

- Account 101 is debited with:

✓ the value of the withdrawals made by the sole proprietor during the entity's activity;
✓ deductions of all kinds;

✓ the loss of the financial year (account 129).

- Account 108 is used to record the personal contributions or withdrawals of the proprietor and, if applicable, his family during the financial year:

✓ When the proprietor contributes his own assets to the entity or pays debts or bills for the entity from his personnel fund, the account 108 is credited, and the relevant assets, debts, or expenses are credited.

✓ In the opposite case, when the proprietor withdraws assets from the entity for his personal use, account 108 is debited, and the relevant assets are credited.

- At the end of the financial year (12/31/N), the balance of account 108 is transferred to account 101.
- At the beginning of the next year (01/01/N+1), the balance of account 12 is also transferred to account 101.

Example

- Below are some transactions related to a sole proprietorship during the year 2020:
  1. The proprietor paid the entity's electricity and gas bills worth 5.000 DZD from his personal funds.
  2. The proprietor withdrew an amount of 7.000 DZD from the entity's bank account for his personal uses.
  3. The entity achieved 4.000 DZD as a net profit for the financial year 2020.

Dr. A/c	Cr. A/c	2020	Debit	Credit
		______________01______________		
607		Non-inventory materials and supplies	5.000	
	108	Sole proprietor account		5.000
		Payment bills from personal funds		
		______________02______________		
108		Sole proprietor account	7.000	
	512	Bank account		7.000
		Personal withdrawal from the bank account		
		__________12/31/2020___________		
101		Sole proprietor's capital	2.000	
	108	Sole proprietor account		2.000
		Transfer of the balance of account 108		
Dr. A/c	**Cr. A/c**	**2021**	**Debit**	**Credit**
		__________01/01/2021___________		
xx		Assets	xxxx	
	120	Profit of the financial year		4.000
	xx	Labilities		xxxx
		Record of the opening balance sheet		
		__________01/01/2021___________		
120		Profit of the financial year	4.000	
	101	Sole proprietor's capital		4.000
		Transfer of the balance of account 120		

Accounting for the Creation of a Company

1. Accounts for Use by Companies

- **Account 101 - Share capital:** is subdivided as necessary and records on its credit side the amount of capital stated in the company deed. This account follows the evolution of the capital amount during the company's lifetime according to the decisions of the competent bodies.

✓ Account 101 is credited at the time of capital increases with:
  - the amount of the contributions in cash or in kind made by partners, after deduction of the premiums linked to the share capital;
  - the amount of the capitalization of reserves.

✓ Account 101 is debited with the reductions in capital, whatever the cause, for example, the absorption of losses or reimbursement to partners.

- **Account 103 - Premiums related to share capital:** records share premiums, merger premiums, contribution premiums, etc. At the time of subscription, premiums are determined when the company decides to increase its capital by issuing new shares. The selling price is usually limited to the nominal value of the share (the lower price) and the real value of the share before the capital increase (the higher price). The difference between the selling price and the nominal value of the share is called the share premium, which is recorded in the credit of account 103, along with account 101, which is recorded at the nominal value of shares. On the debit side, account 456 Partners - Capital transactions is recorded at the selling price of shares.
- **Account 106 – Reserves:** is credited when allocating profits of the financial year and debited when withdrawing amounts from the relevant reserves for incorporation into capital, distribution to partners, and loss write-off.
- **Account 109 - Shareholders: subscribed uncalled capital** is used in the event of a split call of the share capital. The uncalled share is debited in account 109 by crediting account 101. Account 109 is credited by debiting account 456 when the capital is called.
- **Account 11- Retained earnings (debit or credit balance):** may be subdivided to separate positive retained earnings in account 110 - Retained earnings (credit balance) and negative retained earnings in account 119 - Retained earnings (debit balance).
- **Account 12 - Profit or loss for the financial year:** A credit balance in account 12 represents a profit, which is recorded in account 120 - Profit for the financial year. A debit balance in account 12 represents a loss, which is recorded in account 129 - Loss for the financial year.

- **Account 455 - Partners - Current accounts:** records on its credit side the amount of funds temporarily made available or left at the disposal of the company by the partners.
- **Account 456 - Partners - Capital transactions:** is subdivided in order to record separately the transactions relating to the creation of a company or to the increase of its capital. Account 456 is debited with the amount of contributions made in cash or in kind by the partners by crediting the relevant subdivisions of account 10. Account 456 is credited by debiting the accounts of assets that correspond to the contributions.
- **Account 457 - Partners - Dividends payable:** is credited with the amount of the dividends whose distribution has been decided by the competent bodies by debiting account 12 or account 11 or account 106 for reserves whose distribution is not prohibited.

2. Steps of Accounting for a Company Creation

The accounting for creating a company varies depending on the legal form of the company. The focus here will be on the accounting recording for the creation of limited liability companies (LLCs). In this type of company, all shares are subscribed to the capital, meaning the full value of the cash and in-kind shares must be presented upon subscription. In this case, the accounting for the creation of the company goes through two steps:

- **The first step-promise to contribute:** Cash and in-kind contributions are recorded on the debit of account 456, in exchange for recording account 101 in credit.

Dr. A/c	Cr. A/c		Debit	Credit
		_____________01_____________		
456		Partners - Capital transactions	xxxx	
	101	Share capital		xxxx
		Record of share capital		

- **The second step- fulfilling the promise**: When paying the value of cash and in-kind contributions, the relevant asset accounts are recorded on the debit side in exchange for account 456 and other debt accounts on the credit side.

Dr. A/c	Cr. A/c		Debit	Credit
		_____________02_____________		
2xx		Fixed assets	xxxx	
3xx		Inventories	xxxx	
4xx		Accounts receivable and related account	xxxx	
5xx		Cash and cash equivalents	xxxx	
	456	Partners - Capital transactions		xxxx
	16+17	Loans and debts		xxxx
	4xx	Accounts payable and related account		xxxx
		Record of contributions		

Example

- On June 2, 2017, two partners agreed to establish the "Al-Aqsa" Company with a capital of 1.000.000 DZD. The partners' contributions were as follows:
- ✓ Partner Ahmed's contribution was: land worth 400.000 DZD and industrial buildings worth 200.000 DZD.
- ✓ Partner Mohammed's contribution was: industrial machines worth 300.000 DZD and a cash contribution of 100.000 DZD.
- On June 9, 2017, the partners paid all contributions, knowing that half of the cash contribution was deposited in the bank and half in the cash account.

Dr. A/c	Cr. A/c		Debit	Credit
		06/02/2017		
4561		Partner "Ahmed" - Capital transactions	600.000	
4562		Partner "Mohammed" - Capital transactions	400.000	
	101	Share capital		1.000.000
		Record of share capital		
		06/09/2017		
211		Land	400.000	
21311		Industrial buildings	200.000	
2154		Industrial machines	300.000	
512		Bank account	50.000	
53		Cash	50.000	
	4561	Partner "Ahmed" - Capital transactions		600.000
	4562	Partner "Mohammed" - Capital transactions		400.000
		Record of contributions		

3. Allocation of Reserves and Profit or Loss

- Reserves to be recorded in account 106 are profits permanently allocated to the company until the competent bodies decide otherwise. At the time of the appropriation of profits, this account is credited with the amounts intended for:
- ✓ 1061 Legal reserve: limited liability companies and corporations must allocate reserves of 5% of the profits of the year after reducing losses of previous years. When these reserves reach 10% of the capital, their allocation becomes non-compulsory.
- ✓ 1062 Regulated reserves
- ✓ 1063 Statutory or contractual reserves
- ✓ 1064 Ordinary reserves

- ✓ 1068 Other reserves
- Account 12 is balanced after the decision of allocating the profit or loss. Amounts not distributed and not allocated to a reserve account are transferred to account 11-Retained earnings: account 110 in the case of profits, or account 119 in the case of losses.

Example

- During January 2018, the "Al-Aqsa" Company carried out the following transactions:
- ✓ On January 20, the partners agreed to allocate the profit of the year 2017 (a net profit of 40.000 DZD) as follows: legal reserves: 5%; regular reserves: 20%; dividends: 30%.
- ✓ On January 24, the dividends were paid by check to partners.

Dr. A/c	Cr. A/c		Debit	Credit
		______01/20/2018______		
120		Profit of the financial year	40.000	
	1061	Legal reserve		2.000
	1062	Regulated reserves		8.000
	457	Partners - Dividends payable		12.000
	110	Retained earnings		18.000
		Allocation of profit		
		______01/24/2018______		
457		Partners - Dividends payable	12.000	
	512	Bank account		12.000
		Payment of dividends		

Functioning of Other Accounts from Class 1

The account 16- Loans and similar debts records both loans and financial debts similar to loans, with the exception of those recorded in account 17- Debts related to equity interests. This account appears on the liability side of the balance sheet by distinguishing:

- ✓ transactions that fall under current liabilities and under non-current liabilities;
- ✓ interest-bearing and non-interest-bearing transactions.

Account 16 can also be subdivided at the initiative of the entity by distinguishing:

- ✓ transactions carried out in Algeria and those carried out abroad;
- ✓ transactions carried out in national currency and those carried out in foreign currencies.

Account 16 is subdivided into:

- ✓ 161 Non-voting shares
- ✓ 162 Convertible debenture loans
- ✓ 163 Other debenture loans
- ✓ 164 Loans from lending institutions
- ✓ 165 Deposits and sureties received

- ✓ 167 Debts on finance lease contract
- ✓ 168 Other loans and similar debts
- ✓ 169 Debenture redemption premiums

Loan amounts are recorded in the credit of account 16 or one of its sub-accounts when borrowing, and cash and cash equivalent accounts are recorded in debit. When paying the loan, the opposite entry is recorded. The loan is obtained in the form of a single payment and is repaid in installments during the loan repayment period. The installment consists of a portion of the repaid loan and annual financial expenses. The entries are recorded as follows:

- ✓ When obtaining the loan:

Dr. A/c	Cr. A/c		Debit	Credit
		______________01_____________		
5xx		Cash or cash equivalents	xxxx	
	16x	Loans and similar debts		xxxx
		Obtaining a loan		

- ✓ When paying installments of the loan:

Dr. A/c	Cr. A/c		Debit	Credit
		______________02_____________		
16x		Loans and similar debts	xxxx	
66x		Financial expenses	xxxx	
	5xx	Cash or cash equivalents		xxxx
		Payment of a loan installment		

Bank of Questions and Exercises

1- Questions:

1. **Entities are divided according to their legal form into:**
   a) Sole proprietorships and companies
   b) Private and public entities
   c) Commercial, industrial, and service entities
   d) For-profit and non-profit organizations
2. **Account 101 - Sole proprietor's capital is credited with:**
   a) the value of the contributions of the sole proprietor during the activity;
   b) the value of withdrawals by the sole proprietor during the activity;
   c) the profit of the previous financial year.
   d) the loss of the previous financial year.
3. **The legal reserve ratio is equal to:**
   a) 5% of profits before deducting losses of previous years;
   b) 5% of profits after deducting losses of previous years;
   c) 10% of profits before deducting losses of previous years;
   d) 10% of profits after deducting losses of previous years.
4. **Which of the following statements is false?**
   a) In sole proprietorships, the profit of the financial year is transferred to account 101 at the end of the year.
   b) In sole proprietorships, account 456 appears on the debit side when distributing the profit of the financial year.
   c) In companies, account 109 records the value of the uncalled portion of capital on the debit side;
   d) In companies, the balance of account 108 is transferred at the beginning of the financial year to account 101.
5. **Premiums related to share capital are equal to:**
   a) Nominal value of shares – selling price of shares
   b) Selling price of shares – uncalled capital
   c) Nominal value of shares – uncalled capital
   d) Selling price of shares – nominal value of shares

2- Exercises:

Exercise 01:

- On January 7, 2019, the trader “Ahmed” created a sole proprietorship with a capital of 300.000 DZD. Contributions for this entity were as follows:

- Land: 100.000 DZD - Commercial buildings: 50.000 DZD - Furniture: 30.000 DZD – Office equipment 30.000 DZD, Goods for resale 20.000 DZD, Bank account 50.000 DZD, Cash 20.000 DZD.

- During the year 2019, the entity carried out the following transactions:

1. July10, the Trader deposited 30.000 DZD in the entity's cash from his personal funds;
2. July 15, the Entity purchased goods for resale worth 10.000 DZD on account;
3. August 13, the Trader paid from his personal funds: the entity's water bills worth 3.000 DZD, and his own water bills worth 2.000 DZD.
4. August 19, the Trader withdrew 8.000 DZD from the entity's bank account for his own use;
5. October 10, the Trader purchased on account: furniture for the entity worth 20.000 DZD and furniture for the home worth 15.000 DZD;
6. November 2, the Trader paid the supplier (Transaction 2), half from his personal funds and the rest from the Entity's bank account;
7. December 20, the Trader paid all purchases related to Transaction 5 by check from the Entity's bank account.

Required:

a) Record the previous transactions in the Entity's journal;
b) Record the entry of the transfer of account 108- Sole proprietor account on the appropriate date;
c) Record the entry of the transfer of the loss for the year 2019 (7.000 DZD) on the appropriate date.

Exercise 02:

- On September 6, 2020: Three partners agreed to create "Al-Quds Al-Arabi" Company (capital of 3.000.000 DZD). The contributions were as follows:

Partners	Contribution	Amounts
Partner "A"	Cash	1.000.000 DZD
Partner "B"	Good for resale Suppliers Cash	500.000 DZD 200.000 DZD 600.000 DZD
Partner "C"	Land Commercial building	600.000 DZD 500.000 DZD

*The partners pledged to release all in-kind contributions and all cash contributions.

- On September 9, 2020: The partners paid the in-kind and cash contributions, knowing that the cash was deposited in the company's bank account.
- Transactions of Al-Quds Al-Arabi Company during the year 2020 were as follows:

1. September 23, paid expenses in cash: notary fees of 15.000 DZD, deed contract expenses of 20.000 DZD.
2. October 30, obtained a bank loan of 200.000 DZD, which was deposited in the bank account;
3. November 20, the partner “B” deposited 50.000 DZD in the Company’s bank account from his own funds;
4. December 30, paid of an installment of 5% of the bank loan by check.

- During the year 2022, the information related to profits was:

1. January 29, partners agreed to allocate the profit of the year 2021 (a net profit of 60.000 DZD) as follows: legal reserves, ordinary reserves: 15.000 DZD, dividends: 20.000 DZD. (knowing that the Company had a loss of 5.000 DZD in 2020).
2. January 31, the dividends were paid by check to partners.

Required:

Record the appropriate entries in the Company’s journal during the years 2020 and 2022.

CHAPTER SIX:

CLASS 3 - INVENTORY AND WORK IN PROGRESS

Chapter 06:

Class 3 - Inventory and Work in Progress

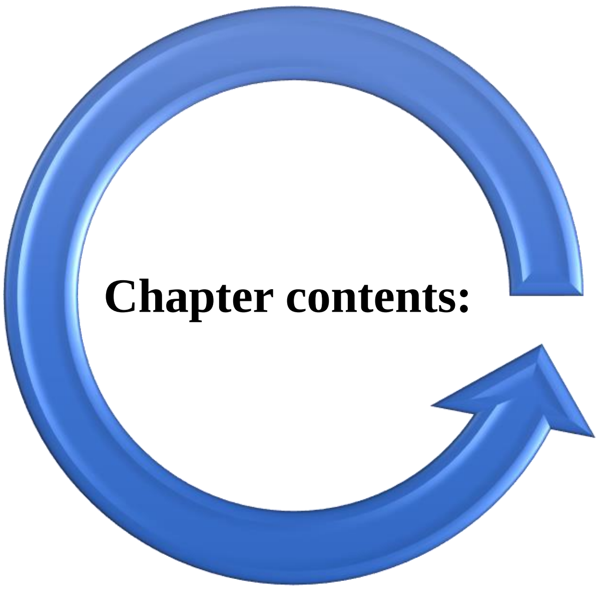
Learning objectives:

After completing this chapter, students should be able to:

LO1: Understand the difference between the perpetual inventory system and the periodic inventory system;

LO2: Record the most important inventory transactions according to the perpetual inventory system;

LO3: Record inventory transactions according to the periodic inventory system.



1. **Elements of Inventories**
2. **Value-Added Tax**
3. **Perpetual inventory system**
4. **Periodic inventory system**
5. **Bank of questions and exercises**

Introduction

The inventory represents one of the most important assets that the entity owns because inventory turnover is the main source of revenues and subsequent profits for the entity's owners. The way a company displays the inventory it has in its balance sheets, income statement, and other financial statements is the focus of inventory accounting. This is usually not as simple as it seems because inventory is frequently a "live figure" that changes all the time based on sales and purchases. There are many questions related to inventory, including:

- ✓ What are the methods of evaluating inventories?
- ✓ How is value-added tax calculated and recorded?
- ✓ How are the most important inventory transactions recorded?

Elements of Inventories

1. Definition of Inventory

The term "inventory" generally refers to the items in an entity's warehouse. It is defined as a group of goods used in production or finished goods held by an entity during the normal course of its business. It consists of items for resale and items at different stages of production, as well as supplies used to support the entity's activity.

Inventory accounts are gathered in Class 03 of the Chart of Accounts. The inventory transactions are recorded in accordance with the entity's own costing methods. There are two ways in which an entity may account for their inventory. It can use a permanent inventory system or a periodic inventory system. The choice of inventory accounting tracking method (perpetual or periodic) is a management decision.

2. What are the Main Types of Inventories?

There are many types of inventories, especially raw materials, work-in-progress, and finished goods. At the accounting level, we retain the distinction between:

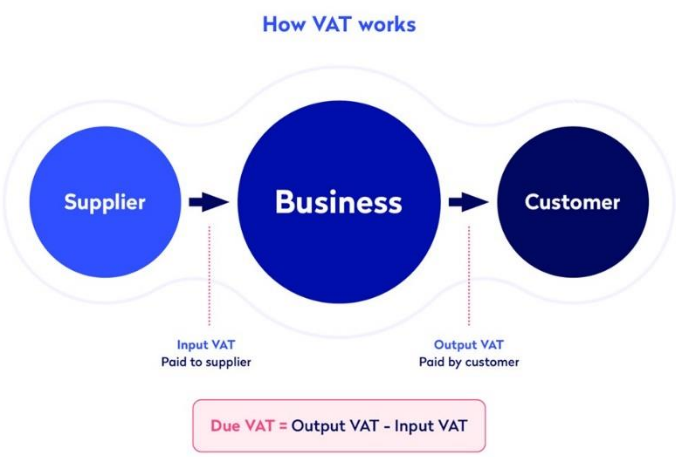
- ✓ **Account 30**: goods purchased with a view to being resold as is.
- ✓ **Account 31:** raw materials and supplies purchased for processing and used in the composition of goods manufactured.

- ✓ **Account 32:** other supplies, including consumable materials (321), consumable supplies (account 322), and packaging (account 326), which are substances and objects that help in processing, manufacturing, or activities of the entity in general without entering into the composition of goods manufactured.
- ✓ **Account 33:** work in progress of goods, i.e., partially completed items that are being produced.
- ✓ **Account 34:** work in progress of services, i.e., partially completed services that are being provided.
- ✓ **Account 35:** goods manufactured by the entity with the aim of completing their manufacturing or selling them, including:
  - Account 351- Intermediate goods that are products that have reached a certain degree of manufacturing and are placed in warehouses until the time of completion of their manufacture;
  - Account 355- Finished goods that have completed the production process and are ready for sale;
  - Account 358- Residual products or recovery materials that are not suitable for normal use or sale.
- ✓ **Account 36**: inventory from fixed assets, which includes items dismantled or recovered from tangible fixed assets;
- ✓ **Account 37:** inventory already owned by the entity but not physically held at the end of the financial year because it has not yet been received, or on deposit or consignment.

Value-Added Tax

1. The Meaning of Value-Added Tax

Value-Added Tax (VAT) is an indirect tax imposed on final spending or consumption. VAT is borne by final consumers and is collected by entities engaged in trade and production for submission to the tax authorities. The amount of tax is proportional to the turnover excluding tax. The normal rate of VAT imposed on purchases and sales of goods and services is 19%, while the reduced rate is 9%.



The principle of VAT is as follows: the entity increases its sales price by the amount of VAT that it invoices to its customer and which it pays to the State after deduction of VAT amounts (so-called VAT recovery operation) that it had to pay to its own suppliers to acquire goods and services that are necessary for its own activities.

2. Accounting for Value-Added Tax

The Financial Accounting System has allocated account **445 - State: Taxes on turnover,** to record VAT, which is divided into the following sub-accounts:

- **Account 4456 - Deductible taxes on turnover**

Taxes on the added value paid in the transactions of purchasing goods, materials, equipment, and services are receivables from the State and are recorded in the debit of account 4456.

When recording purchase invoices, it can be seen that they include several indications: the total excluding taxes, the rate and amount of VAT, and the total of all taxes included. The following rule must be respected:

Including tax = excluding tax + VAT.

Account 4456 is therefore recorded in the purchase invoice entry as follows:

Dr. A/c	Cr. A/c		Debit	Credit
		____________01____________		
2x/38x/6x		Fixed assets/ Stored Purchases/Expenses	Excluding tax	
4456		Deductible taxes on turnover	VAT	
	40x / 5xx	Method of payment		Including tax
		Purchase invoice		

In purchase entries, we debit account 4456. The amount is therefore included in the assets on the balance sheet, which means that the entity has a VAT receivable from the State.

- **Account 4457 - Taxes on turnover collected by the entity**

Taxes on the added value obtained from the sale of goods and services are considered debts to the State. It is credited to account 4457.

When recording sales in accounting, the principle is the same as that explained for purchases, except that this is the accounting of sales.

Account 4457 is recorded directly when the sales invoice is recorded:

Dr. A/c	Cr. A/c		Debit	Credit
		____________01____________		
41x / 5xx		Method of payment	including tax	
	7xx	Revenues		excluding tax
	4457	Taxes on turnover collected by the entity		VAT
		Sales invoice		

In sales entries, we credit account 4457. The amount is therefore included on the liability side of the balance sheet, which means that the entity owes VAT to the State.

- **Account 4455 - Taxes payable on turnover**

The taxes payable, which represent the difference between the taxes collected on sales (account 4457) and the deductible taxes (account 4456), are recorded in the credit of account 4455 and are paid before the 20th of the month following the sales.

Perpetual Inventory System

The perpetual inventory system allows continuous accounting control of inventories and tracking their movement. It also allows, at the finished goods level, to establish a direct correspondence between the costs of inventory sold and the related revenues. The perpetual inventory system automatically updates inventories, so every entry or exit from the warehouse is recognized immediately upon a sale, purchase, or production of goods.

1. Accounting for Purchase Transactions

The value of purchasing goods, raw materials, and other supplies is recorded at the total purchase cost, that is, the purchase price plus all expenses incurred by the entity to deliver these inventories to the place and in the condition in which they are located.

The transaction of purchasing goods for resale, raw materials, and other supplies is recorded according to the perpetual inventory system in two entries as follows:

Dr. A/c	Cr. A/c		Debit	Credit
		____________01____________		
380/381/382		Stored purchases	Purchase cost	
4456		Deductible taxes on turnover	VAT	
	40x / 5xx	Method of payment		Including tax
		Purchase invoice		
		____________02____________		
30		Goods for resale	Purchase cost	
31		Raw materials and supplies		
32		Other supplies		
	380/381/382	Stored purchases		Purchase cost
		Entry of inventories into the warehouse		

Example

- On August 7, 2023, ABC Company purchased goods for resale costing 60.000 DZD and raw materials costing 40.000 DZD, all on account (VAT = 19%).
- Entries according to the perpetual inventory system are as follows:

Dr. A/c	Cr. A/c		Debit	Credit
		_________08/07/2023_________		
380		Purchases of goods	60.000	
381		Purchases of raw materials	40.000	
4456		Deductible taxes on turnover	19.000	
	401	Suppliers		119.000
		Purchase invoice on account		
		_________08/07/2023_________		
30		Goods for resale	60.000	
31		Raw materials and supplies	40.000	
	380	Purchases of goods		60.000
	381	Purchases of raw materials		40.000
		Entry of inventories into the warehouse		

2. Accounting for Manufacturing Processes

Goods are recorded at the total production cost, meaning that their cost includes all direct expenses (such as raw materials and wages) and indirect expenses incurred for good production. Residual goods and recovered materials are recorded at the production cost or the estimated selling price. Recording the production and storage process of goods according to the perpetual inventory method is as follows:

- ✓ First, the expenses incurred by the entity to manufacture these goods are recorded.
- ✓ Second, the entry of goods manufactured into the warehouse is recorded.

Dr. A/c	Cr. A/c		Debit	Credit
		_____________01_____________		
601		Raw materials and supplies consumed	Amounts	
602		Other supplies consumed	of	
631		Employee salaries	expenses	
…		Other expenses		
	31	Raw materials and supplies		Amounts of
	32	Other supplies		expenses
	4xx/5xx	Method of paying expenses		
		Record of manufacturing expenses		
		_____________02_____________		
351		Intermediate goods	Production	
355		Finished goods	cost	
358		Residual goods or recovered materials		Production
	724	Changes in inventory of goods		cost
		Entry of goods into the warehouse		

When goods exit the warehouse, the reversal of the second entry is recorded.

Example

- On April 25, 2023, ABC Company produced finished goods. The production process required the consumption of 50.000 DZD of raw materials withdrawn from the warehouse and the payment of 20.000 DZD as workers' salaries in cash. These goods and recovered materials with an estimated cost of 4.000 DZD, were brought into the warehouse.
- Entries according to the perpetual inventory system are as follows:

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
		________04/25/2023________		
601		Raw materials consumed	50.000	
631		Employee salaries	20.000	
	31	Raw materials and supplies		50.000
	53	Cash		20.000
		Record of production expenses		
		________04/25/2023________		
355		Finished goods	70.000	
358		Recovered materials	4.000	
	724	Changes in inventory of goods		74.000
		Entry of inventories into the warehouse		

3. Accounting for Sales Transactions

- **Transactions of sales of goods for resale, raw materials, and other supplies:** These transactions are recorded in two entries, as follows:

✓ **The first entry** is the sale entry, which is recorded when sales invoices are sent to customers.

✓ **The second entry** is the exit entry, which is recorded when goods, materials, and other supplies are delivered to customers.

Dr. A/c	**Cr. A/c**		**Debit**	**Credit**
		____________01____________		
41x / 5xx		Method of payment	Including tax	
	700	Sales of goods for resale		Selling
	708	Ancillary income		price
	4457	Taxes on turnover collected by the entity		VAT
		Sales invoice		

		02		
600		Purchases of goods sold	cost of	
602		Other supplies consumed	purchase	
	30	Inventory of goods for resale		cost of
	31	Raw materials and supplies		purchase
	32	Other supplies		
		Exit of inventories from the warehouse		

If raw materials are sold as they are without any transformation, they are recorded in accounting as goods sold (Account 700).

Example

- On May 9, 2023, ABC Company sold consumable supplies at a value of 10.000 DZD by bank check (VAT = 19%). The purchase cost of these supplies is 9.000 DZD.
- Entries according to the perpetual inventory system are as follows:

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
		08/09/2023		
512		Bank account	11.900	
	708	Ancillary income		10.000
	4457	Taxes on turnover collected by the entity		1.900
		Sale invoice by check		
		08/09/2023		
602		Other supplies consumed	9.000	
	322	Consumable supplies		9.000
		Exit of supplies from the warehouse		

- **Transactions of sales of inventory of goods:** these transactions are recorded in two entries, as follows:
  - ✓ **The first entry** is the sale entry (when sending sales invoices).
  - ✓ **The second entry** is the exit entry (when sending sold goods).

Dr. A/c	**Cr. A/c**		**Debit**	**Credit**
		01		
41x / 5xx		Method of payment	Including tax	
	701	Sales of finished goods		Selling
	702	Sales of intermediate goods		price
	703	Sales of residual goods		
	4457	Taxes on turnover collected by the entity		VAT
		Sales invoice		

724		_____________02_____________ Changes in inventory of goods	Production cost	
	351	Intermediate goods		Production cost
	355	Finished goods		
	358	Residual goods or recovered materials		
		Exit of inventories from the warehouse		

Example

- On July 22, 2023, ABC Company sold finished goods at a value of 80.000 DZD on account (VAT = 19%). The production cost of these goods is 70.000 DZD.
- Entries according to the perpetual inventory system are as follows:

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
		_________08/22/2023_________		
411		Customers	95.200	
	701	Sales of finished goods		80.000
	4457	Taxes on turnover collected by the entity		15.200
		Sale invoice on account		
		_________08/22/2023_________		
724		Changes in inventory of goods	70.000	
	355	Finished goods		70.000
		Exit of goods from the warehouse		

4. Accounting for Other Inventory Transactions

- **Sales returns and purchase returns:**
  In some cases, the buyer may find that part or all the purchased inventory does not conform to the agreed upon specifications (the presence of a lack of quality or a specific defect). In this case, the buyer has the right to return the non-compliant inventory to the seller. Then another invoice is issued attached to the original invoice, called the return invoice (credit note).
  On the accounting level, sales returns and purchase returns are recorded in reverse of sale entries and purchase entries, respectively (with considering the return quantity and the method of payment).
- **Purchase and sales transactions abroad (in foreign currency):**
  Purchases and sales in foreign currency are recorded in the national currency, similarly to local purchases and sales (according to the principle of monetary unit), by converting amounts using the exchange rate on the same date of the transaction and considering the gain or loss related to the exchange rate change between the date of sending or receiving invoices and the date of payment or collection of money.

In other words, if payment is deferred and the exchange rate changes, a difference occurs between the amount recorded on the date of the transaction and the amount paid.

- ✓ If there are profits, we record the difference in the credit of account 766- Financial foreign exchange gains;
- ✓ If there are losses, we record the difference in the debit of account 666- Financial foreign exchange losses.

- **Advance payments:**

  Advances are recorded when an amount is advanced for a purchase or sale transaction. There are two accounts related to advance payments:

  - ✓ Account 4091- Suppliers - Advance payments on account on orders: It is debited, when the entity pays advances on orders to suppliers, by crediting a cash account. It is balanced when receiving the invoice from the supplier.
  - ✓ Account 4191 - Customers - Advance payments on account received on orders: It records advance payments received by the entity on orders to be delivered, works to be performed, or services to be provided. It is credited by debiting a cash account when the advance payments are received from customers. It is balanced when invoicing.

- **Receivables and payables for returnable packaging:**

  The packaging deposit is an amount paid as security for renting the packaging used for storing goods. There are two accounts related to receivables and payables for returnable packaging:

- ✓ Account 4096 - Suppliers - Receivables for returnable packaging: It is debited when suppliers consign packaging to the entity for the consignment. It is balanced when returning the packaging at the consignment price;
- ✓ Account 4196 - Customers - Payables for returnable packaging and equipment: It is credited with amounts billed by the entity to its customers for returnable packaging. It is balanced by the same amount when the packaging is returned.

Periodic Inventory System

The periodic inventory system updates and records inventories at certain scheduled times at the end of an operating cycle. The update and recognition could generally occur at the end of the year. According to this system, a gap occurs between the sale or purchase of inventory and when the inventory activity is recognized.

The perpetual inventory system

- It is a method that tracks the movement of inventory.
- Records all entries related to the movement of inventory (entry or exit from the warehouse).

The periodic inventory system

- It is a method that does not track inventory movement.
- It does not record any entries or exits from the warehouse.

1. Accounting for Inventories During the Year

According to the periodic inventory system, inventory movement is not recorded during the year.

Purchase transaction: Only one entry is recorded, which is the purchase invoice entry.

Dr. A/c	Cr. A/c		Debit	Credit
		01		
380/381/382		Stored purchases	Purchase cost	
4456		Deductible taxes on turnover	VAT	
	40x / 5xx	Method of payment		Including tax
		Purchases invoice		

Manufacturing process: When producing goods, only production expenses like salaries are recorded (consumed materials or other suppliers are not recorded).

Dr. A/c	Cr. A/c		Debit	Credit
		01		
631		Employee salaries	Amounts of expenses	
6xx		Other expenses		
	4xx/5xx	Method of payment		Amounts of expenses
		Record of manufacturing expenses		

Sale transaction: One entry is recorded, which is the sale invoice entry.

✓ When selling goods for resale, raw materials, and other supplies:

Dr. A/c	Cr. A/c		Debit	Credit
		01		
41x / 5xx		Method of payment	Including tax	
	700	Sales of goods for resale		Selling price
	708	Ancillary income		
	4457	Taxes on turnover collected by the entity		VAT
		Sales invoice		

✓ When selling inventories of goods:

Dr. A/c	Cr. A/c		Debit	Credit
		____________01____________		
41x / 5xx		Method of payment	Including tax	
	701	Sales of finished goods		Selling price
	702	Sales of intermediate goods		
	703	Sales of residual goods		
	4457	Taxes on turnover collected by the entity		VAT
		Sales invoice		

2. Accounting for Inventories at the End of the Year

At the end of each year and after performing a physical inventory count, three entries must be recorded as follows:

Dr. A/c	Cr. A/c		Debit	Credit
		____________12/31/N____________		
600		Purchases of goods sold	Cost of beginning inventory	
601		Raw materials and supplies consumed		
602		Other supplies consumed		
724		Changes in inventory of goods		
	30	Inventory of goods for resale		Cost of beginning inventory
	31	Raw materials and supplies		
	32	Other supplies		
	35	Inventory of goods		
		Write-off of beginning inventory		
		____________12/31/N ____________		
600		Purchases of goods sold	Purchase cost	
601		Other supplies consumed		
602		Raw materials and supplies consumed		
	380/381/382	Stored purchases		Purchase cost
		Write-off of stored purchases (account 38)		
		____________12/31/N ____________		
30		Inventory of goods for resale	Cost of ending inventory	
31		Raw materials and supplies		
32		Other supplies		
35		Inventory of goods		
	600	Purchases of goods sold		Cost of ending inventory
	601	Other supplies consumed		
	602	Raw materials and supplies consumed		
	724	Changes in inventory of goods		
		Record of ending inventory		

Bank of Questions and Exercises

1- Questions:

1. According to the Financial Accounting System:

a) The entity must apply the periodic inventory system;

b) The entity chooses between the perpetual inventory system and the periodic inventory system;

c) The entity must apply the perpetual inventory system;

d) The entity applies the perpetual inventory and periodic inventory systems alternately.

2. Under the perpetual inventory system, when goods for resale are purchased:

a) The method of payment is recorded on the debit side;

b) Purchases of goods are recorded on the debit side and then balanced on the credit side;

c) The value-added tax is recorded on the credit side;

d) The inventory of goods for sale is recorded on the debit side.

3. To record the sale of goods for resale in the periodic inventory system:

a) It is necessary to make two entries in the journal: one to record the sales invoice, and another to record the exit of goods from the warehouse;

b) It is necessary to make two entries in the journal: one to record the sales invoice, and another to record the entry of goods into the warehouse;

c) It is necessary to make only one journal entry to record the sales invoice;

d) It is necessary to make only one journal entry to record the exit of goods from the warehouse.

4. Which of the following items can be included in identifying the cost of finished goods?

a) Depreciation and losses in value

b) Cost of intermediate goods consumed

c) Administrative expenses

d) Deductible taxes on turnover

e) Advertising, publications, public relations

f) Other supplies consumed

g) Rent expenses

5. Which of the following is a disadvantage of the perpetual inventory system?

a) Inventory information is in real-time.

b) The inventory is permanently updated.

c) It allows managers to make current decisions about purchases, manufacturing, and sales.
d) It is cost-prohibitive.

6. The amount of tax payable on turnover is equal to:

a) Total including taxes – total excluding taxes
b) Total excluding taxes – total including taxes
c) Taxes collected on sales – deductible taxes
d) Deductible taxes – taxes collected on sales

2- Exercises:

Exercise 01:

- The transactions carried out by Al-Quds Company during January 2020 were as follows:

1. January 2, purchased 2.000 kg of goods for resale cost 30 DZD/kg, paid by check (VAT = 19%);
2. January 6, sales invoice to the customer (Alfa Company) on account, as follows:

Items	Quantity	Unit price	Amount
Goods for resale	1.000 kg	50	50.000 DZD
		VAT (19%)	9.500 DZD
		Total	**59.500 DZD**

3. January 13, collected from the customer (Alfa Company) by check. (amount of the sales invoice in transaction 2)
4. January 25, the customer (Alfa Company) returned 250 kg of goods to the Company and refunded his money in cash.

Required:

a) Record transactions in Al-Quds Company's journal according to the perpetual inventory system.
b) Record the transactions related to Alpha Company (the customer) in the journal according to the perpetual inventory system.

Exercise 02:

- Below are some transactions carried out by Al-Badr Company during the year 2021:

1. July 2, purchase invoice paid with a note payable as follows:

Items	Quantity	Unit price	Amount
Raw Materials	4.000 kg	15	60.000 DZD
Packaging (non-recoverable)	5.000 u	12	60.000 DZD
		Subtotal	120.000 DZD
		VAT (19%)	22.800 DZD
		Total	**142.800 DZD**

2. September 1, to produce 1.500 units of finished goods, it was consumed for each unit: 2 kg of raw materials, 1 packaging (non-recoverable), and 30 DZD workers' wages paid by check. Finished goods have been entered into the warehouse.
3. September 9, sales invoice collected by a note payable as follows:

Items	Quantity	Unit price	Amount
Finished goods	1.000 u	100	100.000 DZD
Raw Materials	250 kg	20	5.000 DZD
		Subtotal	**105.000 DZD**
		VAT (19%)	**19.950 DZD**
		Total	**124.950 DZD**

4. October 20, to produce 300 units of intermediate goods, 2 kg of raw materials were consumed per unit, and 30 DZD workers' wages per unit were paid in cash. Intermediate goods and residual goods with an estimated value of 2.000 DZD were brought into the warehouse.
5. November 11, an importation invoice on account was as follows:

Items	Quantity	Unit price	Amount
Goods for resale (exchange rate 1€ = 150 DZD)	10.000 kg	0,2 €	**2.000 €**
import duties*	-	-	**90.000 DZD**
Freight expenses*	-	-	**10.000 DZD**
Transportation expenses*	-	-	**20.000 DZD**

* These expenses were paid in cash.

6. November 30, completion of production of 200 units of intermediate goods, by consumption of 1 packaging (non-recoverable) per unit. Finished goods have been entered into the warehouse.
7. December 22, the amount of the imported goods for resale was paid to the foreign supplier by check (exchange rate: 1€ = 152 DZD).

***Required*:**

Record transactions in Al-Badr Company's journal according to the perpetual inventory system.

Exercise 03:

- Al Salam Company's opening balance sheet on January 1, 2022 was as follows:

A/c	Assets	Amount	A/c	Liabilities	Amount
	Non -current assets			**Equity**	
21311	Industrial buildings	200.000	101	Share capital	500.000
2154	Industrial machinery	150.000		**Non-current liabilities**	
	Current assts				
30	Goods for resale (2.000 kg *30 DZD)	60.000	164	Loans from lending institutions	230.000
351	Intermediate goods (1.600 u * 50 DZD)	80.000		**Current liabilities**	
			401	Suppliers	70.000
355	Finished goods (2.000 u *75 DZD)	150.000			
512	Bank and current accounts	160.000			
	Total	**800.000**		**Total**	**800.000**

- During the year 2022, the Company carried out the following transactions:
  1. January 30, purchased raw materials: 5.000 kg at 20 DZD/kg, VAT = 19%, paid by check;
  2. February 5, received 25.000 DZD as an advance from the customer in cash;
  3. March 20, completion of all intermediate goods, consuming 1 kg of raw materials per unit, and paying 8.000 DZD as salaries in cash.
  4. May 9, purchase invoice on account consisting of: 1.000 kg of goods for resale at 30 DZD/kg, 2.000 kg consumable supplies at 15 DZD/kg, VAT = 19%.
  5. June 15, sales invoice on account consisting of: 2.000 kg raw materials at 40 DZD/kg, 2.500 units finished goods at 120 DZD/unit, consumable supplies: 500 kg at 30 DZD/kg, VAT = 19%, advance payment: 25.000 DZD.
  6. July 7, received an electricity and gas bill worth 10.000 DZD; VAT = 9%.
  7. December 20, consumed 500 kg of other supplies from the warehouse.

***Required*:**

a) Record transactions in Al-Salam Company's journal according to the periodic inventory method;

b) Record inventory adjusting entries on December 31, 2022, knowing that the ending inventory was as follows:

Goods for resale	Raw materials	Consumable materials	Finished goods
30.000 DZD	28.000 DZD	15.000 DZD	82.000 DZD

CHAPTER SEVEN:

CLASS 2 - FIXED ASSETS

Chapter 07:

Class 2 - Fixed Assets

Learning objectives:

After completing this chapter, students should be able to:

LO1: Correctly determine the cost of fixed assets;

LO2: Record transactions related to the purchase and creation of fixed assets;

LO3: Record entries related to fixed assets in progress.

Chapter contents:

1. **Concept of fixed assets;**
2. **Accounting for obtaining fixed assets;**
3. **Functionning of fixed asset accounts;**
4. **Accounting for fixed assets in progress**
5. **Bank of questions and exercises.**

Introduction

The second class of the Chart of Accounts is allocated to fixed assets, as these items are of great importance to entities because they represent the economic resources that they rely on in their activities. Every entity, whatever its type, has a variety of fixed assets, which have a lifecycle, such as purchase, depreciation, revaluation, impairment, and disposal. In an entity's books, each asset has an account, where all the financial activities related to the fixed asset are recorded. On this basis, several questions can be raised regarding fixed assets:

- ✓ What is a fixed asset?
- ✓ How are the most important transactions related to fixed assets recorded?
- ✓ How can the cost of a fixed asset be determined?

Concept of Fixed Assets

1- Definition of fixed assets

A fixed asset is an economic resource that is controlled by the entity because of past events (for example, purchase or creation) and from which future economic benefits (inflows of cash or other assets) are expected. This asset is not for the purpose of sale but to be used as a means of exploitation permanently (for more than one year).

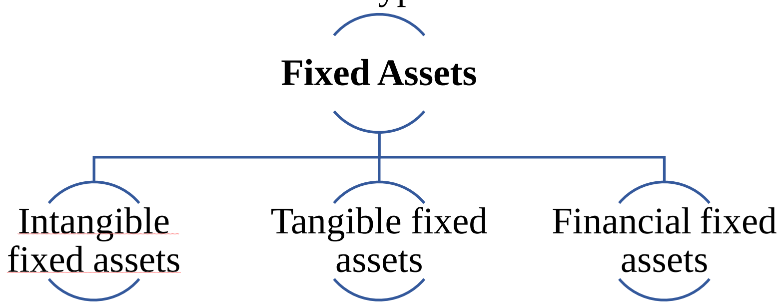
2- Recognition of fixed assets

An item of assets should be recognized as a fixed asset when:

- ✓ It is probable that the future economic benefits associated with the asset will flow to the entity;
- ✓ The asset is identifiable (capable of being separated and sold, transferred, licensed, rented, or exchanged);
- ✓ Its cost can be measured reliably.

3- Types of fixed assets

Generally, fixed assets consist of three types:



- ✓ **Intangible fixed asset:** an identifiable non-monetary asset without physical substance such as patents, goodwill, trademarks, software, licenses, research and development costs, etc. These items are gathered in Account 20 in the Chart of Accounts.

- ✓ **Tangible fixed asset:** a physical item that is held for use in the production or supply of goods or services, for rent to others, or for administrative purposes; and is expected to be used during more than one period, like machinery, tools, furniture, computers, etc. These items are gathered in Account 21.
- ✓ **Financial fixed asset:** a non-physical asset of sustainable use owned by the entity and comprised of money, a contractual right to receive money or other financial assets from another party, or securities issued by another entity, such as participations in share capital, equity securities, loans granted, deposits and guarantees, etc. These items are found in Accounts 26 and 27.

Accounting for Obtaining Fixed Assets

- **In the case of a purchase:**

The transaction of purchase fixed assets is generally recorded in only one entry, which is the purchase invoice entry:

Dr. A/c	Cr. A/c		Debit	Credit
		__________Date__________		
2xx		Fixed asset	Purchase cost	
4456		Deductible taxes on turnover	VAT	
	40x / 5xx	Method of payment		Including tax
		Purchase invoice		

The cost of an item of fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use. Cost elements are:

- ✓ Purchase price minus any trade discounts and rebates;
- ✓ Import duties and other non-refundable taxes or levies
- ✓ Directly attributable costs such as transportation expenses, installation costs, startup testing, site preparation, initial delivery and handling costs, and professional fees such as fees of architects.
- ✓ Other elements, like fees, commissions, contract expenses, and interests, may or may not be included in the purchase cost according to the entity's own costing methods.

- **In the case of self-creation:**

In some cases, the entity constructs a fixed asset with its own resources and for its own use. In this case, the following entries are recorded:

- ✓ Recording construction expenses when incurred:

Dr. A/c	Cr. A/c		Debit	Credit
		____________Date____________		
601		Raw materials and supplies consumed	Amounts of	
602		Other supplies consumed	expenses	
631		Employee salaries		
6xx		Other expenses		
	31	Raw materials and supplies		Amounts of
	32	Other supplies		expenses
	4xx/5xx	Method of payment		
		Record of construction expenses		

✓ Recording the receipt of a fixed asset upon completion of the construction process:

Dr. A/c	Cr. A/c		Debit	Credit
		____________Date____________		
20x		Intangible fixed asset	Construction	
21x		Tangible fixed asset	cost	
	731	Own work capitalized of intangible fixed assets		Construction
	732	Own work capitalized of tangible fixed assets		cost
		Receipt of a fixed asset		

In arriving at the gross cost of self-constructed fixed assets, the same principles apply as described in the case of a purchase. Included in the gross cost are the costs of materials and supplies consumed, as well as the costs that are attributable to the construction activity and can be allocated to a specific asset.

Administration expenses, overhead expenses, post-operating expenses, and initial operating losses should not be assigned to the cost of fixed assets (in the case of purchase or self-creation) because they do not relate to a specific fixed asset.

Functioning of Fixed Asset Accounts

- **Account 20 - Intangible fixed assets**

- **Account 203 - Research and development costs:** records applied research and development costs that may be considered as intangible assets. The recording is as follows:

1) **The first entry**: The expenses incurred by the entity related to research and development are recorded as regular expenses for the period by debiting expense accounts (Class 6) and crediting bank, cash accounts, or accounts payable, as follows:

Dr. A/c	Cr. A/c		Debit	Credit
6xx 	 40x\512\53	____________Date____________ Expenses Accounts payable, banks, cash Record of expenses	xxxx	 xxxx

2) **The second entry**: If these expenses meet the conditions specified in the Financial Accounting System to be considered intangible fixed assets, account 203 is debited by crediting account 731-Own work capitalized of intangible fixed assets.

Dr. A/c	Cr. A/c		Debit	Credit
203	 731	____________Date____________ Research and development costs Own work capitalized of intangible fixed assets Recognition of research and development costs	Cost	 Cost

When a patent is acquired as a result of research and development, account 205- Concessions and similar rights, patents, licenses, and trademarks is debited and account 203 is credited.

- **Account 204- Software and similar assets:** records the cost of purchase or creation of software.

✓ In the event of purchasing software, an entry is recorded as follows:

Dr. A/c	Cr. A/c		Debit	Credit
204 4456	 40x / 5xx	____________Date____________ Software and similar assets Deductible taxes on turnover Method of payment Purchase invoice	Purchase cost VAT	 Including tax

✓ If the software is self-created by the entity, two entries are recorded as follows:

Dr. A/c	Cr. A/c		Debit	Credit
6xx	 4xx/5xx	____________Date____________ Expenses Method of payment Record of creation expenses	xxxx	 xxxx
204	 731	____________Date ____________ Software and similar assets Own work capitalized of intangible fixed assets Development of software	creation cost	 creation cost

- **Account 205 -Concessions and similar rights, patents, licenses, and trademarks:** records the cost incurred to obtain the benefit of the protection granted to the holder of a concession, inventor, author, or beneficiary of the right to use a patent, license, trademark, process, or property rights.

- **Account 207 - Goodwill:** records the purchase of intangible elements of the acquired goodwill resulting from a business combination as part of an acquisition, merger, or consolidation. This account can be debit or credit and must, whatever its balance, appear on the balance sheet as a fixed asset.

Example

- Some transactions relating to ABC Company were as follows during 2022:

1. Purchased a patent for 40.000 DZD by check;
2. Purchased software worth 50.000 DZD on account (VAT = 19%)
3. To complete a research project, the Company paid engineer's fees of 30.000 DZD and non-inventory materials of 10.000 DZD, all in cash. These expenses were recognized as research and development expenses.

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
		_________01_________		
205		Patents	40.000	
	512	Bank account		40.000
		Purchase of a patent by check		
		_________02_________		
204		Software	50.000	
4456		Deductible taxes on turnover	9.500	
	404	Fixed asset supplier		59.500
		Purchase of software on account		
		_________03_________		
607		Non-inventory materials	30.000	
622		Agent commissions and fees	10.000	
	53	Cash		
		Record expenses		40.000
		_________//_________		
203		Research and development expenses	40.000	
	731	Own work capitalized of intangible fixed assets		40.000
		Recognition of research and development expenses		

- **Account 21- Tangible fixed assets**

Accounts of tangible fixed assets are debited, on the date the assets come under the control of the entity, as follows:

- **In the case of a contribution:**

Dr. A/c	Cr. A/c		Debit	Credit
		_____________Date_____________		
21x		Tangible fixed asset	contribution value	
	101/456	Share capital, or sole proprietor's capital\Partners - Capital transactions		contribution value
		Contribution of tangible fixed assets		

- **In the case of a purchase:**

Dr. A/c	Cr. A/c		Debit	Credit
		____________Date____________		
21x		Tangible fixed asset	Purchase cost	
4456		Deductible taxes on turnover	VAT	
	40x / 5xx	Method of payment		Including tax
		Purchases invoice		

- **In the case of self-creation**

Dr. A/c	Cr. A/c		Debit	Credit
		____________Date____________		
601		Raw materials and supplies consumed	Amounts of expenses	
602		Other supplies consumed		
631		Employee salaries		
6xx		Other expenses		
	31	Raw materials and supplies		Amounts of expenses
	32	Other supplies		
	4xx/5xx	Method of payment		
		Record of construction expenses		
		____________Date____________		
21x		Tangible fixed asset	Construction cost	
	732	Own work capitalized of tangible fixed assets		Construction cost
		Self-creation of a tangible fixed asset		

Example

- Some transactions of ABC Company were as follows:

1. Purchased returnable packaging worth 50.000 DZD, its transportation cost is 2.000 DZD, all on account (VAT = 19%).
2. The Company completed furniture for its own use, requiring raw materials from the warehouse worth 40.000 DZD and wages worth 50.000 DZD paid by check.

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
		_________01_________		
2186		Returnable packaging	52.000	
4456		Deductible taxes on turnover	9.880	
	404	Fixed asset supplier		61.880
		Purchase of packaging on account		
		_________02_________		
601		Raw materials consumed	40.000	
631		Employee salaries	50.000	
	31	Raw materials		40.000
	512	Bank account		50.000
		Record construction expenses		
		_________//_________		
2184		Furniture	90.000	
	732	Own work capitalized of tangible fixed assets		90.000
		Construction of furniture		

- **Account 22- Concession fixed assets**
  Intangible or tangible assets put into the concession by the grantor or the grantee are recorded in account 22 and are classified in the same way as those recorded in accounts 20 and 21. On the credit side, the counterpart of the value of the assets placed in the concession by the grantor is recorded in account 229-Grantor's rights, which appears on liabilities (non-current liability).
- **Account 26- Equity securities and receivables from equity securities:**
  This account records investments and loans to subsidiaries over which the company has minimal control. Account 26 brings together several divisional accounts; the most important are as follows:
  - ✓ equity securities;
  - ✓ other forms of participation;
  - ✓ receivables linked to participation;
  - ✓ the remaining payments to be made on unpaid equity securities.

✓ **Account 261 - Equity investments:** is debited with the contribution value by crediting account 101 - capital or account 456- partners - capital transactions, or with the acquisition cost by crediting account 404 - fixed asset suppliers or account 269 -remaining payments on unpaid equity securities or cash accounts.

Equity securities are valued at their entry value or contribution value, that is, what the company paid at the time of its investment. The acquisition cost is composed of:

- ✓ the purchase price
- ✓ directly attributable costs incurred to establish the asset

- **Account 27- Other financial fixed assets:**
  This account mainly brings together securities (shares) held in other companies, guarantee deposits, and loans to subsidiaries or employees.
  - ✓ **Account 274- Loans and receivables under finance lease contracts** correspond to funds paid to third parties under contractual provisions by which the entity undertakes to transfer to natural or legal persons the use of means of payment for a certain period of time.
  - ✓ **Account 275- Deposits and sureties paid** constitute amounts given to the owner by the tenant upon signing the rental contract. This amount is collected and will normally be reimbursed at the end of the contract. This is why it appears on the asset side of the balance sheet. It is an asset and not a charge, since it will be reimbursed. There are security deposits for office rents, for car rentals, etc.

Accounting for Fixed Assets in Progress

The purpose of account 23-Fixed assets in progress is to show the value of fixed assets not yet completed at the end of the financial year, as well as the advances and deposits paid by the entity to third parties with a view to acquiring a fixed asset. Fixed assets in progress are divided into two groups:

- ✓ fixed assets resulting from work entrusted to third parties;
- ✓ fixed assets created by the entity's own resources.

a) Fixed assets acquired from third parties:

Fixed assets whose construction is contracted out to third parties and which have not been completed at the end of the financial year are recorded in account **232** when they relate to the acquisition of an intangible fixed asset or account **237** when they relate to the acquisition of a tangible fixed asset on the basis of invoices or work reports provided by these third parties.

Dr. A/c	Cr. A/c		Debit	Credit
		____________12/31/N____________		
232		Intangible fixed asset in progress	cost	
237		Tangible fixed asset in progress	cost	
4456		Deductible taxes on turnover	VAT	Including tax
	40x / 5xx	Accounts payable, banks, cash…		
		Recognition of fixed assets in progress		

b) Fixed assets created by the entity's own resources:

After recording expenses in the corresponding Class 6 accounts in the first entry, in the second entry, the cost of fixed assets created by the entity's own resources and not completed at the end of the financial year is debited to account **232** intangible fixed assets in progress, or account **237** tangible fixed assets in progress by crediting account 73-Own work capitalized.

Dr. A/c	Cr. A/c		Debit	Credit
		____________ …/…/N____________		
601		Raw materials and supplies consumed	Amounts of expenses	
602		Other supplies consumed		
631		Employee salaries		
6xx		Other expenses		
	31	Raw materials and supplies		Amounts of expenses
	32	Other supplies		
	4xx/5xx	Method of payment		
		Record of construction expenses		
		____________12/31/N____________		
232		Intangible fixed asset in progress	Cost	
237		Tangible fixed asset in progress	Cost	
	731	Own work capitalized of intangible fixed assets		Cost
	732	Own work capitalized of tangible fixed assets		Cost
		Recognition of a fixed asset in progress		

c) Advances and deposits paid on orders for fixed assets:

Advances and installments paid to third parties as part of the acquisition of fixed assets are recorded in the debit of account 238- Advance payments on account on orders for fixed assets.

Dr. A/c	Cr. A/c		Debit	Credit
		___________Date___________		
238		Advance payments on account on orders for fixed assets	xxxx	
	5xx	banks, cash…		xxxx
		payment of advances		

Entities also have the option to record advances for fixed assets during the financial year in account 4091- Suppliers - advance payments on account on orders, but at the end of the year, this account is transferred to account 238 so that it appears on the balance sheet under the fixed asset section.

When the fixed asset is ready to be put into service, the amount recorded in account 23 should be transferred to account 20 or account 21.

a) In the case of fixed assets acquired from third parties:

Dr. A/c	Cr. A/c		Debit	Credit
		___________Date___________		
20x		Intangible fixed asset	Cost of	
21x		Tangible fixed asset	asset	
	232	Intangible fixed asset in progress		xxxx
	237	Tangible fixed asset in progress		xxxx
	238	Advance payments on account on orders for fixed assets		xxxx
	4xx/5xx	Accounts payable, banks, cash…		xxxx
		Completion of a fixed asset		

b) In the case of fixed assets created by the entity's own resources:

Dr. A/c	Cr. A/c		Debit	Credit
		___________Date___________		
20x		Intangible fixed asset	Cost of	
21x		Tangible fixed asset	asset	
	232	Intangible fixed asset in progress		xxxx
	237	Tangible fixed asset in progress		xxxx
	731	Own work capitalized of intangible fixed assets		xxxx
	732	Own work capitalized of tangible fixed assets		xxxx
		Completion of a fixed asset		

Bank of Questions and Exercises

1- Questions:

1. **A fixed asset is:**

a) A long-term source of financing;
b) An asset acquired for the purpose of selling;
c) Expected to generate cash flows in the short term;
d) An economic resource controlled by an entity as a result of past events.

2. **Classify the following items into intangible fixed assets, tangible fixed assets, or financial fixed assets:**

a) Loans and receivables under finance lease contracts;
b) Industrial tools;
c) Deposits and sureties paid;
d) Copyrights;
e) Roadways;
f) Specific installations;
g) Long-term securities other than portfolio investments;
h) Returnable packaging;
i) Trademarks.

3. **ABC Company purchased equipment and incurred the following costs:**

- Price: 100.000 DZD
- Deductible taxes on turnover: 19.000 DZD
- Initial operating losses: 2.000 DZD
- Installation and testing: 5.000 DZD
- Worker training expenses: 20.000 DZD

What amount should be recorded as the cost of the equipment?

a) 100.000 DZD
b) 119.000 DZD
c) 105.000 DZD
d) 146.000 DZD

4. **Indicate which of the following statements is true:**

a) A fixed asset in progress is an asset not yet completed at the end of the financial year.
b) Since intangible assets lack physical substance, they need not appear on the balance sheet.
c) A patent can arise from research and development expenses.
d) Negative goodwill appears on the balance sheet as a liability.

5. Which of the following statements is false?

a) An entity may record advances for fixed assets at the end of the financial year in account 4091.

b) At the end of the financial year, the balance of account 238 is transferred to account 4091.

c) The balance of account 237 should be transferred to account 21 when the tangible fixed asset is completed.

d) The value of intangible fixed assets not yet completed at the end of the financial year is recorded in the debit of account 231.

2- Exercises:

Exercise 1:

On May 6, 2023, Al-Quds Ltd. purchased an industrial machine. The following table contains items related to the purchase and use of this machine:

Items	Cost (DZD)
Cash price	1.000.000
Discount	10.000
Deductible taxes on turnover	188.100
Freight cost	5.000
Employee wages to test equipment	5.000
Costs of training employees to use the equipment	8.000
Overhead costs	20.000
Legal fees of the purchase contract	3.800
Insurance during the first year of operations	7.000
Employee wages to install equipment	7.500
Fees of an external technician to complete the final installation	4.800
Repair costs during the first year of operations	2.500
Materials consumed in the testing process	3.300

Required:

a) Determine the purchase cost of the equipment. Knowing that the company includes only the expenses directly related to the purchase process within the purchase cost.

b) Record the purchase transaction in the journal. Knowing that the cost of the machine and related expenses were paid by check.

Exercise 2:

- Below are some of the transactions carried out by Al-Badr Company during the year 2022:

1- Purchased software worth 20.000 DZD (VAT = 19%), software setup expenses worth 4.000 DZD, all paid by check;

2- Purchased land at a price of 500.000 DZD, with contract expenses worth 20.000 DZD, all paid with a bill note;
3- Completed new administrative buildings using own resources and for self-use required 40.000 DZD of raw materials, 4.000 DZD of consumable supplies, and 40.000 DZD of direct labor paid by check;
4- Imported of an industrial machine worth 1.000 € (exchange rate: 1 € = 160 DZD), import duties worth 48.000 DZD, testing expenses worth 2.000 DZD (duties and expenses were paid by check);
5- Paid the foreign supplier by check (exchange rate: 1 € = 159 DZD).

Required:

Record transactions in the journal according to the perpetual inventory system. Knowing that the company includes only the expenses directly related to the purchase process within the purchase cost.

Exercise 03:

- Al Salam Company carried out the following transactions during the year 2023:

1. Provided 50.000 DZD as long-term loans to workers by check;
2. To develop software for self-use, the company incurred engineer fees worth 10.000 DZD and non-inventory supplies worth 5.000 DZD, all paid by check (the software is not yet completed);
3. Agreed with a contractor to complete warehouses with a total cost of 500.000 DZD. It paid the contractor 20% of the cost as an advance by check.
4. Purchased industrial equipment from Tunisia on account: purchase price = 20.000 TND (exchange rate: 1 TND = 40 DZD), commercial discount: 2% of the purchase price.
5. Paid the supplier (transaction 4) by check (exchange rate: 1TND = 41 DZD).
6. To develop a new product, the company incurred 140.000 DZD, divided equally between subcontracting expenses and employee wages, all paid by check. These expenses have been capitalized into research and development expenses.
7. Research and development expenses were transformed into a patent for the product.
8. Received an invoice from the contractor showing the completion rate of warehouses at 60% of the total cost. (VAT = 19 %).

Required:

a) Record the above transactions in the journal according to the perpetual inventory method.

b) Record in the journal the following transactions that occurred during the year 2024:

1. Received the warehouses from the contractor and paid the remaining amount by check. (VAT = 19 %)
2. To complete the software, the Company incurred fees for testing and setup worth 5.000 DZD paid by check.

CHAPTER EIGHT: DEPRECIATION AND IMPAIRMENT LOSS

Chapter 08:

Depreciation and Impairment Loss

Learning objectives:

After completing this chapter, students should be able to:

LO1: Calculate the annual depreciation and record the appropriate entries.

LO2: Determine the amount of impairment loss and record the appropriate entries.

LO3: Account for the disposal of fixed assets.

Chapter contents:

1. **Concept of depreciation;**
2. **Straight-line depreciation**
3. **Impairment loss;**
4. **Disposal of fixed assets;**
5. **Bank of questions and exercises.**

Introduction

Fixed assets are expected to provide services to the entity for several years; for that reason, they generally decline in service potential over their useful lives. In the accounting context, when talking about the decline of asset value, the terms "depreciation" and "impairment" are frequently used. While these two concepts may seem similar at first glance, they significantly impact the value of fixed assets in different ways.

Depreciation and impairment are essential for management, as they affect their decisions regarding asset purchases for the entity. By knowing how to determine depreciation using different methods, management can make informed choices about when and how much money should be invested in new fixed assets. In this chapter, we try to answer some questions related to depreciation and impairment:

- ✓ What is depreciation, and why is it so important?
- ✓ How is depreciation calculated using different methods?
- ✓ When is an impairment loss on fixed assets recognized?
- ✓ How is the disposal of fixed assets accounted for?

Concept of Depreciation

1. What is Depreciation?

Depreciation is an accounting term that refers to the gradual decrease in asset value over time. In other words, depreciation is an accounting technique for allocating the cost of a fixed asset over its useful life in a systematic way. Through cost allocation, entities can correctly align revenues and expenses in accordance with the matching principle.

Therefore, depreciation corresponds to the consumption of the economic benefits associated with a tangible or intangible asset. On this basis, a set of key takeaways about depreciation can be drawn:

- ✓ Depreciation is applied to assets that are considered to be depreciable assets, whose usefulness to the entity and revenue-producing ability will decline over time.
- ✓ Depreciation does not apply to land because its usefulness and revenue-producing ability generally remain intact over time. In fact, in many cases, the value of land increases over time.

- ✓ Depreciation can be due to several raisons and ordinary factors that causes the asset's usefulness to decline, the most important of which is wear and tear, obsolescence.
- ✓ Wear and tear is the damage that is caused to assets when they are being used normally. For example, a machine that produces 100.000 units in its first year will produce less as the years pass.
- ✓ Obsolescence is the process of becoming out of date before the asset physically wears out. For example, computers are often replaced sooner than planned because improvements in new computing technology make older computers obsolete.
- ✓ Recognizing depreciation on an asset does not result in an accumulation of cash for the replacement of the asset. Which means depreciation is a non-cash expense and does not result in an outflow of cash.
- ✓ Depreciation shows the expense of using an asset over time and is not related to its physical condition.
- ✓ Deprecation is not a process of asset valuation. The book value (cost minus accumulated depreciation) of a fixed asset does not necessarily have to be equal to its fair value. In fact, if the asset is fully depreciated, it could have a zero-book value but still have a significant fair value.
- ✓ The term amortization typically refers to the depreciation of an intangible asset.
- ✓ The Financial Accounting System defines the useful life of some fixed assets, such as intangible assets, whose useful life is assumed not to exceed 20 years, except in some cases that must be justified in the notes of financial statements.

Annual depreciation is reported on the income statement as an expense. Accumulated depreciation is reported on the balance sheet as a deduction from fixed assets.

2. Elements of Depreciation

The depreciable amount is distributed systematically over the asset's useful life by taking into account three factors that affect the calculation of depreciation:

a) Cost: entities record fixed assets at cost, which includes all expenses necessary to acquire the asset and make it ready for intended use, in accordance with the historical cost principle.

b) **Useful life (service life):** it is defined as an estimate of the expected productive life of the asset or how long the asset is likely to remain in service and generate revenues. Useful life may be expressed in terms of time, units of activity (such as machine hours), or units of output. To estimate the useful life, the entity applies the period defined by the Financial Accounting System, depends on past experiences with similar assets, or considers other factors (like the asset's intended use, expected repair, and vulnerability to obsolescence).

c) **Residual value (salvage value):** is an estimate of the net value of an asset that an entity expects to obtain at the end of its useful life after deducting the expected costs of disposal. This value may be based on the asset's worth as scrap or on its expected trade-in value. Like useful life, residual value is an estimate, but it must be determined reliably. In making this estimate, the entity considers how it plans to dispose of the asset and its experience with similar assets.

The residual value is ignored if it cannot be reliably determined or if its amount is insignificant.

3. Methods of Depreciation

Depreciation methods reflect the evolution of the entity's consumption of the economic benefits of an asset. There are several methods of depreciation, and each method has its own advantages and disadvantages depending on the asset being depreciated.

- ✓ **Straight-line depreciation:** This method leads to splitting the value of an asset evenly over its useful life.
- ✓ **Declining-balance depreciation:** This method is used to depreciate more value immediately at the beginning of the asset's useful life and less value later.
- ✓ **Units of production depreciation:** This method is used to depreciate an asset based on how much work it does or can do. This method gives rise to a charge based on the anticipated use or production of the asset.
- ✓ **Progressive depreciation:** Unlike the declining-balance method, the depreciation charge increases from year to year.

All these methods are acceptable under the Financial Accounting System. The entity selects the method it believes to be appropriate and best measures an asset's contribution to revenues. Once an entity chooses a method, it should apply it consistently over the asset's useful life. If the entity cannot determine the evolution of economic benefit consumption reliably, it should adopt the straight-line method.

Straight-Line Depreciation

1. How to Calculate Straight-Line Depreciation?

The straight-line method predominates in practice. Most entities use this method because it is simple to apply. Under this method, entities expense the same amount of depreciation for each year of the asset's useful life. To compute depreciation expense, entities need to determine depreciable cost, i.e., the total amount subject to depreciation, which is equal to the cost of the asset less its residual value. The formula to calculate the depreciation of an asset using the straight-line method looks like this:

Depreciable cost = cost of the asset - residual value

Annual depreciation (value per year) = depreciable cost / useful life

Under the straight-line method, to determine annual depreciation expense, we divide the depreciable cost by the asset's useful life. The next example explains the computation of the annual depreciation expense:

Example

On January 1, 2020, ABC Company purchased a truck for 500.000 DZD. The expected residual value is 10.000 DZD, and the estimated useful life is 5 years.

Depreciable cost = Cost – Residual value

= 500.000 – 10.000

Depreciable cost = 490.000 DZD

Annual depreciation = Depreciable cost / Useful life

= 490.000 / 5

Annual depreciation = 98.000 DZD

Alternatively, an annual rate of depreciation can also be calculated. This rate is equal to 1/useful life. When an entity uses an annual straight-line rate, it applies the percentage rate to the depreciable cost of the asset.

If an entity begins using a fixed asset on any day other than January 1, it is necessary to prorate the annual depreciation on a time basis. Below is an example of how to prorate the annual depreciation using the depreciation rate:

Example

On March 22, 2019, an office bought software for 60.000 DZD. The residual value of the software is 900 DZD, and its useful life is 10 years.
Depreciable cost = Cost – Residual value
Depreciable cost = 60.000 – 900 = 59.100 DZD
Depreciation rate = 1/Useful life
Depreciation rate = 1/10 = 0.1
Annual depreciation = depreciable cost * depreciation rate
Annual depreciation = 59.100 * 0.1 = 5.910 DZD
Depreciation expense for 2019 = 59.100 * 0.1 * 9/12
Depreciation expense for 2019 = 4.432,5 DZD

2. Depreciation Schedule

The following table shows a general depreciation schedule using an annual rate:

Year	Depreciable Cost	Annual Depreciation	Accumulated Depreciation	Book Value*
N	= Cost – Residual Value	= Depreciable Cost * Depreciation Rate	=Accumulated Depreciation of N-1 + Annual Depreciation of N	=Depreciable Cost – Accumulated Depreciation
N+1	....	....	....	....
N+2	....	....	....	....
N+3	....	....	....	....
….	....	....	....	....
….	....	....	....	....
…..	....	....	Depreciable Cost	0

*An asset's book value, also known as carrying value, is the value of the asset net of accumulated depreciation (depreciable cost minus accumulated depreciation) and is reported in the balance sheet.

Note that the annual depreciation is the same each year. Accumulated depreciation increases over years until it equals the depreciable cost, while the book value decreases until it reaches zero value at the end of the asset's useful life.

Example

On January 2, 2016, ABC Company purchased returnable packaging for 200.000 DZD. It has a useful life of 4 years.
Depreciation rate = 1/4 = 0.25
Annual depreciation = 200.000 * 0.25 = 50.000 DZD
The depreciation schedule is as follows:

Year	Depreciable Cost	Annual Depreciation	Accumulated Depreciation	Book Value
2016	200.000	50.000	50.000	150.000
2017	200.000	50.000	100.000	100.00
2018	200.000	50.000	150.000	50.000
2019	200.000	50.000	200.000	0

3. Accounting for Depreciation

At the end of each year, entities record adjustment entries, including depreciation. Depreciation allocations are recorded as an expense in the debit of account 681- Depreciation, Amortization, Impairment and Provisions - fixed assets. On the other side, account 28 -Accumulated amortization and depreciation of fixed assets is credited. Account 28 is divided into sub-accounts in the same way as accounts 20 and 21.

Dr. A/c	Cr. A/c		Debit	Credit
681	28xx	____________12/31/N____________ Depreciation, amortization, impairment and provisions - fixed assets Accumulated amortization and depreciation of fixed assets Record of annual depreciation	Annual depreciation	Annual depreciation

Example

On May 6, 2022, ABC Company purchased a new machine costing 450.000 DZD. It has a useful life of 8 years.

Depreciable cost = 450.000 DZD

Depreciation rate = 1/8 = 0.125

Annual depreciation = 450.000 * 0.125= 56.250 DZD

Depreciation expense for 2022 = 450.000 * 0.125 * 8/12

Depreciation expense for 2022 = 37.500 DZD

The journal entry for the 2022 depreciation expense is as follows:

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
681	2815	_________12/31/2022_________ Depreciation - fixed assets Accumulated depreciation of industrial machinery Record of 2022 depreciation expense	37.500	37.500

Impairment Loss

1. Meaning of Impairment Loss

An impairment loss is the amount by which the book value (carrying amount) of an asset exceeds its recoverable value. The recoverable value of an asset is the higher value between its fair value less disposal costs (net selling price) and its value in use. Specific situations in which an asset might become impaired and unrecoverable include when a significant change occurs to the asset, for example, a damage or a decrease in demand for the asset, or adverse changes to legal factors that affect this asset.

If these types of situations arise, it's necessary to test for impairment. For example, a company may face extensive damage to its machinery due to a natural disaster. This will appear on its books as a sudden decline in the fair value of these assets below their book value.

2. Accounting for Impairment Loss

When a loss of value is observed, an impairment loss is recognized in an entry where account 681 is debited and account 29- Impairment losses of fixed assets is credited.

Dr. A/c	Cr. A/c		Debit	Credit
681 	 29xx	_____________12/31/N_____________ Depreciation, amortization, impairment and provisions - fixed assets Impairment losses of fixed assets Recognition of impairment losses	Amount of loss*	 Amount of loss

*The amount of loss = book value – recoverable value

Recoverable value is the highest of the net selling price and the value in use.

The impairment loss is adjusted at the end of each financial year:
- When impairment increases in already existing losses, account 29 is credited by debiting account 681.
- When impairment reduces, account 29 is debited, and account 781 - Operating reversal of impairment and provisions – fixed assets is credited.

The net amount of fixed assets, after deducting depreciation and impairment losses, appears in the balance sheet.

Example

ABC Company purchased a building many years ago at a historical cost of 2.000.000 DZD. At the end of 2023, it had accumulated 1.000.000 DZD in total depreciation.
An accident occurred in 2023 that caused significant damage to the building structure. The company determined that the situation required an impairment test.
After assessing the damage, ABC Company valued the building at only 900.000 DZD.
The book value in 2023 = 2.000.000 – 1.000.000 = 1.000.000 DZD.
The loss value = 1.000.000 – 900.000 = 100.000 DZD.
The journal entry for impairment loss in 2023 is as follows:

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
681 	 2913	_________12/31/2023_________ Impairment loss - fixed assets Impairment losses of constructions Recognition of impairment losses	100.000	 100.000

3. Differences between Depreciation and Impairment Loss

Depreciation and impairment are two common accounting terms that refer to the reduction in asset value over time. While they may seem similar, there are some key differences between these two concepts.

Depreciation is a gradual decrease in asset value due to wear and tear, obsolescence, or other usual factors. For example, equipment might depreciate over time as it becomes less efficient or outdated. Depreciation is calculated based on the useful life of an asset and its estimated residual value.

On the other hand, impairment occurs when there is a sudden drop in asset value due to external factors such as changes in market conditions or internal factors such as damage to the asset itself. Impairment can occur if an asset's book value exceeds its recoverable amount, which means that it will not be able to generate enough cash flow anymore.

Disposal of Fixed Assets

1. Methods of Disposal of a Fixed Asset

An entity could dispose of a fixed asset during its useful life or at the end of its useful life. In general, there are three ways in which an entity makes a fixed asset disposal:

- ✓ **Sale:** When a tangible or intangible asset is sold to another party, profits and losses from the sale of this asset are determined by the difference between the net disposal proceeds and the book value of the asset. These profits or losses are recognized as operating income or expense in the income statement.
- ✓ **Retirement:** Means that a fixed asset is scrapped or discarded. The tangible or intangible asset is eliminated from the balance sheet when it exits the entity or when the entity no longer expects any future economic benefit either from its use or its subsequent disposal.
- ✓ **Exchange:** When an entity changes a fixed asset with another and the transaction has "commercial substance," it records the asset acquired at its fair value (or, if that is not readily available, the fair value of the asset given up) and records a gain or loss on the exchange of fixed assets. An exchange has commercial substance if the future cash flows change as a result of the exchange.

2. Accounting for Sale of Fixed Assets

In this chapter, only the accounting for the sale of fixed assets is examined. In the case of sale before the end of the asset's useful life, the entity must determine the book value of the fixed asset at the disposal date to determine the gain or loss. But before that, it must record depreciation for the fraction of the year until the date of disposal if the disposal occurs before the end of the year.

- ✓ **Depreciation of the year N = depreciable cost * depreciation rate * n/12**

To determine the capital gain or loss to be recognized in the income statement, the entity compares the book value of the asset with the proceeds received from the sale as follows:

- ✓ **Accumulated depreciation until the disposal date = accumulated depreciation of N-1 + depreciation of N**

  Or
- ✓ **Accumulated depreciation until the disposal date = depreciable cost * depreciation rate * ∑n/12**
- ✓ **Book value of the asset = depreciable cost – accumulated depreciation – impairment losses**

If the proceeds of the sale exceed the book value of the asset, a gain on disposal occurs (this gain is recorded in the credit of account 752 -Capital gains on non-financial fixed assets). If the proceeds of the sale are less than the book value, a loss on disposal occurs (this loss is recorded in the debit of account 652 -Capital losses on non-financial fixed assets).

- ✓ **Capital gains/losses = proceeds of sale of the asset - book value of the asset**

Therefore, the accounting for sale of assets is made through two entries as follows:

Dr. A/c	Cr. A/c		Debit	Credit
		______________../../N____________		
681		Depreciation, amortization, impairment and provisions - fixed assets	Depreciation	
	28xx	Accumulated amortization and depreciation of fixed assets		Depreciation
		Recognition of depreciation expense		
		______________../../N____________		
404/512/ 53/..		Method of payment	Proceeds of sale	
28xx		Accumulated amortization and depreciation of fixed assets	Accumulated depreciation	
29xx		Impairment losses of fixed assets	Impairment loss	
652		Capital losses on non-financial fixed assets	Losses	
	20/21	Fixed asset		Depreciable cost
	752	Capital gains on non-financial fixed assets		Gains
		Disposal of fixed assets		

Example

On July 1, 2020, ABC Company sold furniture for 50.000 DZD in cash. This furniture was recorded at a historical cost of 150.000 DZD on January 1, 2018, with an estimated useful life of 5 years.

Depreciation rate = 1/5 = 0.2

Depreciation expense for 2020 = 150.000 * 0.2 * 6/12

Depreciation expense for 2020 = 15.000 DZD

The journal entry for the depreciation expense for 2020 is as follows:

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
		________07/01/2020_________		
681		Depreciation - fixed assets	15.000	
	2818	Accumulated depreciation of furniture		15.000
		Record of 2020 depreciation expense		

Accumulated depreciation = 150.000 * 0.2 * 30/12 = 75.000 DZD

The book value = 150.000 – 75.000 = 75.000 DZD

Gain or loss = 50.000 – 75.000

Loss = - 25.000 DZD

The journal entry for sale and loss on disposal of the furniture is as follows:

Dr. A/c	*Cr. A/c*		*Debit*	*Credit*
		________07/01/2020_________		
53		Cash	50.000	
2818		Accumulated depreciation of furniture	75.000	
652		Capital losses on non-financial fixed assets	25.000	150.000
	2184	Furniture		
		Sale of furniture in cash		

Bank of questions and exercises

1- Questions:

1. Which of the following statements is false?

a) Depreciation can occur as a result of an unusual event, such as a change in economic conditions or damage that impacts the asset.
b) Depreciation allows entities to systematically spread the cost of assets over several years.
c) There are many different depreciation methods; the most common is straight-line depreciation.
d) The straight-line method requires that the entity estimate a residual value at the end of the asset's useful life.

2. Which of the following statements is true?

a) If an intangible asset has an infinite life, it should be amortized.
b) The amortization period of an intangible asset can exceed 20 years.
c) Amortization is an amount computed at the end of the useful life of an intangible asset.
d) Amortization does not apply to brands because their usefulness generally remains intact over time.

3. The book value of an asset is equal to:

a) Asset's fair value less sale costs.
b) Asset's historical cost less its fair value.
c) Asset's depreciable cost less accumulated depreciation.
d) Asset's historical cost less residual value.

4. Impairment loss:

a) Can occur as the result of a usual event, such as wear and tear or obsolescence.
b) Should be tested regularly to prevent overstatement on the balance sheet.
c) Exists when an asset's book value is less than its fair value.
d) Is an expense in the current period that appears on the income statement and simultaneously reduces the value of the impaired asset on the balance sheet.

5. Equipment with a cost of 450.000 DZD has an estimated residual value of 30.000 DZD and an estimated life of 4 years. The depreciation method is the straight-line method. What is the amount of the annual depreciation?

a) 112.500 DZD.
b) 105.000 DZD.
c) 113.400 DZD.
d) 120.000 DZD.

6. A building has a cost of 900.000 DZD and an accumulated depreciation of 800.000 DZD. It is sold for 80.000 DZD. What is the amount of the gain or loss on disposal of this building?

a) 20.000 DZD loss.
b) 20.000 DZD gain.
c) 80.000 DZD loss.
d) 80.000 DZD gain.

7. An industrial machine that costs 144.000 DZD and has 120.000 DZD of accumulated depreciation. It is disposed of for 36.000 DZD in cash. The entry to record this event would include:

a) 12.000 DZD credit in the capital gain account.
b) 12.000 DZD debit in the capital loss account.
c) 36.000 DZD credit in the industrial machine account.
d) 120.000 DZD debit in the accumulated depreciation account.

2- Exercises:

Exercise 01:

- A student has prepared the following list of statements about depreciation and impairment loss:

✓ Depreciation is a process of asset valuation, not cost allocation.
✓ Depreciation provides for the proper matching of expenses with revenues.
✓ The book value of a fixed asset should approximate its fair value.
✓ Impairment loss applies to three classes of fixed assets: land, buildings, and equipment.
✓ Depreciation does not apply to a building because its usefulness and revenue-producing ability generally remain intact over time.
✓ The revenue-producing ability of a depreciable asset will decline due to wear and tear or obsolescence.
✓ Recognizing the depreciation of an asset results in the accumulation of cash for the asset replacement.
✓ The balance of accumulated depreciation represents the total cost that has been charged to expenses.
✓ Depreciation expenses and accumulated depreciation are reported on the income statement.
✓ Three factors affect the identification of impairment loss: cost, useful life, and residual value.

Required:

Identify each statement as true or false. If false, indicate how to correct the statement.

Exercise 02:

- On October 1, 2020, ABC Company purchased a new machine at a cost of 960.000 DZD. he company estimated 12.000 DZD as a residual value and 5 years as a useful life.

Required:

a) Calculate the annual depreciation under the straight-line method;
b) Prepare the depreciation schedule for the machine's useful life;
c) Record the journal entry for the 2020 depreciation expense.

Exercise 03:

- On January 1, 2018, Al-Quds Company purchased a truck for 360.000 DZD. The truck has an expected residual value of 6.000 DZD and an estimated useful life of 8 years. The depreciation method used is straight-line depreciation.
- On December 31, 2021, the company found some indicators stating that the situation of this truck qualifies for impairment testing. After assessing, the company determined the value of the truck is only 150.000 DZD.

Required:

a) Calculate the annual depreciation;
b) Determine the impairment loss of this truck on December 31, 2021;
c) Record the appropriate journal entries on December 31, 2021.
d) Prepare the depreciation schedule for this truck.

Exercise 04:

- On December 22, 2015, Al-Aqsa Company completed construction of an industrial building for 2.400.000 DZD. The company estimated that the building would have a useful life of 20 years.
- The recoverable value of this building at the end of 2020 was 1.500.000 DZD.
- On May 17, 2022, this building was sold for 1.100.000 DZD by check.

Required:

a) Calculate the annual depreciation;
b) Determine the impairment loss in 2020 and record the appropriate journal entries;
c) Record the journal entries for the sale of this building.

APPENDIX 1:

THE CHART OF ACCOUNTS

The Chart of Accounts

The Chart of Accounts (COA) is an index of accounts that an entity could use in the ledger arranged by category. Each account typically includes an identification code, name, and brief description to enable immediate identification of individual accounts. The Chart of Accounts exists in its official form in the Financial Accounting System, but the entity can extend the account numbers to suit the size and type of its business.

01 CLASS 1: EQUITY AND LIABILITIES

10 Capital, reserves, and similar

101 Issued capital, share capital, or sole proprietor's capital

103 Premiums related to share capital

104 Valuation difference

105 Revaluation difference

106 Reserves

- 1061 Legal reserves
- 1062 Regulated reserves
- 1063 Statutory or contractual reserves
- 1064 Ordinary reserves
- 1068 Other reserves

107 Difference in equity method

108 Sole proprietor account

109 Shareholders: subscribed uncalled capital

11 Retained earnings (debit or credit balance)

12 Profit or loss for the financial year

120 Profit for the financial year

129 Loss for the financial year

13 Deferred revenues and expenses – outside operating cycle

131 Equipment grants

132 Other investment grants

133 Deferred tax assets

134 Deferred tax liabilities

138 Other deferred income and expenses

15 Provisions for charges - non-current liabilities

153 Provisions for pensions and similar obligations

155 Provisions for taxes

156 Provisions for renewal of fixed assets (concession)

158 Other provisions for expenses - non-current liabilities

16 Loans and similar debts

161 Non-voting shares

162 Convertible debenture loans

163 Other debenture loans

164 Loans from lending institutions

165 Deposits and sureties received

167 Debts on finance lease contract

168 Other loans and similar debts

169 Debenture redemption premiums

17 Debts related to equity interests

171 Debts related to equity interests (Group)

172 Debts related to equity interests (non-Group)

173 Debts related to joint ventures

178 Other debts related to equity interests

18 Intra-entity transactions

181 Intra-entity transactions between establishments

188 Intra-entity transactions through a joint venture

02 CLASS 2: FIXED ASSETS

20 Intangible fixed assets
203 Research and development costs
204 Software and similar assets
205 Concessions and similar rights, patents, licenses, trademarks
207 Goodwill
208 Other intangible fixed assets

21 Tangible fixed assets
211 Land
212 Land fixtures and installations
213 Constructions
2131Buildings
21311 Industrial buildings
21315 Administrative and commercial buildings
21318 Other constructions
2136 Building installations, fittings, and fixtures
2137 Infrastructure works: roadways, railways…
215 Technical installations, industrial machinery, equipment and tools
2151 Specialized complex installations
2152 Specific installations
2154 Industrial machinery and equipment
2155 Industrial tools
2157 Fixtures and fittings for industrial machinery, equipment, and tools
218 Other tangible fixed assets
2182 Transport equipment
2183 Office equipment and computer hardware
2184 Furniture
2186 Returnable packaging

22 Concession fixed assets
221 Concession land
222 Concession land fixtures and installations
223 Concession constructions
225 Concession technical installations
228 Other concession fixed assets
229 Grantor's rights

23 Fixed assets in progress
232 Tangible fixed assets in progress
237 Intangible fixed assets in progress
238 Advance payments on account on orders for fixed assets

26 Equity securities and receivables from equity securities
261 Equity investments
262 Other types of equity securities
265 Equity securities valued by equity method
266 Receivables from equity securities (Group)
267 Receivables from equity securities (non-Group)
268 Receivables from joint ventures
269 Remaining payments on unpaid equity securities

27 Other financial fixed assets

271 Long-term securities other than portfolio investments
272 Securities representing debt rights (bonds)
273 Portfolio investments
274 Loans and receivables under finance lease contracts
275 Deposits and sureties paid
276 Other long-term receivables
279 Remaining payments on unpaid long-term securities

28 Depreciation of fixed assets

280 Depreciation of intangible fixed assets
2803 Depreciation of research and development costs
2804 Depreciation of software and similar
2805 Depreciation of concessions and similar rights, patents, licenses, trademarks
2808 Depreciation of other intangible fixed assets
281 Depreciation of tangible fixed assets
2812 Depreciation of land fixtures and installations
2813 Depreciation of constructions
2815 Depreciation of technical installations, industrial machinery, equipment, and tools
2818 Depreciation of other tangible fixed assets
282 Depreciation of concession fixed assets

29 Impairment losses of fixed assets

290 Impairment losses of intangible fixed assets
2903 Impairment losses of research and development costs
2904 Impairment losses of software and similar
2905 Impairment losses of concessions and similar rights, patents, licenses, trademarks
2907 Impairment losses of goodwill
2908 Impairment losses of other intangible fixed assets
291 Impairment losses of tangible assets
2912 Impairment losses of land fixtures and installations
2913 Impairment losses of constructions
2915 Impairment losses of technical installations, industrial machinery, equipment, and tools
2918 Impairment losses of other tangible fixed assets
292 Impairment losses of concession fixed assets
293 Impairment losses of fixed assets in progress
296 Impairment losses of equity interests and receivables from equity interests
297 Impairment losses of other long-term securities
298 Impairment losses of other financial fixed assets

03 CLASS 3: INVENTORY AND WORK IN PROGRESS

30 Inventory of goods for resale
31 Raw materials and supplies
32 Other supplies
321 Consumable materials
322 Consumable supplies
326 Packaging (non-recoverable)
33 Work in progress of goods
331 Goods in progress
335 Work in progress
34 Work in progress of services
341 Studies in progress
345 Services in progress
35 Inventory of goods
351 Intermediate goods
355 Finished goods
358 Residual goods or recovered materials (waste, scrap)
36 Inventory from fixed assets
37 Inventory outside
38 Stored Purchases
380 Purchases of goods
381 Purchases of raw materials and supplies
382 Purchases of other supplies
39 Impairment losses of inventory and work in progress
390 Impairment losses of inventory of goods for resale
391 Impairment losses of raw materials and supplies
392 Impairment losses of other supplies
393 Impairment losses of work in progress of goods
394 Impairment losses of work in progress of services
395 Impairment losses of inventory of goods
397 Impairment losses of inventory outside

04 CLASS 4: ACCOUNTS RECEIVABLE AND PAYABLE

40 Suppliers - Accounts payable and related accounts
401 Suppliers
403 Suppliers - Note payable
404 Fixed asset suppliers
405 Fixed asset suppliers- Note payable
408 Suppliers - Invoices not yet received
409 Suppliers with a debit balance
4091 Suppliers - Advance payments on account on orders
4096 Suppliers - Receivables for returnable packaging and equipment
4097 Suppliers - Other debit balance payables
4098 Allowances, discounts, rebates, and other credit notes not yet received
41 Customers - Accounts receivable and related accounts
411 Customers
413 Customers - Notes receivable
416 Customers - Doubtful accounts
417 Receivables for work or services in progress
418 Customers - Revenue not yet invoiced
419 Customers with a credit balance
4191 Customers - Advance payments on account received on orders
4196 Customers - Payables for returnable packaging and equipment
4197 Customers - Other credit balance receivables

4198 Allowances, discounts, rebates, and other credit notes to be issued

42 Employees and related accounts

421 Employees - Salaries payable
422 Social activities fund
423 Employee profit - sharing
425 Employees - Advance payments on account
426 Employees - Deposits
427 Employees - Allowable salary deductions
428 Employees - Accrued expenses and accrued income

43 Social agencies and related accounts

431 Social security
432 Other social agencies
438 Social agencies - Accrued expenses and accrued income

44 State and other public authorities and international organizations and related accounts

441 State and other public authorities - Grants receivable
442 State- taxes and duties collected from third parties
443 Specific transactions with the State and public authorities
444 State - Income taxes
445 State - Taxes on turnover
4455 Taxes payable on turnover
4456 Deductible taxes on turnover
4457 Taxes on turnover collected by the entity
4458 Taxes on turnover to settle or pending
446 International organizations
447 Other taxes, duties, and similar payments
448 State - Accrued expenses and accrued income

45 Group and partners

451 Group transactions
455 Partners - Current accounts
456 Partners - Capital transactions
457 Partners - Dividends payable
458 Partners - Joint ventures and group transactions

46 Sundry accounts receivable and payable

462 Receivables from sale of fixed assets
464 Payables on purchases of marketable securities and derivative financial instruments
465 Receivables from sales of marketable securities and derivative financial instruments
467 Other accounts receivable and payable
468 Sundry accrued expenses and accrued income

47 Suspense accounts

476 Expenses awaiting allocation
477 Revenues awaiting allocation

48 Prepaid expenses or deferred income and provisions

481 Provisions - Current liabilities
486 Prepaid expenses
487 Deferred income

49 Impairment losses of accounts receivable and payable

491 Impairment losses of trade receivables
495 Impairment losses of group and partner accounts
496 Impairment losses of sundry accounts receivable
498 Impairment losses of other receivables and payables

05 CLASS 5: CASH AND FINANCIAL INSTRUMENTS

50 Marketable securities
- 501 Shares in affiliated companies
- 502 Own shares
- 503 Other own shares and equity securities
- 506 Bonds, treasury bills, and short-term notes
- 508 Other marketable securities and similar receivables
- 509 Remaining payments on unpaid marketable securities

51 Banks, financial and similar institutions
- 511 Cash equivalents
- 512 Banks and current accounts
- 515 Treasury and public agency accounts
- 517 Other financial institutions
- 518 Accrued interest
- 519 Short term bank advances

52 Derivative financial instruments

53 Cash

54 Imprest accounts and letters of credit
- 541 Imprest accounts
- 542 Letters of credit

58 Internal transfers
- 581 Fund transfers
- 588 Other internal transfers

59 Impairment losses of current financial assets
- 591 Impairment losses of values in banks
- 594 Impairment losses of imprest accounts and letters of credit

06 CLASS 6: EXPENSES

60 Consumed purchases
- 600 Purchases of goods sold
- 601 Raw materials and supplies consumed
- 602 Other supplies consumed
- 603 Changes in inventory
- 604 Purchases of studies and services
- 605 Purchases of equipment, facilities, and works
- 607 Non-inventory materials and supplies
- 608 Ancillary purchase costs
- 609 Allowances, discounts, rebates received on purchases

61 External services
- 611 Subcontracting
- 613 Rent expenses
- 614 Occupancy costs and condominium fees
- 615 Maintenance and repairs
- 616 Insurance premiums
- 617 Study and research
- 618 Documentation and sundry
- 619 Allowances, discounts, rebates received on external services

62 Other external services
- 621 External employees
- 622 Agent commissions and fees
  - 6221 Commissions and brokerage fees for purchases
  - 6222 Commissions and brokerage fees for sales
  - 6224 Freight forwarding costs
  - 6226 Fees
  - 6227 Legal and litigation fees
  - 6228 Sundry

623 Advertising, publications, public relations
624 Transport of goods and collective transport of employees
625 Travel, assignments and entertainment expenses
626 Postage and telecommunication costs
627 Banking and similar services
628 Contributions and sundry
629 Allowances, discounts, rebates received on other external services

63 Payroll expenses

631 Employee salaries
634 Sole proprietor salary
635 Contributions to social security
637 Other social expenses
638 Other payroll expenses

64 Taxes, duties and similar payments

641 Taxes, duties and similar payments on payroll
642 Non-recoverable taxes and duties on turnover
645 Other taxes, duties (except income tax)

65 Other operating expenses

651 Royalties and license fees for concessions, patents, licenses, software, rights and similar assets
652 Capital losses on non - financial fixed assets
653 Attendance fees
654 Bad debts written off
655 Share of profit or loss from joint ventures
656 Fines and penalties, grants awarded, donations, gifts
657 Exceptional expenses from operating transactions
658 Sundry operating expenses

66 Financial expenses

661 Interest expenses
664 Loss on receivables from equity interests
665 Valuation differences on financial assets - Capital losses
666 Financial foreign exchange losses
667 Losses from sales of marketable securities
668 Other financial expenses
6680 Financial allowances given

67 Exceptional expenses

68 Depreciation, provisions and impairment

681 Depreciation, provisions and impairment - Fixed assets
682 Depreciation, provisions and impairment - Concession fixed assets
685 Depreciation, provisions and impairment - Current assets
686 Depreciation, provisions and impairment - Financial assets

69 Income taxes and similar taxes

692 Active deferred taxation
693 Passive deferred taxation
695 Taxes on profits based on the result of ordinary activities
698 Other income taxes

07 CLASS 7: REVENUES

70 Sales of goods for resale, manufactured goods, and services

700 Sales of goods for resale
701 Sales of finished goods
702 Sales of intermediate goods
703 Sales of residual goods
704 Sales of works
705 Sales of studies
706 Other services
708 Ancillary income
709 Sales allowances, discounts, rebates given

72 Changes in inventory of finished goods and work in progress

723 Changes in work in progress of goods
724 Changes in inventory of goods

73 Own work capitalized

731 Own work capitalized of intangible fixed assets
732 Own work capitalized of tangible fixed assets

74 Operating grants

741 Loss compensation grants
748 Other operating grants

75 Other operating income

751 Royalties and license fees for concessions, patents, licenses, software, rights, and similar assets
752 Capital gains on non-financial fixed assets
753 Attendance fees, directors and managers fees, and compensation
754 Share of investment grants transferred to income for the financial year
755 Share of profit or loss from joint ventures
756 Collection of bad debts written off
757 Exceptional income from operating transactions
758 Other exceptional income from operations

76 Financial income

761 Income from equity interests
762 Income from financial assets
763 Income from receivables
765 Valuation differences on financial assets - Capital gains
766 Financial foreign exchange gains
767 Net income from sales of marketable securities
768 Other financial income
7680 Financial allowances received

77 Exceptional income

78 Reversal of impairment and provisions

781 Operating reversal of impairment and provisions – Fixed assets
785 Operating reversal of impairment and provisions – Current assets
786 Financial reversal of impairment and provisions

APPENDIX 2:

GLOSSARY OF ACCOUNTING TERMS

Glossary of Accounting Terms

The vocabulary used in financial accounting is distinct and full of expressions with extremely specific meanings that generally deviate from common sense interpretations. The most relevant terms of financial accounting in its first part are covered in this section, with the aim of helping to explore accounting basic ideas as well as expanding understanding of accounting vocabulary frequently used in accounting offices and companies.

A	
Account (الحساب)	A formal record in the general ledger represents, in words and money, transactions that result in changes to resources and claims of an entity.
Accounts Payable (الذمم الدائنة)	Amounts owed to a creditor for goods received or services obtained.
Accounts Receivable (الذمم المدينة)	Uncollected amounts from a debtor, usually for goods delivered or services provided.
Accounting Changes (التغيرات المحاسبية)	Changes in an accounting principle or estimate that necessitate disclosure and explanation in notes to the financial statements.
Accounting Policies (السياسات المحاسبية)	Basic assumptions, fundamental principles, qualitative characteristics, and specific practices applied by an entity in preparing and presenting its financial statements.
Accrual Basis (أساس الاستحقاق)	An assumption states that transactions are recognized on the date of their occurrence, which means recognizing revenue when earned and expenses when incurred.
Accumulated Depreciation (الاهتلاك المتراكم)	The total of depreciation expenses pertaining to an asset or group of assets from the time the assets were placed in service until the date of the current financial statements.
Additional Paid in Capital (علاوة المساهمة)	Amounts paid for a share in excess of its par value or stated value; also, other amounts paid by stockholders and charged to equity accounts other than share capital.
Amortization (إهتلاك التثبيتات المعنوية)	Allocation of the cost of an intangible asset to expenses over its useful life in a systematic and rational manner.
Annual Report (التقارير السنوية)	Report to stockholders, which includes the company's annual, audited balance sheet and statements of income, changes in equity, and cash flows, as well as other financial and business information.
Acquisition cost/Purchase cost (تكلفة الشراء)	The purchase price resulting from the agreement of parties on the date of the transaction, less any trade discounts and similar items, plus import duties and other non-refundable taxes, plus costs directly attributable to obtaining control of the asset and preparing it for use.
Asset (أصل)	A resource controlled by an entity as a result of past events and from which it expects future economic benefits.
Audit (التدقيق)	Inspection of an entity’s accounting records and procedures. It is done by an auditor from within the entity (internal audit) or by an outsider (external audit) for the purpose of verifying the accuracy and completeness of records.

B	
Balance (الرصيد)	The difference between debit entries and credit entries in an account.
Balance Sheet (الميزانية)	A financial statement presents, at a specified date, the balances of an entity's assets, liabilities, and equity of its owners. Also known as the statement of financial position.
Book Value (القيمة المحاسبية الصافية)	Amount for which an asset is recognized in the balance sheet after deduction of accumulated depreciation and impairment losses.
C	
Capital (رأس المال)	The amount invested in a proprietorship, partnership, or corporation by owners. It is made in cash or in kind.
Capital Gain (فوائض القيمة)	A portion of the total gain recognized on the sale or exchange of a fixed asset.
Capitalized Costs (المصاريف المرسملة)	Costs incurred during the time necessary to bring an asset to the condition and location for its intended use and included as part of the historical cost of the asset.
Cash (النقدية)	Cash on hand and demand deposits.
Cash Flows (التدفقات النقدية)	Cash receipts and cash disbursements relating to a particular activity during a specified accounting period.
Chart of Accounts (مدونة الحسابات)	An accounting tool that provides a list of the account names an entity uses to label items in accounting books.
Combined Financial Statements (القوائم المالية المجمعة)	Financial statements comprise the accounts of two or more entities.
Comparability (قابلية المقارنة)	A qualitative characteristic that results from the permanence of the methods applied to prepare financial statements. This characteristic ensures users make meaningful comparisons over time and between entities.
Conservatism (الحيطة والحذر)	An accounting principle that means the consideration of a reasonable degree of precaution in exercising the judgments under conditions of uncertainty. Therefore, assets or revenues should not be overstated, and liabilities or expenses should not be undervalued.
Consistency (الثبات)	An accounting principle states that from one period to another, accounting policies must be applied in the same manner for the preparation and presentation of information to ensure the comparability of information over periods.
Consolidated Financial Statements (القوائم المالية الموحدة)	Combined financial statements of a parent company and one or more of its subsidiaries as one economic unit.

Control of an Asset (مراقبة أصل)	The power to obtain the future economic benefits related to an asset.
Cost (التكلفة)	Sum of all expenses necessary to acquire the asset and make it ready for its intended use.
Cost Accounting (المحاسبة التحليلية)	Procedures used for rationally classifying, recording, and allocating current or predicted costs that relate to a certain good or production process.
Credit (دائن)	Entry on the right side of a double-entry bookkeeping system represents the increase of liabilities and revenues or the decrease of assets and expenses.
Creditor (الدائن)	Party that loans money or other assets to the entity.
Current Asset (أصل متداول)	An asset that the entity expects to convert into cash, sell, or consume as part of its normal operating cycle or held primarily for trading purposes within twelve months following the end of the current financial year.
Current Cost (التكلفة الحالية)	The amount of cash that would have to be paid if the same or equivalent asset were acquired currently.
Current Liability (خصوم جارية)	An obligation that the entity expects to extinguish as part of its normal operating cycle, or payment of which must take place within twelve months following the closing date of the current financial year.
D	
Declining-Balance Method (الإهتلاك المتناقص)	Method that records greater depreciation than straight-line depreciation in the early years and less depreciation in the last years of an asset's useful life.
Debit (مدين)	Entry on the left side of a double-entry bookkeeping system represents the increase of assets and expenses or the decrease of liabilities and revenues.
Deferred Income (مداخيل مؤجلة)	Income received but not earned until all events have occurred. Deferred income is recorded as a liability.
Depreciation (اهتلاك)	Systematic distribution of the depreciable amount made for wear and tear or obsolescence on an asset over its estimated useful life, according to a depreciation plan and taking into account the probable residual value of the asset.
Disbursement (تسديد)	Payment by cash or check.
Disclosure (الإفصاح)	Process of divulging accounting information so that the content of financial statements could be understood.
Discount (تخفيض)	Reduction from the full amount of a price or debt.

Distributions (توزيع)	Items paid by an entity to its owners, such as cash, stocks, or earnings.
Double-Entry rule (قاعدة القيد المزدوج)	Method of recording accounting transactions in which each transaction is entered into two equal parties, debit and credit.
E	
Economic Entity (الوحدة المحاسبية)	The accounting entity is considered autonomous and distinct from the participants in its equity. The financial statements of the entity consider only the effects of its own transactions and events, not those of their owners.
Equity (الأموال الخاصة)	Residual interest of participants in equity in the assets of an entity after deducting its external liabilities.
Exemption (إعفاء)	Amount of a taxpayer's income that is not subject to tax.
Exchange Rate Difference (فرق سعر الصرف)	Difference arising from the conversion of a number of units of a foreign currency into the currency presented in the financial statements at different exchange rates.
Expenses (مصاريف)	Reductions in economic benefits during the financial year in the form of consumption, outflows, reductions in assets, or incurrence of liabilities.
Extraordinary Elements (العناصر الاستثنائية)	Revenues or expenses resulting from exceptional circumstances and corresponding to cases of force majeure, such as expropriation or an unforeseeable natural disaster.
F	
Fair Value (القيمة العادلة)	Price at which property would change hands between well-informed, consenting parties acting under normal competitive conditions without any compulsion to buy or sell.
Faithful Presentation/ Reliability (التمثيل الصادق)	A qualitative characteristic means that financial statements are able to provide relevant information, are free from significant error and bias, and can be trusted by users to present a true and fair view of what they assume to present.
Financial Accounting (المحاسبة المالية)	An activity based on recording and summarizing transactions to produce information used in decision-making by interested parties.
Financial Accounting System (النظام المحاسبي المالي)	A set of principles, agreements, and rules derived from the International Accounting Standards that regulate the financial accounting activities of entities subject to their application in accordance with the provisions of the law in Algeria.

Financial Fixed Assets **(التثبيتات المالية)**	A debt whose settlement must take place within a period of more than one year, or a security or similar value that the entity has decided to keep for more than one financial year.
Financial Statements **(القوائم المالية)**	A complete and inseparable set of accounting and financial documents provides a presentation of the financial position, performance, and changes in the entity's position at a point in time and its results of operations for a period that then ended. They include the balance sheet, income statement, statement of cash flow, statement of changes in equity, and notes.
Financial Year **(السنة المالية)**	Period of 12 consecutive months chosen by an entity as its accounting period, which may or may not be a calendar year.
Fixed Asset / Non-current assets **(الأصول الثابتة/التثبيتات)**	An asset that is intended to be used continuously for the needs of the entity's activities, such as tangible, intangible, or financial assets that are held for long-term investment purposes, or that the entity does not intend to realize within twelve months following the close of its financial year.
Forecast **(تقديرات)**	Prospective financial statements that represents an entity's expected financial position, results of operations, and cash flows.
Franchise **(ترخيص)**	Legal arrangement whereby the owner of a trade name, the franchiser, contracts with a party that wants to use the name on a non-exclusive basis to sell goods or services, the franchisee.
G	
GAAP (Generally accepted accounting principles) **(المبادئ المحاسبية المقبولة عموما)**	A recognized common set of accounting principles, standards, and procedures. They are a combination of accepted methods of doing accounting and authoritative standards set by policy boards.
General Ledger **(دفتر الأستاذ)**	A book of accounts that collects asset, liability, expense, and revenue items of an entity.
Going Concern **(استمرارية الاستغلال)**	Normal situation of an entity under which it is presumed that it has neither the intention nor the need to terminate or to reduce significantly its activities in the foreseeable future.
Goodwill **(فارق الاقتناء)**	An intangible asset that is associated with the purchase of one entity by another. Specifically, it represents the excess of the acquisition cost over the acquirer's interest in the fair value of identifiable assets less assumed liabilities on the date of the transaction.

H	
Historical Cost (التكلفة التاريخية)	A fundamental principle in accounting that is used in the reporting of assets. It means the price paid to acquire an asset on the date of its acquisition or production.
I	
Impairment Loss (خسائر القيمة)	The amount by which the book value of an asset exceeds its recoverable amount.
Income Statement (قائمة الدخل)	A financial statement that summarizes expenses and revenues generated by the entity and also shows whether the entity is making profit or loss for a given period.
Independence of Periods (استقلالية الدورات)	An accounting principle states that the net income of one period is independent of what precedes it and what follows it.
Insolvency (إعسار)	When an entity's liabilities exceed its assets.
Installment (قسط)	One of the portions, usually equal, into which a debt is divided for payment at specified intervals over a fixed period.
Intangible Fixed Asset (تثبيتات معنوية)	A non-monetary asset, identifiable and without physical substance, held by an entity for the production, supply of goods or services, rental, or use for administrative purposes.
International Accounting Standards (IAS/IFRS) (المعايير المحاسبية الدولية)	Set of globally accepted accounting standards for the preparation and presentation of financial statements. It was originally issued under the name of International Accounting Standards (IAS) and was later replaced by the International Financial Reporting Standards (IFRS), but the principles and concepts of IAS continue to be relevant in the context of IFRS.
Inventory (مخزون)	Tangible assets held for sale in the normal course of business, or materials and supplies used in a production process or provision of services.
Investment (استثمار)	Expenditure used to purchase goods or services that could produce a return to the investor.
J	
Joint Venture (مشروع مشترك)	When two or more persons or entities gather capital to provide a product or service. Often carried out as a partnership.
L	
Lease Contract (عقد إيجار)	Agreement by which the lessor transfers to the lessee, for a specified period, the right to use an asset in exchange for a payment or series of payments.

Liability (خصم)	Debts or obligations owed by the entity (the debtor) to another entity (the creditor) resulting from past events (payable in money, goods, or services).
Limited Liability Company (LLC) (شركة ذات مسؤولية محدودة)	Form of doing business that prevents owners (members) from being liable for the entity's financial losses and debt liabilities.
Liquidation (تصفية)	Winding up an activity by distributing its assets to the appropriate parties and settling its debts.
Loss (خسارة)	Excess of expenses over revenues for a period or activity.
M	
Management Accounting (محاسبة إدارية)	Reporting designed to assist management in decision-making, planning, and control. Also known as Managerial Accounting.
Market Value (القيمة السوقية)	Amount that can be obtained for the sale of an investment security in an active market or the amount to be paid for its acquisition.
Materiality (الأهمية النسبية)	Information is material if it is significant, i.e., omission or misstatement of information in financial statements could impact economic decisions made by users.
Matching Principle (مبدأ المقابلة)	It involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from one period.
N	
Net Financial Position (المركز المالي الصافي)	The net worth of the entity, i.e., the excess of assets over external liabilities (current and non-current liabilities).
Net Selling Price (سعر البيع الصافي)	The amount that can be obtained from the sale of an asset in a transaction between knowledgeable and willing parties, minus exit costs.
Net Sales (صافي المبيعات)	The sum of an entity's gross sales less any adjustments for returns, allowances, or discounts taken.
Neutrality (الحياد)	Accounting information should not be subject to bias or lead to biased data and predetermined results.
Non-Compensation (عدم المقاصة)	Offsetting between assets and liabilities on the balance sheet, or between expenses and revenues on the income statement, is not permitted, except in cases where it is imposed or authorized by the Financial Accounting System.
Non-Current Liabilities (الخصوم غير الجارية)	Debts owed by an entity that must be paid within at least 12 months. Also called long-term liabilities.

Non-Profit Organization (المنظمات غير الربحية)	An incorporated organization that exists for educational or charitable purposes and from which its shareholders or trustees do not aim to benefit financially.
Notes to the Financial Statements (الملاحق)	A set of additional information, explanations, or comments of significant importance and useful to users about the basis of financial statement preparation, the specific accounting methods used, and other documents supplementing the financial statements.
O	
Operating Cycle (دورة الاستغلال)	Period of time between the acquisition of raw materials, goods, and services involved in the manufacturing process and the final cash collection resulting from sales.
P	
Partnership (شراكة)	Organizational legal structure that includes an arrangement where parties, known as partners, agree to cooperate to carry on a trade or business for profit and share the resulting profits or losses.
Periodic Inventory (الجرد المتناوب)	System of inventory in which updates are made on a periodic basis. Under this system, the entity physically counts its inventories at the end of the period and uses the information to balance the general ledger.
Perpetual Inventory (الجرد الدائم)	System that requires a continuous follow and record of all receipts and withdrawals of each item of inventory.
Physical Inventory (الجرد المادي)	Set of operations consisting of recording, in nature, quantity, and value, all the assets and liabilities of the entity based on physical checks, at least once every twelve months (generally at the end of the financial year).
Present Value (القيمة الحالية)	Current estimate of the present value of future cash flows in the normal course of business discounted at a given rate.
Presentation Currency (عملة العرض)	The currency that used to present amounts in financial statements.
Production Cost (تكلفة الإنتاج)	Cost of consumable materials and services used in the production of an asset, increased by other costs incurred by the entity during production processes to bring this asset to the state and to the location intended, that is, the direct costs and the indirect costs reasonably attributable to the production of the asset.
Profit or Loss for the Financial Year (Net Income) (نتيجة الدورة)	The difference between the total revenues and the total expenses for one financial year. It corresponds to a profit in the event of an excess of revenues over expenses and to a loss otherwise.

Promissory Note (كمبيالة)	Evidence of a debt with a specific amount due. The note may specify a maturity date, or it may be payable on demand.
Provision for Charges (مؤونة الأعباء)	Liability whose maturity or amount is uncertain.
R	
Recoverable Value (القيمة القابلة للتحصيل)	The higher value between the net selling price of an asset and its value in use.
Recognition (الاعتراف)	Process that consists of incorporating into the balance sheet or income statement an element meeting the definitions and recognition criteria.
Relevance (الملائمة)	A qualitative characteristic means that information can influence users' decisions by helping them evaluate past, present, and future events or by confirming or correcting their past evaluations.
Research and Development (R&D) (مصاريف البحث والتطوير)	Research is an original and planned activity undertaken with the aim of acquiring new scientific or technical knowledge in the hope of developing new or improved products and services. Development is the application of research findings into a plan or design for the production of new or substantially improved products and services.
Reserves (الاحتياطات)	Shares of net profits retained by the entity.
Residual Value (القيمة المتبقية)	The amount an entity expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.
Revenues/Income (مداخيل)	Increases in economic benefits during the financial year in the form of inflows, increases in assets, or decreases in liabilities. These revenues include, for example, sales of goods and services; earnings from interest, dividend, and rents.
S	
Security (سند)	Any kind of transferable certificate of ownership, including equity securities and debt securities.
Sole Proprietorship (مؤسسة فردية)	An unincorporated business run solely by one individual called the sole proprietor.
Solvency (الملاءة المالية)	Longer-term cash availability to meet financial commitments when they come due.
Statement of Cash Flows (قائمة التدفقات النقدية)	One of the basic financial statements that categorizes net cash provided or used during a period as operating, investing, and financing activities and reconciles beginning and ending cash and cash equivalents.

Statement of Changes in Equity (قائمة التغيرات في حقوق الملكية)	A financial statement that measures the changes in owners' equity throughout a specific accounting period. Also called the statement of retained earnings.
Straight-Line Depreciation (الاهتلاك الخطي)	The simplest method for calculating depreciation. Under this method, the same amount of depreciation expense is deducted from the value of an asset over its useful life.
Substance over Form (تفوق الحقيقة الاقتصادية على الشكل القانوني)	A principle states that transactions and other events are recognized and presented in the financial statements in accordance with their substance and their economic reality, not only with their legal form.
T	
Tangible Fixed Assets (التثبيتات العينية)	Assets with a physical existence that are held for production, supply of goods or services, rental, or use for administrative purposes and which it expects to use for more than one year.
V	
Valuation (التقييم)	The process of determining the monetary amounts at which financial statement items are recognized and reported on the balance sheet and income statement.
Value in Use (القيمة النفعية)	Present value of estimated future cash flows expected from the continued use of an asset and its disposal at the end of its useful life.
U	
Understandability (قابلية الفهم)	A qualitative characteristic states that information is easily comprehensible by any user having a reasonable knowledge of economic activities and accounting and having the willingness to study the information in a reasonably diligent manner.
Useful Life (المدة النفعية)	The period during which the entity expects to use a depreciable asset or the number of production units or similar units that the entity expects to obtain from the relevant asset.

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