Peoples Democratic Republic For Algeria
Ministry of Higher Education
and Scientific Research
University of Continuig Education Didouche Mourad

Financial Accounting 01 :

Lessons and activity

Lectures for First Year Students
of Bachelor of Accounting and Finance Semester 01

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Specialization in economic sciences

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Ministerial Program for the Financial Accounting Module

Subject of the course material: Financial Accounting
Teaching unit: Core (Fundamental)
Credit value: 4
Coefficient: 2

Objectives of the course material:
To provide mastery of the basic principles of general accounting, including the control of asset and liability accounts, bookkeeping, and the preparation of financial statements.

Prerequisite knowledge required:
Some general principles of mathematics, statistics, and management.

Annual content of the module as defined by the curriculum of the Ministry of Higher Education and Scientific Research:

- The conceptual accounting framework of financial accounting.
- Study of account operations: Class 1 (Equity accounts), Class 2 (Fixed assets), Class 3 (Inventory and current accounts), Class 4 (Third-party accounts), Class 5 (Financial accounts).
- Study of management accounts: Class 6 (Expenses), Class 7 (Revenues).
- Study of the presentation and preparation of financial statements: Balance sheet, Income statement, Cash flow statement, Statement of changes in equity.
- Accounting treatment of company incorporation operations.
- Accounting treatment of purchasing and sales operations, commercial discounts, and value-added tax.
- Accounting treatment of commercial papers and packaging accounts.
- Year-end accounting procedures.

Required period: First-year L.M.D.

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Preface

Financial accounting is one of the fundamental pillars of business sciences. It provides the necessary tools and techniques to record, classify, and communicate financial information in a reliable and systematic way. The purpose of this course handout is to guide undergraduate students through the essential concepts of financial accounting and to develop both their theoretical understanding and practical application skills.

This pedagogical material has been structured to combine lectures and activities. Each chapter introduces the theoretical content, followed by an activity or exercise designed to reinforce learning through practice. In this way, students will not only acquire knowledge but also learn how to apply it in real-life accounting situations.

The content of this handout covers the following main areas:

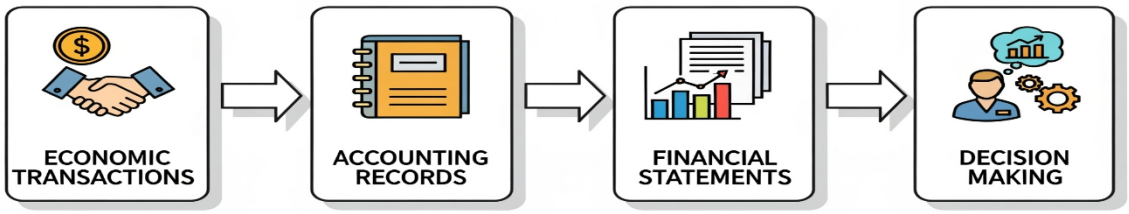
- An introduction to the science of accounting and its importance in economic life.
- Basic concepts such as economic flows, accounts, accounting documents, and the accounting cycle.
- Accounting books and financial statements.
- Practical applications including company incorporation, equity accounts, value added tax (VAT), fixed assets, and inventories.

Each chapter contains clear explanations, examples, and guided activities to make the learning process more interactive and student-centered. The activities are designed to simulate real accounting tasks, such as recording journal entries, preparing trial balances, calculating depreciation, or evaluating inventories.

This handout can be used as a main reference for the "Financial Accounting 01" module, but it is also complemented by general exercises and case studies provided at the end, to ensure a comprehensive understanding of the subject matter.

Finally, it is important to highlight that accounting is not only about recording numbers; it is about providing useful and reliable financial information for decision-making. By the end of this course, students are expected to be able to analyze, interpret, and prepare basic financial information in accordance with accounting principles.

THE ROLE OF ACCOUNTING IN BUSINESS



Chapter One: Introduction to Financial Accounting

1.1 Definition of Accounting

Definition:

Accounting is not merely a mechanical act of recording transactions, but a **systematic and comprehensive process** that involves identifying, recording, classifying, summarizing, interpreting, and reporting financial activities of an organization. Through this process, accounting provides **reliable and relevant information** to a wide range of users, including managers, investors, creditors, and regulators, in order to support effective decision-making[1].

Moreover, accounting is often referred to as the **"language of business"**, since it translates economic events into structured reports. These reports—such as the balance sheet, income statement, cash flow statement, and statement of changes in equity—offer an overall picture of an entity's financial health, performance, and sustainability[2].

From a broader perspective, accounting plays a dual role:

1. **Stewardship** – ensuring accountability and resource management.
2. **Decision-usefulness** – providing information that helps users forecast future cash flows and evaluate management efficiency[3].

Key Terms

In accounting and financial reporting, certain key terms provide the conceptual foundation for understanding the processes and objectives of the discipline. The following terms are fundamental:

1. Process

A **process** refers to a systematic, step-by-step sequence of activities designed to achieve a specific outcome. In accounting, the process involves a chain of stages such as identifying transactions, recording them, posting to ledgers, and preparing financial statements.

- **Example:** The accounting cycle itself is a process that begins with analyzing transactions and ends with preparing post-closing trial balances.
- **Significance:** Viewing accounting as a process highlights its structured and organized nature, ensuring reliability and consistency in financial information.

2. Financial Transactions

A **financial transaction** is any business activity that results in a measurable change in the financial position of an entity, expressed in monetary terms.

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[1] هورنجرن، تشارلز. ت، ساندیم، جاري. ل، وإليوت، جون. أ. (المحاسبة المالية: مقدمة)، ترجمة: مركز البحوث، دار المريخ للنشر، الرياض، 2018، ص. 25.

[2] Kieso, D. E., Weygandt, J. J., & Kimmel, P. D. (2019). *Financial Accounting: Tools for Business Decision Making* (9th ed.). Wiley, p. 40.

[3] IFRS Foundation. (2021). *Conceptual Framework for Financial Reporting*. IFRS Foundation, London, p. 12.

- **Examples:** Purchasing raw materials, paying salaries, selling goods, or receiving a bank loan.
- **Significance:** Only activities that can be measured in monetary units are recorded in the accounting system, in line with the **Monetary Unit Assumption**.

3. Systematic Recording

Systematic recording refers to the consistent and organized documentation of financial transactions according to established accounting principles and standards.

- **Example:** Recording sales invoices daily in the sales journal, then posting them to the ledger.
- **Significance:** This ensures completeness, accuracy, and comparability of financial data across periods, forming the basis for transparency in reporting.

4. Decision-Making

In accounting, **decision-making** refers to the process by which stakeholders—such as managers, investors, creditors, and regulators—use financial information to make informed judgments.

- **Example:** Investors use profitability ratios to decide whether to buy shares; managers use cost data to control expenses.
- **Significance:** High-quality accounting information enhances decision-making, supports strategic planning, and ensures accountability.

These key terms—**process, financial transactions, systematic recording, and decision-making**—illustrate the essence of accounting as both a technical discipline and a decision-support system. They highlight the dual role of accounting: as a structured process of recording data and as a tool for guiding economic and business decisions.[1]

Example:
When a company **sells products for cash**, accounting records:

- **Debit:** Cash account (money coming in).
- **Credit:** Sales account (revenue earned).

This allows the company to **track its income** and **understand cash flows** accurately.

1.2 Origin and Development of Accounting

Definition and Historical Background:

The practice of accounting has **ancient roots**. Its origins can be traced back to early civilizations such as Mesopotamia and Ancient Egypt (around 3000 B.C.), where people recorded agricultural production, tax collection, and trade transactions on clay tablets and papyrus

[1] عبد الحميد، السيد، *مبادئ المحاسبة المالية*، دار وائل للنشر، عمّان، 2014، ص. 189.

scrolls. These primitive forms of record-keeping aimed to control resources and manage wealth effectively[1].

Luca Pacioli and the Birth of Modern Accounting:

The modern foundation of accounting is attributed to **Luca Pacioli**, an Italian mathematician and Franciscan friar, who in 1494 published his famous book *"Summa de Arithmetica, Geometria, Proportioni et Proportionalità."* In this work, Pacioli formalized the **double-entry bookkeeping system**, introducing the principle that:

"For every debit, there must be a corresponding credit."

This innovation revolutionized financial record-keeping and laid the groundwork for modern accounting practices[2].

Evolution of Accounting Over the Centuries:

- **Ancient Period (3000 B.C. – 15th century):**

  Early civilizations such as Mesopotamia, Egypt, Greece, and Rome developed **primitive record-keeping systems**. Clay tablets and papyrus scrolls were used to record agricultural yields, tax collections, and trade transactions. These records served primarily as **tools for resource control and wealth management**, rather than for decision-making as in modern times [3].

- **15th Century:**

  The publication of *Summa de Arithmetica* by **Luca Pacioli** in 1494 formalized the **double-entry bookkeeping system**. This principle ensured accuracy and balance in financial records and marked the **transition from informal record-keeping to systematic accounting[4]**.

- **19th Century:**

  With the rise of large-scale manufacturing and industrial enterprises, the complexity of business operations increased dramatically. This led to the need for **detailed cost accounting** to monitor efficiency, allocate resources, and measure profitability. Accounting became a tool not only for external reporting but also for **internal management control[5]**.

- **20th Century:**

  The growth of corporations, expansion of stock markets, and **international trade** demanded greater transparency and comparability of financial statements. This period saw the creation of **national accounting standards** and the later emergence of

[1] الدسوقي، أحمد(*تاريخ الفكر المحاسبي*)، دار الفكر الجامعي، الإسكندرية، 2015، ص. 17.

[2] Sangster, A. (2016). *Luca Pacioli: The Father of Accounting*. Routledge, London, p. 45.

[3] المرجع السابق ،الدسوقي، أحمد.

[4] Sangster, A. (2016). *Luca Pacioli: The Father of Accounting*. Routledge, London, p. 45.

[5] الدهشان، محمود .*(المحاسبة المالية: مدخل معاصر)*، دار وائل للنشر، عمان، 2018، ص. 39.

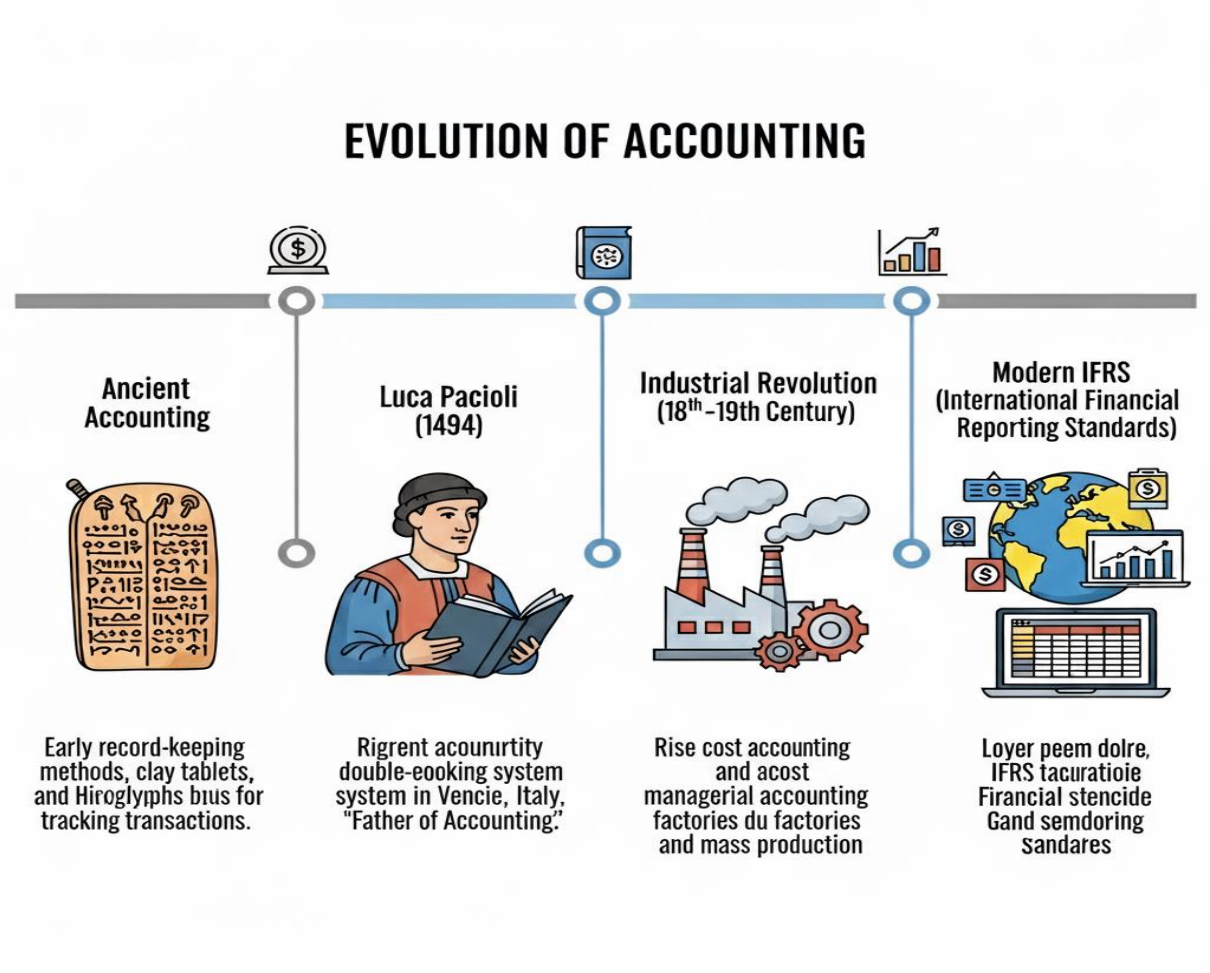
International Accounting Standards (IAS), which aimed to harmonize practices globally[1].

- **21st Century:**

  Modern accounting is characterized by **globalization and technological transformation**. The widespread adoption of **International Financial Reporting Standards (IFRS)** has promoted consistency across jurisdictions. At the same time, digital tools, **ERP systems, big data analytics, and artificial intelligence** have revolutionized how accountants record, analyze, and report information, making accounting a **strategic function in corporate governance**[2].

Key Insight:

Accounting has evolved from a **simple record-keeping tool** to a **global financial information system** that supports **decision-making**, **investment analysis**, and **corporate governance**.



[1] المرجع السابق،الدهشان، محمود.

[2] Nobes, C., & Parker, R. (2020). *Comparative International Accounting* (14th ed.). Pearson Education, London, p. 30.

1.3 Objectives of Financial Accounting

Definition:

Financial accounting aims to **collect, record, summarize, and present** financial data in a structured manner, in order to provide relevant and reliable information for a wide range of users—including investors, managers, creditors, regulators, and governments—to support effective decision-making[1].

Main Objectives:

1. **Systematic Recording of Financial Transactions**
    - All business transactions are recorded **chronologically** and **accurately** using standardized accounting principles.
    - This ensures that no financial activity is **omitted**, **duplicated**, or **misrepresented**.
2. **Preparation of Financial Statements**
    - Financial accounting produces essential reports, mainly:
        - **Balance Sheet** → shows the company's **financial position** (assets, liabilities, equity).
        - **Income Statement** → presents **revenues, expenses, and profit or loss** over a period.
        - **Cash Flow Statement** → details **inflows and outflows of cash** to monitor liquidity.[2]
3. **Providing Reliable Information for Decision-Making**
    - Different stakeholders—shareholders, managers, creditors, and state authorities—depend on accurate accounting information for strategic and operational decisions.
    - Reliability and relevance of data help reduce uncertainty and improve the quality of financial planning[3].
4. **Ensuring Compliance with Laws and Standards**
    - Accounting ensures businesses comply with **legal obligations, taxation systems, and international standards** such as the International Financial Reporting Standards (IFRS).
    - This guarantees comparability and transparency of financial reporting across firms and countries.

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[1] أبو نصار، أحمد. *(المحاسبة المالية: مدخل نظري وتطبيقي)*، دار اليازوري العلمية، عمان، 2017، ص. 44.

[2] Kieso, D. E., Weygandt, J. J., & Warfield, T. D. (2020). *Intermediate Accounting* (17th ed.). Wiley, p. 65.

[3] هلال، علي محمد. *(المحاسبة المالية وفق المعايير الدولية لإعداد التقارير المالية)*، دار وائل للنشر، عمان، 2019، ص. 53.

5. **Measuring Business Performance**
    - Accounting evaluates whether a company is making **profits or losses**, how effectively it uses its **resources**, and its overall **financial health** over a given period. [1]

Example:
At the **end of the fiscal year**, a company prepares its **Income Statement**:

- If **revenues > expenses** → the company made a **profit**.
- If **expenses > revenues** → the company incurred a **loss**.

This information helps managers decide whether to **expand operations**, **reduce costs**, or **adjust pricing strategies**.

1.4 Importance of Accounting

Definition:
Accounting is often referred to as the **"language of business"** because it translates an organization's financial activities into **structured, standardized, and meaningful information**. This information is not only understandable and comparable but also **reliable and relevant** for various stakeholders, including investors, managers, employees, creditors, governments, and the public[2].

Importance of Financial Accounting:

1. **Supporting Decision-Making**

   Accounting provides managers and business owners with accurate data that enable them to plan, control, and evaluate operations. For example, investment decisions, cost-reduction strategies, and pricing policies all rely on accounting reports[3].

2. **Ensuring Transparency and Accountability**

   By disclosing the financial position and performance of the business through financial statements, accounting promotes **trust** among shareholders, creditors, and potential investors. It also ensures that managers are accountable for the resources under their control.

3. **Assisting Governments and Regulatory Bodies**

   Governments depend on accounting information for **tax collection, economic planning, and financial regulation**. Accurate accounting reduces tax evasion and enhances the efficiency of public finance[4].

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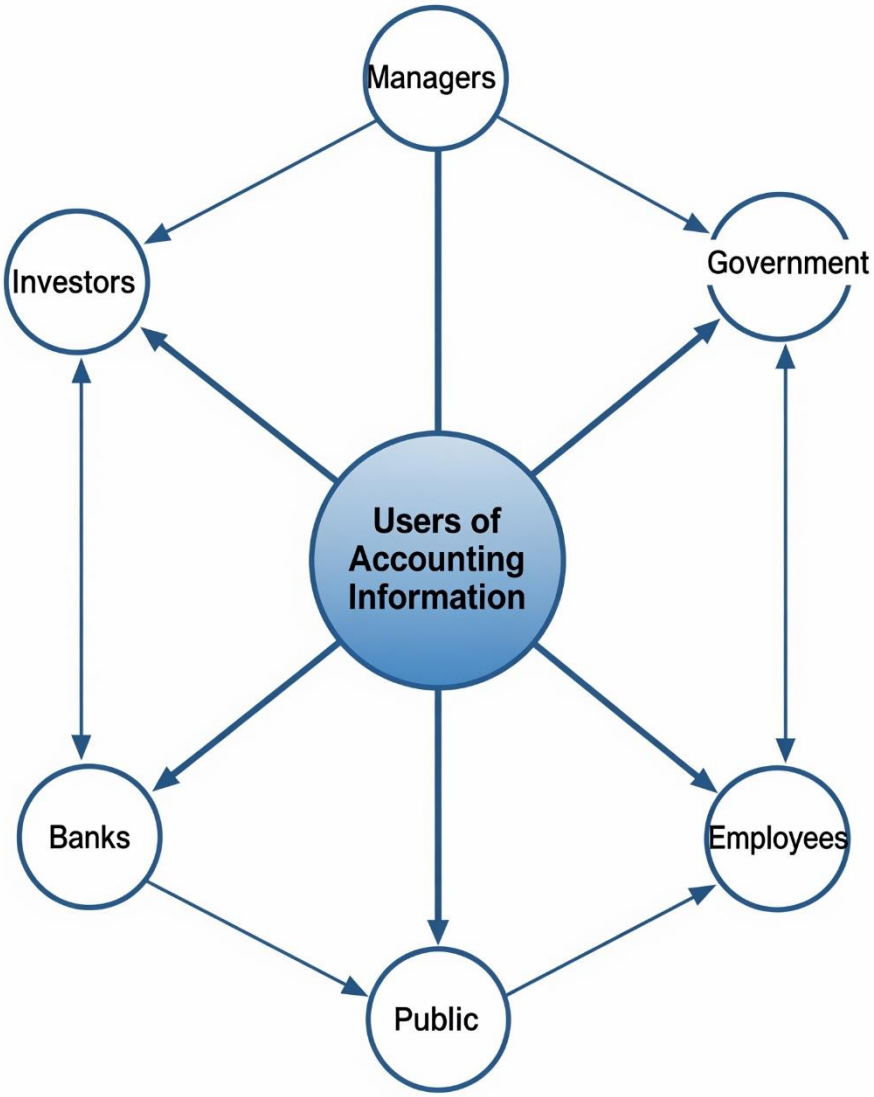
[1] Horngren, C. T., Sundem, G. L., Elliott, J. A., & Philbrick, D. (2019). *Introduction to Financial Accounting* (12th ed.). Pearson, p. 28.

[2] المرجع السابق، أبو نصر، أحمد، ص. 58.

[3] Kimmel, P. D., Weygandt, J. J., & Kieso, D. E. (2020). *Accounting: Tools for Business Decision Making* (9th ed.). Wiley, p. 22.

[4] المرجع السابق، هلال، علي محمد، ص. 65.

4. **Facilitating Performance Comparison**
    - Accounting enables the comparison of a company's performance:
        - **Over time** → by comparing financial results across different years.
        - **Across companies** → by using standardized accounting principles and reports.
5. **Acting as the "Language of Business"**
    - Accounting serves as a **common communication tool** between the organization and external parties such as **banks**, **investors**, **creditors**, **employees**, and the **public**.



1.5 Accounting Assumptions and Principles

Definition:

Financial accounting is grounded in a set of **basic assumptions** and **generally accepted principles** (GAAP) that provide the framework for recording, summarizing, and reporting financial transactions. These assumptions and principles ensure that financial statements are **consistent, comparable, reliable, and objective**, thereby making them useful for decision-making by different stakeholders[1].

A. Basic Accounting Assumptions

The accounting framework rests on a set of basic assumptions that ensure consistency, comparability, and reliability of financial information. These assumptions, though implicit, provide the foundation upon which accounting principles and standards are developed:

1. Business Entity Assumption

The **business entity assumption** dictates that the activities of a business are treated as separate and distinct from those of its owners or other businesses. This separation ensures that only business-related transactions are recorded in the entity's accounts, while personal transactions of the owner remain outside the scope of business records.

- **Example:** If the owner of a company purchases a personal vehicle, this transaction is not recorded in the company's financial records. Only assets, liabilities, income, and expenses related to the company itself are included.
- **Significance:** This principle enhances the accuracy of financial reporting by preventing the mixing of private and business transactions. It also protects stakeholders' interests by ensuring transparency regarding the business's true financial position.[2]

2. Going Concern Assumption

The **going concern assumption** presumes that a business will continue its operations into the foreseeable future, without the intention or necessity of liquidation. This assumption underlies the valuation of assets and liabilities.

- **Example:** A company records its machinery at historical cost less accumulated depreciation, assuming it will continue to use the machine in production rather than selling it at liquidation value.
- **Significance:** This principle allows the use of accrual accounting and the deferral of certain costs (e.g., prepaid expenses, deferred revenues). If evidence exists that the entity is no longer a going concern (e.g., bankruptcy), financial statements must be prepared on a liquidation basis, in compliance with **IAS 1 – Presentation of Financial Statements**.[3]

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[1] المرجع السابق، أبو نصر، أحمد، ص. 72.

[2] عبد الحميد، السيد، *مبادئ المحاسبة المالية*، دار وائل للنشر، عمّان، 2014، ص. 201.

[3] كيزو، دونالد، ويغانت، جيري، ووارفيلد، تيري، *المحاسبة المتوسطة*، Wiley، 2020، ص. 143.

3. Monetary Unit Assumption

The **monetary unit assumption** requires that all business transactions be expressed in terms of a single, stable monetary unit (such as the dollar, euro, or Algerian dinar).

- **Example:** If a machine was purchased in 2010 for $50,000, it continues to be reported at this historical amount, regardless of inflation or changes in purchasing power.
- **Significance:** This assumption provides a common denominator for recording and reporting financial information, which makes financial statements understandable and comparable. However, it ignores the effects of inflation unless adjusted for under specific standards (e.g., **IAS 29 – Financial Reporting in Hyperinflationary Economies**)[1].

4. Accounting Period Assumption

The **accounting period assumption** states that the life of a business can be divided into specific and equal time intervals for the purpose of reporting financial performance and position. Common intervals include monthly, quarterly, or annually.

- **Example:** Companies prepare annual financial statements at the end of each fiscal year to present their results and financial position to stakeholders. Interim reports (quarterly or semi-annual) may also be required for listed companies under IFRS.
- **Significance:** This assumption allows businesses to evaluate performance periodically, facilitates comparison across periods, and supports timely decision-making by investors, creditors, and managers.[2]

These four basic assumptions—**Business Entity, Going Concern, Monetary Unit, and Accounting Period**—constitute the foundation of modern accounting systems. They ensure the consistency, relevance, and reliability of financial reporting, whether under national systems like the SCF in Algeria or international standards such as IFRS. Their application provides confidence to users of financial statements and strengthens the credibility of the accounting profession.[3]

B. Basic Accounting Principles

The **basic accounting principles** provide the foundation for preparing and presenting reliable, relevant, and comparable financial information. These principles, though evolving with the introduction of International Financial Reporting Standards (IFRS), remain crucial for maintaining consistency and credibility in accounting practices.

1. Historical Cost Principle

The **historical cost principle** requires that assets be recorded and reported at their original purchase price, rather than their current fair market value.

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[1] نوبس، كريستوفر، وباركر، روبرت، *المحاسبة الدولية المقارنة*، Pearson، 2020، ص. 188.
[2] ميغز، والتر، وميغز، روبرت، *المحاسبة: أساس لاتخاذ القرارات التجارية*، McGraw-Hill، 2017، ص. 210.
[3] هورنجرن، تشارلز، *المحاسبة المالية: مقدمة*، Pearson، 2019، ص. 85.

- **Example:** If a company purchases machinery for 1,000,000 DZD, the asset remains recorded at that amount in the balance sheet, regardless of fluctuations in its market value.
- **Significance:** This principle provides objectivity and verifiability since historical cost is based on actual transactions. However, it may reduce relevance when there are significant changes in market value or inflation, which is why IFRS sometimes requires fair value measurement (e.g., IAS 16 for property, plant and equipment; IFRS 13 for fair value measurement).[1]

2. Revenue Recognition Principle

The **revenue recognition principle** states that revenue should be recognized when it is earned and realizable, regardless of when cash is actually received.

- **Example:** If goods are delivered in December but payment is received in January, the revenue is recorded in December, as this is when it was earned.
- **Significance:** This principle supports the accrual basis of accounting and ensures that financial performance is measured accurately within each period. Under **IFRS 15 – Revenue from Contracts with Customers**, revenue is recognized based on the transfer of control of goods or services, not merely on cash collection[2].

3. Matching Principle

The **matching principle** requires that expenses be recognized in the same period as the revenues they help generate. This ensures that reported profits reflect true economic performance.

- **Example:** Salaries paid in January for work done in December must be recorded as December expenses, since they contributed to revenues earned in that month.
- **Significance:** This principle ensures that net income is not overstated or understated. It underpins the accrual accounting system and is critical in preparing the income statement. For example, depreciation expenses are matched with the revenues generated by the use of fixed assets.[3]

4. Full Disclosure Principle

The **full disclosure principle** requires that all relevant financial information be presented in the financial statements and accompanying notes to ensure stakeholders are not misled.

- **Example:** Contingent liabilities, pending lawsuits, or significant accounting policies must be disclosed in the notes to financial statements, even if they are not recorded as actual figures in the accounts.

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[1] عبد العزيز، محمد، *نظرية المحاسبة*، دار الجامعة الجديدة، الإسكندرية، 2016، ص. 145.
[2] كيزو، دونالد، ويغانت، جيري، وكيمل، بول، *المحاسبة المالية: أدوات لاتخاذ القرارات التجارية*، Wiley، 2019، ص. 225.
[3] أبو قحف، عبد السلام، *المحاسبة المالية: مدخل متكامل*، دار الجامعة الجديدة، الإسكندرية، 2015، ص. 221.

- **Significance:** This principle enhances transparency and helps investors, creditors, and regulators make informed decisions. Under **IAS 1 – Presentation of Financial Statements**, entities are required to provide adequate disclosures that fairly present their financial position and performance.[1]

These principles—**historical cost, revenue recognition, matching, and full disclosure**—form the bedrock of modern accounting. They ensure that financial information is accurate, consistent, and useful for decision-making. While IFRS and SCF have introduced refinements (such as fair value accounting), the underlying principles remain vital in guiding accountants and ensuring trust in financial reporting.[2]

- *Example:* If the company faces a **lawsuit**, this must be mentioned in the **notes** to the financial statements.

Category	Assumptions	Principles
Definition	Fundamental ideas about how accounting works	Rules guiding how transactions are recorded
Examples	Business Entity, Going Concern, Monetary Unit, Accounting Period	Historical Cost, Revenue Recognition, Matching, Full Disclosure
Purpose	Provide the **context** for accounting	Provide the **rules** for applying accounting
Focus	**What we assume** about the business	**How we record** and report transactions

[1] نوبس، كريستوفر، وباركر، روبرت، *المحاسبة الدولية المقارنة*، Pearson، 2020، ص. 236.
[2] هورنجرن، تشارلز، *المحاسبة المالية: مقدمة*، Pearson، 2019، ص. 112.

Activity 1: General Introduction to Accounting

Instructions:

Answer the following questions to test your understanding of the basic concepts of **financial accounting**.

1. Define "Accounting" in Your Own Words (2–3 sentences)

Explain what accounting means, focusing on its **purpose** and **function** in business.

2. List Three Users of Financial Accounting Information and Explain Why They Need It

Identify any three users (e.g., investors, managers, government, creditors, employees, banks) and briefly explain how they use accounting information.

3. Give a Short Example of a Financial Transaction and Explain How It Would Be Recorded

Describe a simple transaction, specify the **accounts affected**, and indicate whether they are **debited** or **credited**.

4. Match the Following Principles with Their Correct Definition

Principle	Definition
1. Revenue Recognition	A. Expenses must be linked to revenues.
2. Matching	B. Assets are recorded at purchase cost.
3. Historical Cost	C. Record revenue when it is earned.
4. Full Disclosure	D. All relevant financial information should be disclosed.

Chapter Two: Basic Concepts in Financial Accounting

2.1 Economic Flows and Transactions

Definition:

An **economic flow** refers to any movement of resources—whether **money, goods, or services**—that has a direct or indirect impact on the financial position of a business. These flows represent the fundamental financial activities that occur **inside or outside the company**, and they are essential for understanding how resources are **generated, allocated, consumed, or exchanged** within the economic system[1].

Such flows form the **basis of accounting records**, as every transaction reflects a change either in assets, liabilities, or equity. For example, the sale of finished goods not only increases revenue but also reduces inventory, while the payment of salaries decreases cash and recognizes expenses. Thus, identifying and measuring these flows is crucial for producing financial statements that are **reliable, comparable, and useful** for decision-making[2].

In modern accounting, economic flows are always analyzed according to the **duality principle**, meaning that each transaction affects the business in at least two ways (e.g., purchasing equipment increases fixed assets but decreases cash). This dual impact ensures balance in the accounting system and provides a clear picture of the company's financial dynamics[3].

A. Types of Economic Flows

1. Internal Economic Flows

- These are transactions that **occur within the company** and **do not involve external parties**.
- They represent the **use** or **transformation** of resources internally.
- **Examples:**
  - Depreciation of machinery → reduces the **book value** of assets.
  - Consumption of raw materials during production → decreases inventory but increases production costs.

2. External Economic Flows

- These are transactions between the company and **external parties** such as customers, suppliers, banks, and employees.
- They represent the **exchange** of resources with the outside environment.
- **Examples:**
  - Selling finished products to customers → increases **revenue** and **cash** (or accounts receivable).

[1] المرجع السابق، أبو نصر، أحمد، ص. 98.
[2] المرجع السابق، هلال، علي محمد، ص. 105.
[3] المرجع السابق، Horngren, C. T. وآخرون، ص. 78.

- Purchasing raw materials from suppliers → increases **inventory** but reduces **cash** or creates **liabilities**.
- Paying employee salaries → decreases **cash** and records **expenses**.

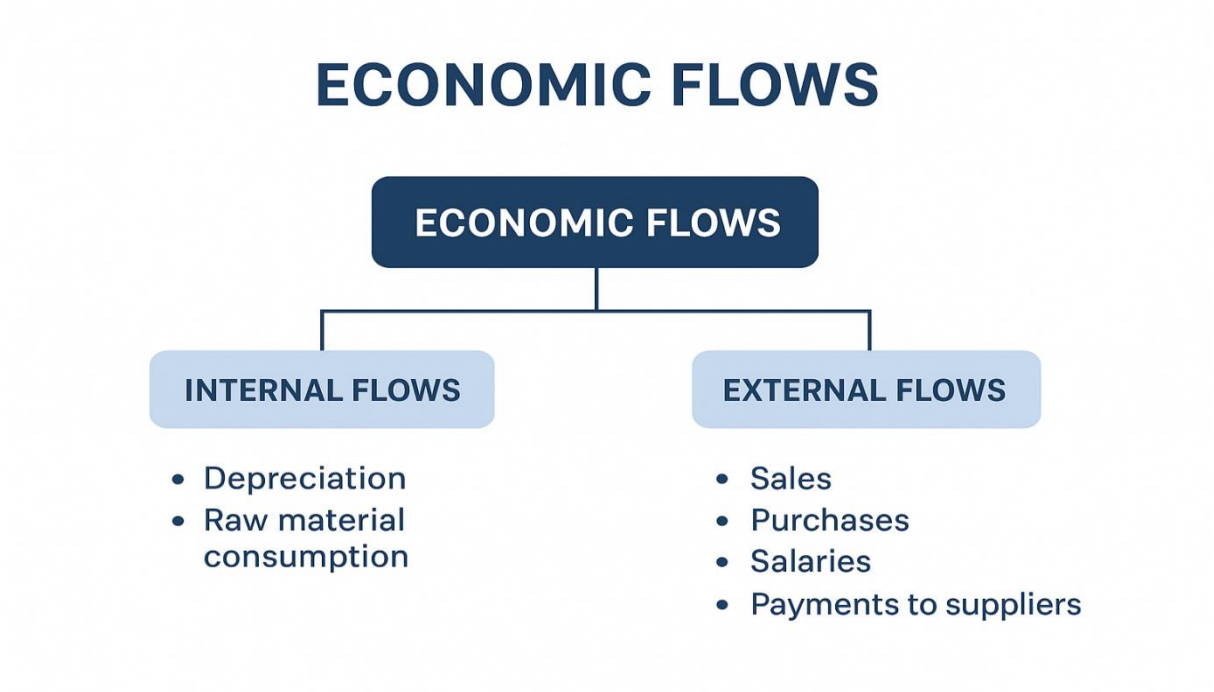
B. Definition of a Transaction

A **transaction** is any financial event that has a **monetary impact** on a company's assets, liabilities, or equity. In other words, if an event is measurable in monetary terms and affects the financial statements, it is considered a transaction[1].

Examples:

- **Buying raw materials for cash →**
  - **Debit:** Inventory (asset increases).
  - **Credit:** Cash (asset decreases).
- **Paying employee salaries →**
  - **Debit:** Salaries Expense (cost increases).
  - **Credit:** Cash (asset decreases).

Transactions form the **foundation of accounting records**, as each one represents an **economic flow** that must be captured according to the **duality principle** (every debit has a corresponding credit). This ensures the balance and reliability of financial statements[2].



[1] المرجع السابق، Kieso, D. E., Weygandt, J. J., & Warfield, T. D.، ص. 130.
[2] المرجع السابق، Horngren, C. T. وآخرون، ص. 85.

2.2 The Account and the Double-Entry System

A. The Account

Definition:
An **account** is a structured record within the accounting system that is used to **classify, accumulate, and summarize** the effects of financial transactions on a particular element, such as **Cash, Sales, Purchases, or Equipment**. Each account provides a detailed history of changes in a specific asset, liability, equity, revenue, or expense category over time[1].

Each account has **two sides**:

- **Debit (Dr)** → On the **left side** of the account.
- **Credit (Cr)** → On the **right side** of the account.

Purpose:
Accounts are designed to:

- Track **increases and decreases** in different elements of financial statements.
- Provide a **classification system** that organizes transactions into meaningful categories (e.g., separating Cash from Accounts Receivable).
- Form the basis for preparing **trial balances and financial statements**.

B. The Double-Entry System

The **double-entry system** is the **foundation of modern accounting**. It requires that every transaction must affect at least **two accounts**, with the total amount debited equal to the total amount credited. This principle ensures that the **accounting equation (Assets = Liabilities + Equity)** always remains in balance[2].

Key Characteristics

1. **Dual Aspect Principle**
    - Every economic transaction has a **twofold effect**: one on the debit side and another on the credit side.
    - *Example:* Purchasing equipment for cash decreases Cash (Credit) but increases Equipment (Debit).
2. **Balance Maintenance**
    - The equality of **total debits and total credits** guarantees that financial statements remain internally consistent and accurate.

[1] المرجع السابق، أبو نصر، أحمد، ص. 135.
[2] المرجع السابق، أبو نصر، أحمد، ص. 140.

3. **Universal Application**
    - The double-entry system is applied to **all types of transactions**: assets, liabilities, equity, revenues, and expenses[1].

Basic Rule:

"For every debit, there is an equal credit".

Implications:

- Total **Debits = Credits** in every transaction.
- This maintains the **balance** of the accounting equation:

Assets = Liabilities + Owner's Equity

C. Example

Transaction:
A company **purchases raw materials** for **200,000 DZD** in cash.

Journal Entry:

- **Debit:** Purchases → **200,000 DZD** *(increase in expenses)*
- **Credit:** Cash → **200,000 DZD** *(decrease in assets)*

D. Visual Representation: T-Accounts

Purchases Account	
Debit (Dr)	*Credit (Cr)*
200,000 DZD (Purchase)	
Cash Account	
Debit (Dr)	*Credit (Cr)*
	200,000 DZD (Payment)

This shows that **purchasing goods** increases the **Purchases account** (on the debit side) and **reduces Cash** (on the credit side).

E. Key Takeaways

- **Accounts** summarize the effect of transactions.
- **Double-entry** ensures **accuracy and balance**.
- **Debits and credits** are **equal in every transaction**.

[1] المرجع السابق، هلال، علي محمد، ص. 147.

2.3 Accounting Documents (Journal, Ledger, Trial Balance)

1. Journal (Book of Original Entry)

Definition

The **Journal** is the **book of original entry** where all financial transactions of a business are recorded **chronologically (by date)**. Each entry shows the **date of the transaction, the accounts affected, the amounts debited and credited, and a brief explanation**. The journal thus serves as the **first stage** in the accounting cycle, providing a systematic record of all business activities[1].

Purpose and Importance

- **Chronological Record**
  The journal preserves a **day-to-day record** of all financial activities, which ensures that no transaction is omitted or overlooked.
- **Double-Entry Recording**
  Every journal entry applies the **debit-credit principle**, ensuring that the accounting equation remains balanced[2].
- **Basis for Posting to the Ledger**
  Transactions recorded in the journal are later **posted to ledger accounts**, where they are classified and summarized for financial reporting.
- **Audit Trail**
  The journal provides documentary evidence of transactions, serving as a **reference for auditors and regulators**.

Each journal entry must include:

- **Date** of the transaction.
- **Accounts** involved (debit & credit).
- **Amounts** for debit and credit.
- **Explanation** of the transaction.

Format of a Journal Entry:

Date	Debit Account	Debit (DZD)	Credit Account	Credit (DZD)	Explanation
01/03	Office Supplies	70,000	Cash	70,000	Purchase of supplies for cash

Key Point: The **journal** is called the **Book of Original Entry** because all accounting records start here.

[1] المرجع السابق، أبو نصر، أحمد، ص. 165.
[2] المرجع السابق، هلال، علي محمد، ص. 172.

2. Ledger (Book of Accounts)

Definition

The **Ledger** represents the **second stage in the accounting process**, often called the **Book of Accounts** or the **Book of Final Entry**. It is in the ledger that all journal entries are **classified and posted** to their respective accounts, showing the **debit and credit movements** separately. This classification provides a clear picture of how each transaction affects the company's financial position[1].

Example: Posting the above journal entry to the ledger:

Office Supplies Account

Date	Description	Debit (DZD)	Credit (DZD)	Balance (DZD)
01/03	Purchase in cash	70,000		70,000

Cash Account

Date	Description	Debit (DZD)	Credit (DZD)	Balance (DZD)
01/03	Payment for supplies		**70,000**	**(70,000)**

Key Point: The ledger **classifies and summarizes** the information recorded in the journal, showing **account balances** clearly.

3. Trial Balance

Definition

The **Trial Balance** is a list of all accounts and their respective **debit or credit balances** after transactions have been posted to the ledger. It is usually prepared at the end of an accounting period to ensure that the total debits equal the total credits, thereby verifying the **arithmetical accuracy** of the bookkeeping process[2].

It is prepared to:

- **Check mathematical accuracy** (i.e., Debits = Credits).
- Ensure data integrity before preparing **financial statements**.

Example :

Suppose the ledger of a company shows the following balances at year-end:

- Cash: Debit 1,000,000 DZD
- Inventory: Debit 500,000 DZD
- Accounts Payable: Credit 400,000 DZD

[1] رمضان حمود. *(المحاسبة المالية: وفق المعايير الدولية لإعداد التقارير المالية)*، دار الكتب الجديدة، بيروت، 2018، ص. 92.
[2] عوض، علي. *(المحاسبة المالية: تطبيقات معاصرة)*، مكتبة الأنجلو المصرية، القاهرة، 2017، ص. 133.

- Sales Revenue: Credit 1,100,000 DZD

The trial balance would appear as follows:

Account Name	Debit (DZD)	Credit (DZD)
Cash	1,000,000	
Inventory	500,000	
Accounts Payable		400,000
Sales Revenue		1,100,000
Total	**1,500,000**	**1,500,000**

Key Point: If the trial balance **does not balance**, it indicates an **error** in journalizing or posting.

Summary Table

Steps	Book Name	Purpose	Output
Step 1	**Journal**	Record transactions chronologically.	Journal entries.
Step 2	**Ledger**	Classify and summarize transactions.	Account balances.
Step 3	**Trial Balance**	Check accuracy of debit & credit totals.	Balanced trial balance.

2.4 The Accounting Cycle

A. Definition

The **accounting cycle** is a **systematic and recurring process** that businesses follow during a specific accounting period (monthly, quarterly, or yearly) in order to ensure that all financial data are properly recorded, processed, and reported. It represents the **complete sequence of steps** through which raw financial transactions are transformed into structured **financial statements** that provide reliable information for decision-making[1].

In practice, the accounting cycle includes the following key stages:

- **Recording financial transactions** → Every transaction (e.g., purchase of raw materials, sales of products, payment of salaries) is first entered in the **Journal** in chronological order.
- **Posting to the Ledger** → Journal entries are transferred to the **Ledger**, where transactions are classified under individual accounts (Cash, Inventory, Accounts Payable, Revenues, etc.).

[1] عبد العزيز، محمد. *(نظرية المحاسبة)*، دار الجامعة الجديدة، الإسكندرية، 2016، ص. 145.

- **Adjusting entries** → At the end of the period, adjustments are made for items such as depreciation, accrued expenses, or prepaid revenues to ensure that income and expenses are matched to the correct period.
- **Preparing financial statements** → Once adjustments are complete, the balances are summarized in a **Trial Balance**, which forms the basis for preparing the **Balance Sheet, Income Statement, and Cash Flow Statement**[1].

B. The 9 Steps of the Accounting Cycle

The accounting cycle is a systematic process that ensures the accurate recording, classification, and reporting of financial transactions within a specific accounting period. It transforms raw business events into meaningful financial statements that provide stakeholders with reliable information for decision-making.

Step 1. Identifying and Analyzing Transactions

This step involves identifying all events that have a financial impact on the business and analyzing them in terms of their effect on assets, liabilities, equity, revenues, or expenses.

- **Example:** Purchasing raw materials for 150,000 DZD in cash decreases *Cash* and increases *Raw Materials Inventory*.
- **Significance:** Non-financial events (e.g., signing a contract without exchange of value) are not recorded.

Step 2. Recording Transactions in the Journal

Transactions are first recorded chronologically in the **general journal**, often referred to as the *book of original entry*.

- **Format:** Each entry includes the date, accounts affected, amounts, and explanation.
- **Significance:** This ensures a chronological record of all business activities and maintains auditability.

Step 3. Posting to Ledger Accounts

Journal entries are transferred (posted) to the **general ledger**, where transactions are classified by account.

- **Example:** The debit entry for *Raw Materials* and credit entry for *Cash* are posted to their respective T-accounts.
- **Significance:** This provides an organized summary of each account's activity.

[1] Meigs, W. B., Meigs, R. F., Bettner, M. S., & Whittington, O. R. (2017). *Accounting: The Basis for Business Decisions* (11th ed.). McGraw-Hill, p. 158.

Step 4. Preparing an Unadjusted Trial Balance

At the end of the period, balances from the ledger are listed in a trial balance to ensure that total debits equal total credits.

- **Significance:** This step verifies arithmetic accuracy but does not guarantee the absence of all errors.

Step 5. Making Adjusting Entries

Adjustments are necessary to align revenues and expenses with the correct accounting period, in line with the **accrual basis principle**. Examples include:

- Depreciation of fixed assets (systematic allocation of cost).
- Accrued revenues (earned but not yet received).
- Accrued expenses (incurred but not yet paid).
- Prepaid expenses (paid in advance but not yet incurred).
- **Significance:** Adjustments ensure compliance with the **matching principle**.

Step 6. Preparing an Adjusted Trial Balance

After adjustments, a new trial balance is prepared to confirm the equality of debits and credits.

- **Significance:** This forms the immediate basis for preparing financial statements.

Step 7. Preparing Financial Statements

Using the adjusted trial balance, the main financial statements are prepared:

- **Income Statement:** Measures profitability (revenues – expenses).
- **Balance Sheet:** Shows the financial position (assets, liabilities, equity).
- **Cash Flow Statement:** Explains cash movements from operating, investing, and financing activities.
- **Significance:** These statements provide critical information for stakeholders in accordance with **IAS 1 – Presentation of Financial Statements**.

Step 8. Closing the Accounts

Temporary accounts (revenues, expenses, dividends) are closed to reset balances for the next period. Their net effect is transferred to **Retained Earnings**.

- **Significance:** This step ensures that only permanent accounts (assets, liabilities, equity) carry forward.

Step 9. Preparing Post-Closing Trial Balance

A final trial balance is prepared after closing entries to confirm that only permanent accounts remain open.

- **Significance:** This validates the readiness of the accounting system for the next period and ensures accuracy in financial reporting.

The accounting cycle, through its nine steps, provides a structured pathway from identifying business events to preparing reliable financial statements. It ensures compliance with accounting principles, enhances transparency, and maintains the integrity of financial information across periods.[1]

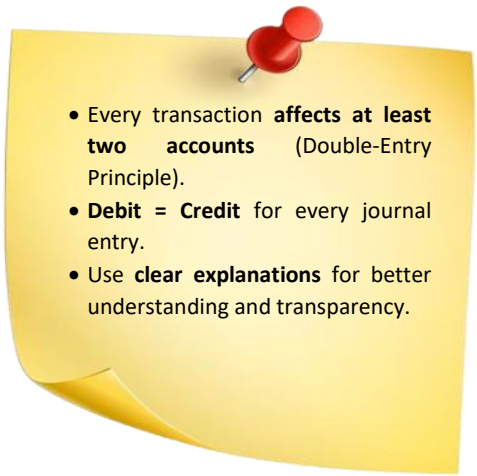
Summary Table

Step	Process	Output
1	Identify & Analyze Transactions	List of financial events
2	Record in Journal	Journal entries
3	Post to Ledger	Account balances
4	Unadjusted Trial Balance	Check debit-credit equality
5	Adjusting Entries	Updated journal entries
6	Adjusted Trial Balance	Accurate financial data
7	Prepare Financial Statements	Income Statement, Balance Sheet, Cash Flow
8	Close Accounts	Transfer to Retained Earnings
9	Post-Closing Trial Balance	Verify closing balances

Activity 2: Recording Transactions in the Journal

Using the information below, **record each transaction** in the **general journal** of the company for **March 2025**:

1. The owner invests **1,500,000 DZD** in cash to start the business.
2. The company purchases **office equipment** for **300,000 DZD** in cash.
3. The company buys **merchandise** on credit from a supplier for **800,000 DZD**.
4. Sold goods for **500,000 DZD** in cash.
5. Paid **employee salaries** amounting to **180,000 DZD**



[1] Sangster, A., *Luca Pacioli: The Father of Accounting*, Routledge, London, 2016, p. 45.

Date	Details	Debit (DZD)	Credit (DZD)	Explanation
01/03/2025	**Cash**	1,500,000		Owner’s investment
.....	**Owner’s Capital**	.....	1,500,000	.....
05/03/2025	**Office Equipment**	300,000	.....	Bought office equipment
.....	**Cash**	.....	300,000	.....
10/03/2025	**Merchandise Inventory**	800,000	.....	Purchased goods on credit
.....	**Accounts Payable**	.....	800,000	.....
15/03/2025	**Cash**	500,000	.....	Sold goods for cash
.....	**Sales Revenue**		500,000	.....
25/03/2025	**Salaries Expense**	180,000	.....	Paid employees’ salaries
.....	**Cash**	.....	180,000	.....

Chapter Three: Accounting Books and Financial Statements

3.1 The Journal

A. Definition

The **Journal**, also known as the **Book of Original Entry**, is the **first step in the accounting process**. It records all financial transactions of a company **chronologically (by date)** before they are transferred to the **Ledger**. Each journal entry shows the **date, the accounts affected, the amounts debited and credited, and a brief explanation (narration)**[1].

The Journal serves as the **foundation of the double-entry system**, ensuring that every transaction is recorded in accordance with the debit-credit principle. Without it, the financial data would lack order and reliability[2].

B. Purpose of the Journal

- To maintain an **organized record** of every financial transaction.
- To provide a **complete audit trail** for verifying accounting data.
- To ensure **accuracy** before posting entries to the ledger.

C. Structure of a Journal Entry

Each journal entry contains the following elements:

1. **Date of the transaction** → When the transaction occurred.
2. **Accounts involved** → One account is **debited** and another is **credited**.
3. **Amounts** → The monetary values for debit and credit.
4. **Narration** → A short explanation of the transaction.

D. Example

On **March 5, 2025**, the company purchased **office supplies** for **75,000 DZD** in cash.

Date	Debit Account	Debit (DZD)	Credit Account	Credit (DZD)
05/03/2025	Supplies	75,000	Cash	75,000
(Being purchase of office supplies for cash)				

[1] المرجع السابق، رمضان حمود، ص. 101.

[2] Alexander, D., Britton, A., & Jorissen, A. (2020). *International Financial Reporting and Analysis* (8th ed.). Cengage Learning, p. 89.

3.2 The Ledger

A. Definition

The **Ledger**, also known as the **Book of Accounts** or the **Book of Final Entry**, is the **second step in the accounting process**. It contains a collection of all **individual accounts** (Cash, Inventory, Accounts Receivable, Accounts Payable, Equity, Revenues, Expenses, etc.), where journal entries are **classified and posted**. The purpose of the ledger is to **track the cumulative effect of each transaction** on a specific account over time[1].

B. Purpose of the Ledger

The **general ledger** occupies a central role in the accounting system as it acts as the comprehensive record of all financial transactions classified by account. Each entry recorded in the journal is eventually transferred (posted) to the ledger, where transactions are summarized and organized under their respective accounts. The ledger thus serves as the backbone of financial reporting.

The purposes of the ledger can be summarized as follows:

1. Summarizing All Transactions Related to a Specific Account

The ledger provides a complete record of all transactions affecting each account, whether assets, liabilities, equity, revenues, or expenses.

- **Example:** All cash receipts and payments are recorded in the *Cash Account*, enabling the company to monitor liquidity at any time.
- **Significance:** This systematic classification makes it easier to trace financial data, analyze business activities, and ensure that transactions are accurately reflected.

2. Showing Balances of Each Account Separately

Each ledger account shows the cumulative effect of debit and credit entries over time, resulting in a running balance.

- **Example:** The *Supplies Account* will show opening balance, additions, consumption, and closing balance.
- **Significance:** By maintaining separate balances for each account, the ledger provides clarity and prevents the mixing of unrelated transactions. This enables accountants and managers to monitor the financial position of specific resources or obligations.

3. Facilitating the Preparation of the Trial Balance

The balances extracted from the ledger form the basis of the **Trial Balance**, which is essential for checking the arithmetical accuracy of the accounting system.

[1] المرجع السابق، عوض، علي، ص. 140.

- **Example:** At the end of an accounting period, balances of *Cash, Accounts Receivable, Sales, Salaries Expense*, etc., are taken from the ledger to prepare the trial balance.
- **Significance:** Without the ledger, it would be impossible to consolidate account information in a structured manner, and financial statements could not be reliably prepared.

4. Supporting the Preparation of Financial Statements

The ledger acts as the final source from which financial statements are prepared. Each line item in the **Balance Sheet** and **Income Statement** traces back to balances in the ledger.

- **Example:** The balance in the *Sales Account* contributes directly to reported revenues, while the *Depreciation Account* affects both expenses and asset valuation.
- **Significance:** The reliability of financial reporting depends heavily on the accuracy and completeness of ledger postings, making it a vital component of the accounting cycle.

In summary, the ledger not only organizes and classifies transactions but also ensures that accounting records are comprehensive and accurate. By facilitating the preparation of the trial balance and serving as the basis for financial statements, the ledger is indispensable for ensuring transparency, accountability, and informed decision-making.

C. Structure of Ledger Accounts (T-Accounts)

The **ledger account** is the basic unit for classifying and summarizing financial transactions. In practice, it is commonly represented using the **T-account format**, which provides a simple and visual way to understand the effects of transactions under the double-entry system.

The structure of a T-account can be explained as follows:

- **Left side → Debit (Dr):** Represents increases in assets and expenses, and decreases in liabilities, equity, and revenues.
- **Right side → Credit (Cr):** Represents increases in liabilities, equity, and revenues, and decreases in assets and expenses.

D. Example

On **March 5, 2025**, the company purchased **office supplies** for **75,000 DZD** in cash.
From the **Journal** entry:

Date	Debit Account	Debit (DZD)	Credit Account	Credit (DZD)
05/03/2025	Supplies	75,000	Cash	75,000
(Being purchase of office supplies for cash)				

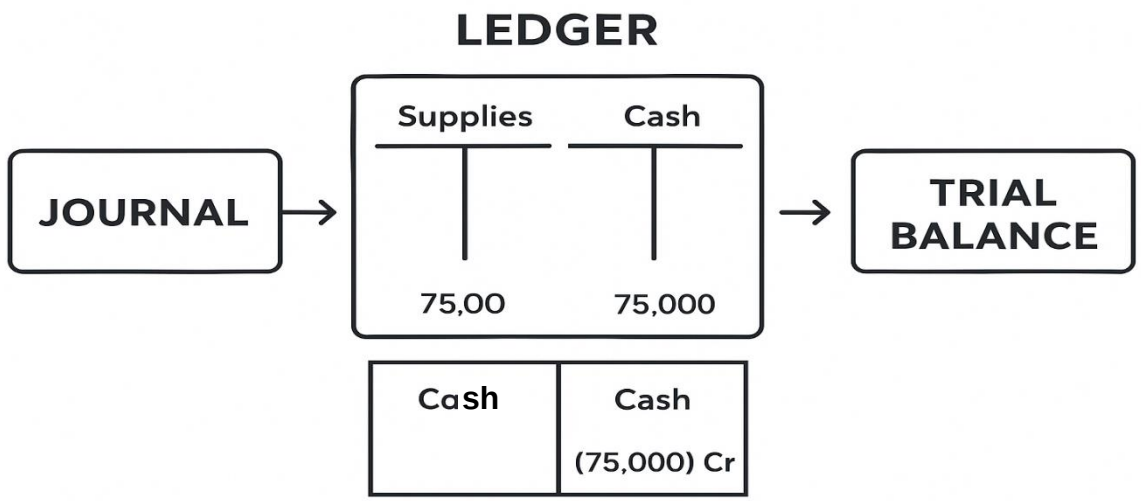
E. Posting to the Ledger

1. Supplies Account

Date	Description	Debit (DZD)	Credit (DZD)	Balance
05/03/2025	Purchase of office supplies	75,000	—	75,000 Dr

2. Cash Account

Date	Description	Debit (DZD)	Credit (DZD)	Balance
05/03/2025	Payment for office supplies	—	75,000	(75,000) Cr



3.3 The Trial Balance

A. Definition

The **Trial Balance** is a fundamental accounting statement that provides a summary of all the ledger accounts and their respective debit or credit balances at a given date. It is usually prepared at the end of an accounting period (monthly, quarterly, or annually) in order to verify the arithmetical accuracy of the double-entry bookkeeping system. By ensuring that the total debits equal the total credits, the trial balance acts as an essential internal control mechanism before the preparation of financial statements.

Beyond being a simple list of balances, the trial balance serves multiple purposes:

- **Error Detection:** It helps to identify certain types of errors, such as posting errors, incorrect balancing of accounts, or mistakes in transferring figures from the journal to the ledger. However, it cannot detect all errors (e.g., errors of omission, errors of commission, or compensating errors).

- **Basis for Financial Statements:** It provides the foundation for preparing the income statement, balance sheet, and cash flow statement. The balances from the trial balance are classified and adjusted to produce accurate financial reports in compliance with accounting standards (IAS/IFRS or SCF in Algeria).
- **Facilitating Adjustments:** At the end of the period, adjusting entries for accruals, deferrals, depreciation, and provisions are made and reflected in the adjusted trial balance. This ensures that revenues and expenses are recognized in the correct accounting period, in line with the accrual basis principle.
- **Types of Trial Balance:**

The **Trial Balance** is a fundamental step in the accounting cycle.
It serves as a **control mechanism** to verify the mathematical accuracy of bookkeeping and to ensure that total debits equal total credits.
However, depending on the stage of the accounting process, **different types of trial balances** are prepared — each serving a specific purpose in the preparation of financial statements.

The three main types are explained below:

1. Unadjusted Trial Balance

The **Unadjusted Trial Balance** is prepared **before any end-of-period adjustments** are made.
It lists all accounts from the general ledger along with their **debit and credit balances** as recorded during the accounting period.

- **Purpose:**
  To check the **arithmetical accuracy** of the recording process before adjustments for accruals, depreciation, or other corrections.
- **Characteristics:**
  - Prepared immediately after all transactions are posted to the ledger.
  - Includes only the balances resulting from day-to-day transactions.
  - Serves as the **initial checkpoint** for detecting posting or recording errors.
- **Example:**
  If total debits and credits in the unadjusted trial balance do not match, it indicates errors such as:
  - Double posting,
  - Omissions,
  - Transposition mistakes, or
  - Incorrect account classification.

In essence, this first trial balance acts as a **raw accounting summary** — a preliminary verification before refining the financial records.

2. Adjusted Trial Balance

After recording the necessary **adjusting entries** — such as accrued revenues, accrued expenses, depreciation, inventory adjustments, and prepaid expenses — an **Adjusted Trial Balance** is prepared.

- **Purpose:**
  To reflect the **true financial position and performance** of the company by incorporating all necessary adjustments at the end of the accounting period.
- **Role in Financial Reporting:**
  The **Adjusted Trial Balance** becomes the **immediate basis for the preparation of financial statements**, including:
  - The **Income Statement**,
  - The **Balance Sheet**,
  - And the **Statement of Cash Flows**.
- **Example:**
  Suppose depreciation expense of **50,000 DZD** and accrued interest of **10,000 DZD** were not recorded earlier.
  After adjustment, the updated balances will appear in the adjusted trial balance, ensuring that all revenues and expenses are recognized in the correct period — in line with the **matching principle**.
- **Key Benefit:**
  It ensures that all **period-end corrections** have been properly integrated, allowing management and auditors to rely on the information for accurate reporting.

3. Post-Closing Trial Balance

The **Post-Closing Trial Balance** is prepared **after all closing entries have been recorded and posted**.
It includes only the **permanent (real) accounts**, such as assets, liabilities, and equity, while all **temporary (nominal) accounts** — revenues, expenses, and dividends — have been closed to retained earnings.

- **Purpose:**
  To confirm that after closing, **total debits still equal total credits**, ensuring the ledger is balanced before the start of a new accounting period.
- **Features:**
  - Contains balances for **balance sheet accounts only**.
  - Serves as the **opening point** for the next accounting cycle.

- Verifies that all temporary accounts were properly closed.

- **Example:**
  After closing entries, accounts such as **Sales Revenue**, **Rent Expense**, and **Depreciation Expense** will have zero balances, while accounts like **Cash**, **Accounts Receivable**, and **Capital** will retain their balances and appear in the post-closing trial balance.

- **Significance:**
  This final check ensures **continuity and accuracy** between accounting periods, providing a clean foundation for future transactions.

Summary Table – Comparison of Trial Balance Types

Type	Stage of Preparation	Includes	Main Purpose
Unadjusted Trial Balance	Before adjustments	All accounts prior to end-of-period entries	Test initial mathematical accuracy
Adjusted Trial Balance	After adjustments	All accounts including adjusted balances	Basis for financial statement preparation
Post-Closing Trial Balance	After closing entries	Only permanent accounts (assets, liabilities, equity)	Verify equality before new period starts

The importance of the trial balance lies not only in verifying arithmetic accuracy but also in providing assurance that the accounting system is functioning correctly, maintaining the reliability of financial data, and supporting the decision-making process of managers, investors, and regulatory bodies.[1].

B. Purpose of the Trial Balance

- To **check the mathematical accuracy** of the ledger accounts.
- To **detect possible errors** in journalizing or posting.
- To serve as the **basis** for preparing the **financial statements** (Balance Sheet, Income Statement, etc.).

C. Key Features

- Prepared **after posting** all journal entries to the ledger.
- **Debit balances = Credit balances** → ensures double-entry correctness.

[1] المرجع السابق، رمضان حمود، ص. 118.

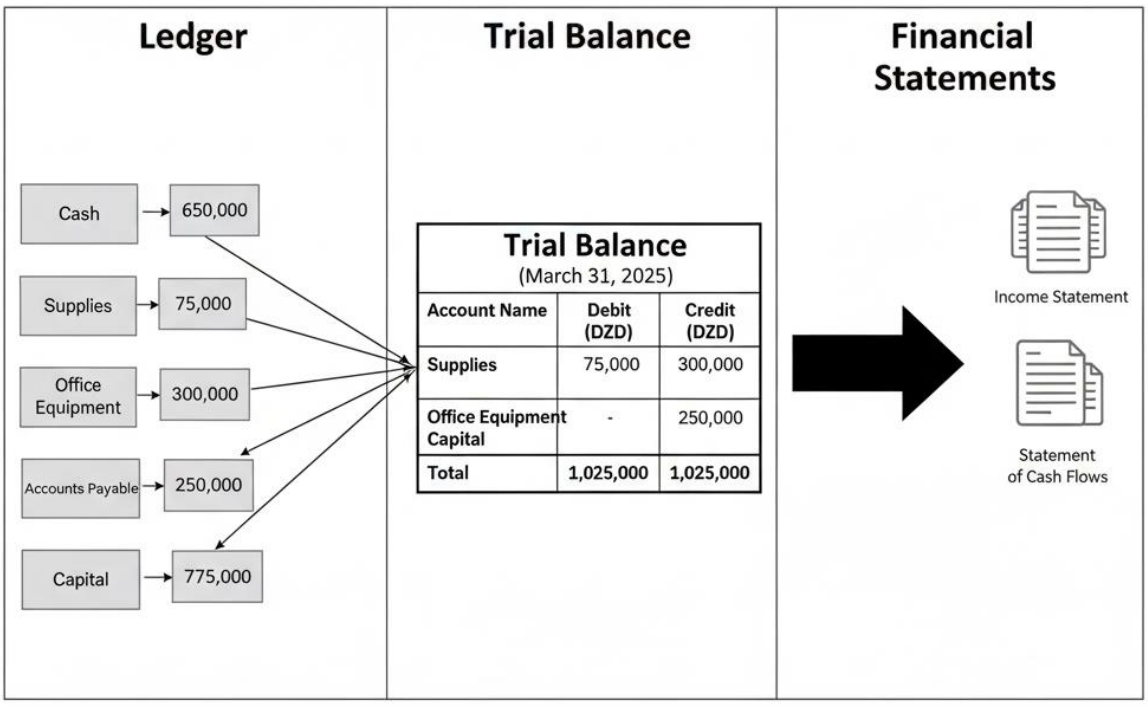
- Does **not** guarantee that there are **no accounting errors** (e.g., wrong amounts recorded in both sides)

D. Format of a Trial Balance

Example: On **31 March 2025**, a company prepares its trial balance based on ledger balances.

Account Name	Debit (DZD)	Credit (DZD)
Cash	650,000	—
Supplies	75,000	—
Office Equipment	300,000	—
Accounts Payable	—	250,000
Capital	—	775,000
Total	**1,025,000**	**1,025,000**

- If **total debits ≠ total credits**, there is an **error** in journalizing or posting.
- Even if totals match, other errors may still exist (e.g., omission of a transaction).
- The trial balance is the **foundation** for preparing the **financial statements**.



3.4 Financial Statements

A. Definition

Financial statements are the **final product of the accounting process**. They provide a structured summary of the **financial performance** (results of operations) and **financial position** (resources and obligations) of a business during a specific accounting period. These reports are essential because they deliver **reliable, relevant, and comparable information** to various users—including managers, investors, creditors, governments, and other stakeholders—for effective decision-making.[1]

B. Main Financial Statements

There are **four primary financial statements** that work together to provide a **complete picture** of the company's finances:

1. Balance Sheet *(Statement of Financial Position)*

- **Purpose**: Shows the company's **assets**, **liabilities**, and **equity** at a **specific date**.
- **Formula**:

Assets = Liabilities + Equity

- **Example (31 March 2025):**

Assets	DZD	Liabilities & Equity	DZD
Cash	650,000	Accounts Payable	250,000
Supplies	75,000	Owner's Capital	775,000
Office Equipment	300,000		
Total Assets	**1,025,000**	**Total Liabilities & Equity**	**1,025,000**

2. Income Statement *(Profit and Loss Statement)*

- **Purpose**: Shows the company's **revenues** and **expenses** over a specific period to determine **net income** or **net loss**.
- **Formula**:

Net Income = Revenues – Expenses

- **Example (March 2025):**

Revenues	DZD
Sales Revenue	**500,000**
Total Revenues	**500,000**

Expenses	DZD
Salaries Expense	180,000
Supplies Expense	75,000
Total Expenses	**255,000**

[1] أبو قحف، عبد السلام. *(المحاسبة المالية: مدخل متكامل)*، دار الجامعة الجديدة، الإسكندرية، 2015، ص. 205.

Net Income = 500,000 – 255,000 = 245,000 DZD

3. Cash Flow Statement

- **Purpose**: Explains how **cash** flows **in** and **out** of the company during a period.
- **Three Sections**:
  1. **Operating Activities** → day-to-day business operations
  2. **Investing Activities** → purchase or sale of long-term assets
  3. **Financing Activities** → owner's contributions, loans, dividends
- **Example (March 2025):**

Cash Flows	DZD
Operating Activities	+350,000
Investing Activities	–300,000
Financing Activities	+150,000
Net Cash Flow	**+200,000**

4. Statement of Changes in Equity

- **Purpose**: Shows **changes in owner's equity** during a period.
- Includes:
  - **Owner's capital**
  - **Retained earnings**
  - **Reserves**
- **Example:**

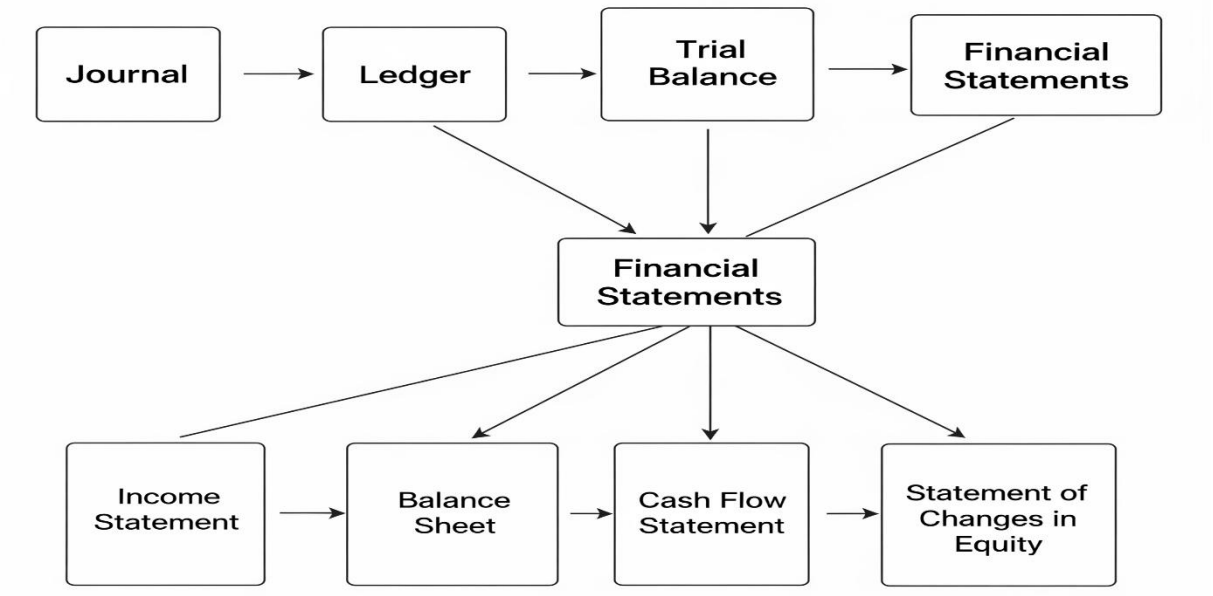
Equity Components	DZD
Owner's Capital (start)	600,000
+ Net Income	245,000
– Withdrawals	70,000
Owner's Equity (end)	**775,000**

C. Importance of Financial Statements

- Help **owners** and **managers** make informed decisions.
- Provide **transparency** for **investors** and **creditors**.
- Assist **governments** in taxation and regulation.
- Facilitate **performance comparisons** across companies and periods.

D. Visual Connection Between the Four Statements

Ideally, we'd represent the **flow of information** like this:



Activity 3: Preparing a Simple Trial Balance

Using the following balances extracted from the ledger of **ABC Company** on **31/03/2025**, prepare a **trial balance** in **DZD**:

- **Cash**: 600,000 DZD
- **Accounts Receivable**: 200,000 DZD
- **Supplies**: 100,000 DZD
- **Equipment**: 1,000,000 DZD
- **Accounts Payable**: 400,000 DZD
- **Capital**: 1,200,000 DZD
- **Sales Revenue**: 500,000 DZD
- **Salaries Expense**: 200,000 DZD

Step 1: Classify Accounts into Debit and Credit

Account	Type	Balance (DZD)	Debit (DZD)	Credit (DZD)
Cash	Asset	600,000	600,000	…….
Accounts Receivable	Asset	200,000	200,000	…….
Supplies	Asset	100,000	100,000	…….
Equipment	Asset	1,000,000	1,000,000	…….
Accounts Payable	Liability	400,000	…….	400,000
Capital	Equity	1,200,000	…….	1,200,000
Sales Revenue	Revenue	500,000	…….	500,000
Salaries Expense	Expense	200,000	200,000	…….

Step 2: Prepare the Trial Balance

ABC Company
Trial Balance
As of 31 March 2025

Account Name	Debit (DZD)	Credit (DZD)
Cash	**600,000**	…….
Accounts Receivable	**200,000**	…….
Supplies	**100,000**	…….
Equipment	**1,000,000**	…….
Salaries Expense	**200,000**	…….
Accounts Payable	…….	**400,000**
Capital	…….	**1,200,000**
Sales Revenue	…….	**500,000**
Total	**2,100,000**	**2,100,000**

Check: Total Debits = Total Credits = 2,100,000 DZD ?

Chapter Four: Accounting for the Establishment of a Company

4.1 Incorporation Transactions

When a company is established, it undertakes a set of **incorporation transactions** that create its **legal and financial existence**. These transactions are essential because they establish the company's **initial capital, ownership structure, and organizational expenses**. From an accounting perspective, incorporation transactions mark the beginning of the **accounting cycle** for the new entity[1].

Main Incorporation Transactions

1. **Registration Fees and Legal Expenses**
    - Costs related to establishing the company, such as:
        - Lawyer's fees
        - Notary fees
        - Registration taxes
2. **Initial Contributions from Shareholders**
    - These contributions can be:
        - **Cash contributions**
        - **Non-cash contributions** (e.g., equipment, buildings, vehicles)
3. **Issuance of Shares**
    - In exchange for their contributions, shareholders receive **shares** representing their ownership in the company.

Example

Company **"XYZ SARL"** is incorporated with a **capital of 5,000,000 DZD**.

- **Legal fees** of **100,000 DZD** are paid in cash.
- Shareholders agree to contribute:
    - **4,000,000 DZD** in cash
    - **1,000,000 DZD** in equipment

[1] المرجع السابق، أبو قحف، عبد السلام، ص. 221.

Journal Entries

1. Recording Legal Fees

Date	Account	Debit (DZD)	Credit (DZD)
01/04/2025	Legal Expenses (Incorporation)	100,000	
	Cash		100,000
(Payment of legal fees for incorporation)			

2. Recording Shareholders' Contributions

Date	Account	Debit (DZD)	Credit (DZD)
01/04/2025	Cash	4,000,000	
	Equipment	1,000,000	
	Share Capital		5,000,000
(Recording shareholders' contributions in cash and equipment)			

Key Takeaways

- **Incorporation expenses** are recorded separately to track the initial costs of establishing the company.
- **Shareholders' contributions** increase the company's assets (cash, equipment, etc.).
- **Share capital** represents the total value of contributions and defines the ownership structure.

4.2 Shareholder Contributions

When a company is incorporated, **shareholder contributions** constitute the foundation of its **initial capital**. These contributions may take the form of **cash** or **non-cash (in-kind) assets**, such as land, machinery, intellectual property, or vehicles. From an accounting perspective, these contributions are recorded under **Share Capital**, which reflects the owners' equity in the company[1].

Types of Shareholder Contributions

1. Cash Contributions

- Shareholders deposit **money** directly into the company's **bank account** or **cash register**.
- Example: Capital deposited in the bank.

[1] المرجع السابق، أبو قحف، عبد السلام، ص. 229.

2. Non-Cash Contributions

- Shareholders may also contribute **tangible assets** (e.g., buildings, vehicles, machines) or **intangible assets** (e.g., patents, trademarks, know-how).
- These contributions **must be valued** at their **fair market value** to ensure accurate recording.[1]

Key Point

All shareholder contributions, whether in cash or assets, must be valued fairly and recorded in the company's accounting books at their market value.

Example

A shareholder of **ABC SARL** contributes a **delivery van** valued at **2,000,000 DZD** as part of their capital contribution.

Journal Entry

Date	Account	Debit (DZD)	Credit (DZD)
05/04/2025	Vehicles (Asset)	2,000,000	
	Share Capital		2,000,000
	(Recording contribution of a delivery van at market value)		

4.3 Allocation of Equity Accounts

Once a company is incorporated, its **equity (رأس المال الخاص)** is divided into several **specific accounts** in the accounting books. These equity accounts reflect **shareholders' rights** over the company's **net assets** (total assets minus total liabilities) and represent the residual interest that remains after all obligations are settled[2].

Main Equity Accounts

Equity represents the **residual interest of the owners (or shareholders)** in the assets of an enterprise after deducting all its liabilities.

It is therefore the company's **own financing**, reflecting the amount invested by the owners and the profits retained over time.

Under both the **Algerian SCF** and **IFRS (IAS 1 – Presentation of Financial Statements)**, equity is shown in the balance sheet as a separate section, demonstrating the entity's financial independence and long-term stability.

The main components of equity are described below.

[1] المرجع السابق، Kieso, D., Weygandt, J., & Warfield, T. D.، ص. 108.
[2] عبد الحميد، السيد. *(مبادئ المحاسبة المالية)*، دار وائل للنشر، عمّان، 2014، ص. 189.

1. Share Capital (Account 101)

Share Capital represents the **nominal (par) value of shares issued to shareholders** in exchange for their investment when the company is formed.
It is the foundation of the company's financial structure and symbolizes the owners' permanent commitment to the business.

- **Accounting View:**

  The amount subscribed by shareholders is recorded in **Account 101 – Share Capital**. In the case of joint-stock companies, the nominal value per share and the total number of shares are defined in the company's bylaws.

- **Legal Aspect (Algeria):**

  The *Commercial Code* sets a **minimum capital requirement** depending on the type of company (e.g., joint-stock, limited liability).

  The share capital can only be modified through formal decisions (capital increase or reduction) approved by the General Assembly.

- **Example:**
  A company is incorporated with a share capital of **5,000,000 DZD**, divided into **50,000 shares** of **100 DZD** each.

Journal Entry:

  - Debit: Bank (512) → 5,000,000 DZD
  - Credit: Share Capital (101) → 5,000,000 DZD

This account remains unchanged unless there is a **capital restructuring**, such as new share issues, capitalization of reserves, or partial repayment to shareholders.

2. Share Premium (Prime d'émission)

Share Premium arises when new shares are issued **at a price higher than their nominal value**.
It represents **an additional contribution** made by investors beyond the par value, reflecting the company's reputation and growth potential.

- **Economic Meaning:**

  It is not a revenue but an **equity reserve**, strengthening the financial structure without increasing the nominal share capital.

  It enhances the company's solvency and can be used for specific purposes such as covering issuance costs or forming special reserves.

- **Example:**
  The company issues 10,000 new shares at a **nominal value of 100 DZD** but sells them for **120 DZD** each.
    - Nominal capital = 1,000,000 DZD
    - Share premium = 200,000 DZD

Journal Entry:

- Debit: Bank (512) → 1,200,000 DZD
- Credit: Share Capital (101) → 1,000,000 DZD
- Credit: Share Premium (104) → 200,000 DZD

- **Purpose:**
  Share premium can be used to:
    - Cover share issuance costs,
    - Increase capital (by capitalization),
    - Strengthen reserves or retained earnings.

In practice, it reflects **investor confidence** and a **positive market perception** of the company's financial performance.

3. Reserves (Account 11)

Reserves are portions of the company's **accumulated profits** that are retained rather than distributed as dividends.

They represent **self-financing** and serve to protect the company against future risks, strengthen equity, or finance future projects.

Reserves are recorded under **Account 11** and are classified into several categories depending on their purpose and origin:

a. Legal Reserves

- Required by **Algerian Commercial Law**.
- Each year, **5% of the net profit** must be appropriated to the legal reserve until it reaches **20% of the share capital**.
- This reserve cannot be distributed unless the company is liquidated.
- It ensures the **protection of creditors** and the **financial stability** of the firm.

b. Statutory Reserves

- Created according to the **company's statutes or bylaws**.

- Their formation is optional but often intended to meet specific financial commitments or investment needs.

c. Optional (or Discretionary) Reserves

- Decided voluntarily by the shareholders' general assembly.
- They can be used for **future expansions, modernization, or reinvestment**.
- They represent a flexible tool for **long-term planning and internal growth**.

Comprehensive Example:

At year-end, the company achieves a **net profit of 800,000 DZD**. The General Assembly decides to allocate:

- **5%** to the legal reserve,
- **10%** to an optional reserve,
- The remaining amount to retained earnings.

Calculations:

- Legal reserve: 800,000 × 5% = 40,000 DZD
- Optional reserve: 800,000 × 10% = 80,000 DZD
- Retained earnings: 680,000 DZD

Journal Entry:

- Debit: Profit for the Year (120) → 800,000 DZD
- Credit: Legal Reserve (111) → 40,000 DZD
- Credit: Optional Reserve (113) → 80,000 DZD
- Credit: Retained Earnings (119) → 680,000 DZD

Analytical Insight

- **Share Capital** ensures **financial stability** and reflects the shareholders' permanent investment.
- **Share Premium** strengthens the company's capital structure and is often seen as a signal of **investor trust** and **corporate credibility**.
- **Reserves** provide a **buffer against future losses**, support future expansion, and contribute to **self-financing capacity**.

Together, these components form the backbone of equity and demonstrate the company's **financial independence**, **long-term sustainability**, and **prudence in profit management**.

4. Retained Earnings (Account 12)

Definition

Retained earnings represent the portion of net profits that are **not distributed to shareholders as dividends**, but instead **reinvested into the company**. They appear in the equity section of the balance sheet under account (12). Retained earnings reflect the company's **capacity for self-financing**, which strengthens its financial position and reduces dependence on external borrowing[1].

Uses of Retained Earnings

- **Future Growth:** Financing expansion projects (e.g., new branches, technological upgrades).
- **Debt Repayment:** Reducing liabilities to improve solvency.
- **Reserves Creation:** Allocating part of profits to legal or general reserves for contingencies.
- **Reinvestment in Operations:** Funding working capital and operational needs[2].

Accounting Treatment

At the end of the accounting period:

- **If net profit exists:**
  - Debit: Income Summary (closing revenues and expenses).
  - Credit: Retained Earnings.
- **If dividends are declared:**
  - Debit: Retained Earnings.
  - Credit: Dividends Payable (liability).

Equity Formula

Equity=Share Capital+Share Premium+Reserves+Retained Earnings

Example

Company **XYZ SARL** has the following equity structure at **31/12/2025**:

- **Share Capital (Account 101) → 5,000,000 DZD**
- **Share Premium → 500,000 DZD**
- **Reserves (Account 11) → 300,000 DZD**

[1] المرجع السابق، رمضان حمود، ص. 156.
[2] المرجع السابق، Kieso, D., Weygandt, J., & Warfield, T. D.، ص. 143.

- **Retained Earnings (Account 12) → 200,000 DZD**

Equity=5,000,000+500,000+300,000+200,000=6,000,000DZD

Activity 4: Recording the Establishment of a Company

Record the following transactions for **ABC SARL** during its incorporation in **April 2025**:

1. The company is incorporated with **authorized share capital** of **10,000,000 DZD**.
2. Shareholders subscribe and contribute:
    - **6,000,000 DZD** in cash.
    - **Land** valued at **4,000,000 DZD**.
3. The company pays **250,000 DZD** in **legal fees** related to incorporation.

Step 1: Recording Shareholders' Contributions

Date	Account	Debit (DZD)	Credit (DZD)
02/04/2025	Cash	6,000,000	
	Land	4,000,000	
	Share Capital		10,000,000
(Recording shareholders' contributions in cash and land)			

Step 2: Recording Legal Fees

Date	Account	Debit (DZD)	Credit (DZD)
05/04/2025	Legal Expenses (Incorporation)	250,000	
	Cash		250,000
(Payment of incorporation-related legal fees)			

Chapter Five: Class One Accounts – Equity and Results

Chapter Five: Class One Accounts – Equity and Results

Definition

Class One accounts in the accounting system represent the **equity of the company**. They provide a comprehensive view of the resources contributed by shareholders (capital), the **profits retained** in the business (retained earnings), and the **results of the current financial year** (net income or loss). In essence, these accounts reflect the **residual interest of shareholders** after deducting liabilities from total assets[1].

5.1 Account 11: Capital and Reserves

Capital (Share Capital): represents the initial contributions of shareholders, either in the form of **cash** or **non-cash assets (in-kind)** such as land, equipment, or intellectual property. It serves as the **financial and legal foundation** of the company, defining the ownership rights of shareholders and the minimum capital requirements set by corporate law[2].

Reserves: are portions of the company's profits that are **set aside** for specific or legal purposes. They represent a part of shareholders' equity but are **restricted** for certain uses, ensuring the financial stability and sustainability of the business[3].

Legal Reserve: A portion of net income that must be allocated by law. *Example:* In Algeria, **5% of net income** is required to be transferred to the legal reserve until it reaches 10% of the share capital.

1. **Statutory or Optional Reserves:** These are created voluntarily by the company to strengthen its financial position or for future investments.

Example Journal Entry (Localized to Algeria)

Assume a company has **net income of 1,500,000 DZD** and must allocate **5% to the legal reserve**.

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Net Income of the Year (Account 13)	75,000	
	Legal Reserve (Account 110)		75,000

Calculation:

$$5\% \times 1{,}500{,}000 \text{ DZD} = 75{,}000 \text{ DZD}$$

This entry decreases net income and increases the legal reserve in the equity section of the balance sheet.

[1] المرجع السابق، عبد الحميد، السيد، ص. 201.
[2] المرجع السابق، عبد العزيز، محمد، ص. 210.
[3] المرجع السابق، Kieso, D., Weygandt, J., & Warfield, T. D.، ص. 201.

5.2 Account 12: Retained Earnings

1. Definition

Retained Earnings represent the portion of a company's **net profits** that is **not distributed to shareholders as dividends**, but rather **kept within the company**. This account accumulates over time and is shown under the **equity section** of the balance sheet. Retained earnings play a crucial role in the company's financial strategy, as they represent a **form of self-financing** that reduces reliance on external borrowing and strengthens long-term financial sustainability[1].

Unlike dividends, which provide short-term returns to shareholders, retained earnings are oriented towards the **future growth and resilience of the business**. By reinvesting these funds, the company increases its productive capacity, expands operations, and creates greater shareholder value in the long run[2].

Main Uses of Retained Earnings

- **Reinvestment in the Business**
  Allocating profits for acquiring new machinery, developing new products, or expanding into new markets.
- **Covering Future Expenses and Obligations**
  Used to settle debts, manage unexpected financial losses, or finance working capital needs.
- **Strengthening the Company's Financial Position**
  Retained earnings enhance equity, improve solvency ratios, and build resilience against economic shocks[3].

Retained earnings reflect the company's **internal reinvestment strategy** rather than cash paid out to shareholders. Understanding this concept is key to analyzing a company's financial health.

2. Accounting Mechanism

At the beginning of each fiscal year, the **balance of Net Income (Account 13)** is transferred to **Retained Earnings (Account 12)**. This closing process is an essential step in the **accounting cycle** because it ensures that the results of the previous year are permanently incorporated into equity, while preparing revenue and expense accounts to start fresh for the new year[4].

[1] المرجع السابق، عبد العزيز، محمد، ص. 233.
[2] المرجع السابق، Kieso, D., Weygandt, J., & Warfield, T. D.، ص. 215.
[3] المرجع السابق، أبو قحف، عبد السلام، ص. 274.
[4] حسين، أحمد. *المحاسبة المالية: مدخل متكامل*. دار المريخ للنشر، الرياض، 2019، ص. 242.

Outcomes of the Process

1. **Resetting the Net Income Account**
   The Net Income account, considered a **temporary account**, is cleared to zero. This allows revenues and expenses to be accumulated anew in the next fiscal year without mixing results across different periods.

2. **Reflecting Profits in Equity**
   The profits or losses of the previous year are transferred to the **equity section** of the balance sheet. This strengthens the company's financial position by showing how past performance contributes to shareholders' equity[1].

Accounting Treatment

- **If the company earned a profit:**
  - Debit: Net Income (Account 13)
  - Credit: Retained Earnings (Account 12)
- **If the company incurred a loss:**
  - Debit: Retained Earnings (Account 12)
  - Credit: Net Income (Account 13)

This ensures that financial results are correctly allocated and permanently reflected in shareholders' equity[2].

3. Practical Example

Suppose the company has a **net income of 3,000,000 DZD** at year-end. This amount is closed into Retained Earnings.

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Net Income of the Year (Account 13)	3,000,000	
	Retained Earnings (Account 12)		3,000,000

Explanation:

- This entry transfers the **net income** from the income statement to **equity**, increasing retained earnings.
- No cash is involved; it is an **internal accounting transfer** to reflect profits in the company's financial position.
- **Retained Earnings = Internal investment** within the company, not a distribution to shareholders.

[1] Nobes, C., & Parker, R. (2020). *Comparative International Accounting* (14th ed.). Pearson, p. 188.

[2] الخولي، عبد السلام. *المحاسبة في الشركات المساهمة*. دار الفكر الجامعي، الإسكندرية، 2017، ص. 211.

- Recording retained earnings helps understand **how profits affect equity** and the **financial strength** of the company.
- In Algeria, retained earnings may also be used to **cover legal or tax-related obligations**, making them a flexible financial tool.

5.3 Account 13: Net Income of the Year

Definition

Account 13 – Net Income of the Year is the account used to record the **financial result of a company** for a specific accounting period. It acts as a **temporary summary account**, where all revenues and expenses are consolidated to determine whether the company achieved a profit or a loss during that year[1].

- A **credit balance** in Account 13 indicates a **net profit**, meaning revenues exceeded expenses.
- A **debit balance** indicates a **net loss**, meaning expenses exceeded revenues.

At the end of the accounting period, this account must be **closed**:

- Profits are transferred to **Retained Earnings (Account 12)** or partially distributed as **dividends** to shareholders.
- Losses are charged against **Retained Earnings** or other available reserves[2].

This ensures that the account is reset for the next fiscal year and that the equity section of the balance sheet accurately reflects the allocation of profits.

Importance of Account 13

- Provides a **clear measure of performance** for a given period.
- Serves as the **bridge** between the Income Statement and the Balance Sheet.
- Ensures **proper allocation of profits** to retained earnings or dividend distributions.
- Facilitates **comparability** of results across fiscal years[3].

Example 1: Closing Net Profit

Suppose a company generates a **net profit of 2,250,000 DZD** for the year. The journal entry to record this closing is as follows:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Income Summary / Revenues	2,250,000	
	Net Income of the Year (Account 13)		2,250,000

[1] عبد الرؤوف، محمود. *المدخل إلى المحاسبة المالية*. مكتبة الأنجلو المصرية، القاهرة، 2018، ص. 198.
[2] المرجع السابق، Kieso, D., Weygandt, J., & Warfield, T. D.، ص. 245.
[3] المرجع السابق، حسين، أحمد، ص. 266.

This entry transfers the result of the accounting period into Account 13, showing the net income for the year.

Example 2: Distribution of Dividends

If the company decides to distribute **750,000 DZD** of this profit as dividends, the corresponding journal entry is:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Net Income of the Year (Account 13)	750,000	
	Dividends Payable		750,000

This entry records the portion of profit allocated to shareholders while reducing the balance of Account 13. The remaining profit after dividends can then be transferred to Retained Earnings (Account 12), ensuring the equity section of the balance sheet accurately reflects the allocation of profits.

Activity 5: Year-End Closing Entries and Profit Allocation

Scenario

At the end of **2025**, XYZ Company has the following financial result:

- **Net Income of the Year (Account 13): 5,000,000 DZD**

The company decides to allocate the net income as follows:

1. **10% to Legal Reserve (mandatory by law)**
2. **7% to Optional Reserve (company decision)**
3. **2,000,000 DZD as Dividends**
4. The **remaining balance** to Retained Earnings (Account 12)

Instructions

1. Prepare the **journal entries** to allocate the net income to:
    - Legal Reserve
    - Optional Reserve
    - Dividends
    - Retained Earnings
2. Show the **amounts in DZD**, ensuring all calculations are correct.
3. Ensure that the **Net Income of the Year (Account 13)** is properly **closed at the end of the fiscal year**.
4. Present your **journal entries in a table format** with the following columns:
    - Date
    - Account
    - Debit (DZD)
    - Credit (DZD)

Chapter Six: Accounting for Value Added Tax (VAT)

Chapter Six: Accounting for Value Added Tax (VAT)

6.1 Concept and Mechanism of VAT

Definition of VAT

Value Added Tax (VAT) is an **indirect tax** imposed on the consumption of goods and services. Unlike **direct taxes** (such as corporate income tax or personal income tax), which are paid directly by the taxpayer to the government, VAT is collected **indirectly through businesses** at each stage of the production and distribution chain[1].

Businesses act as **tax intermediaries**:

- They **collect VAT on sales** of goods and services → called **Output VAT**.
- They **pay VAT on purchases** of goods and services → called **Input VAT**.

Mechanism of VAT

1. Purchases (Input VAT)

When a company acquires goods or services, the supplier charges VAT on the invoice. This amount is called **Input VAT**.

- Input VAT is **recoverable** because the company is allowed to deduct it from the VAT it collects on its sales.
- This ensures that VAT is **not a cost for businesses** but rather a tax borne by the final consumer.

2. Sales (Output VAT)

When a company sells goods or services, it is legally required to **add Value Added Tax (VAT)** to the selling price. This tax, called **Output VAT**, is collected by the company **on behalf of the state**. Unlike sales revenue, Output VAT **does not belong to the company**; it is a liability that must be transferred to the **tax authorities** after offsetting any Input VAT already paid on purchases[2].

Accounting Treatment

- When recording a sale:
    - **Debit:** Accounts Receivable / Cash (total including VAT)
    - **Credit:** Sales Revenue (net of VAT)
    - **Credit:** Output VAT (liability to the state)

This separates the company's own revenue from the VAT it collects as an intermediary[3].

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[1] عبد الكريم، الجبوري. *مبادئ المحاسبة المالية*. دار الكتب الوطنية، بغداد، 2020، ص. 310.

[2] المرجع السابق، حسين، أحمد، ص. 318.

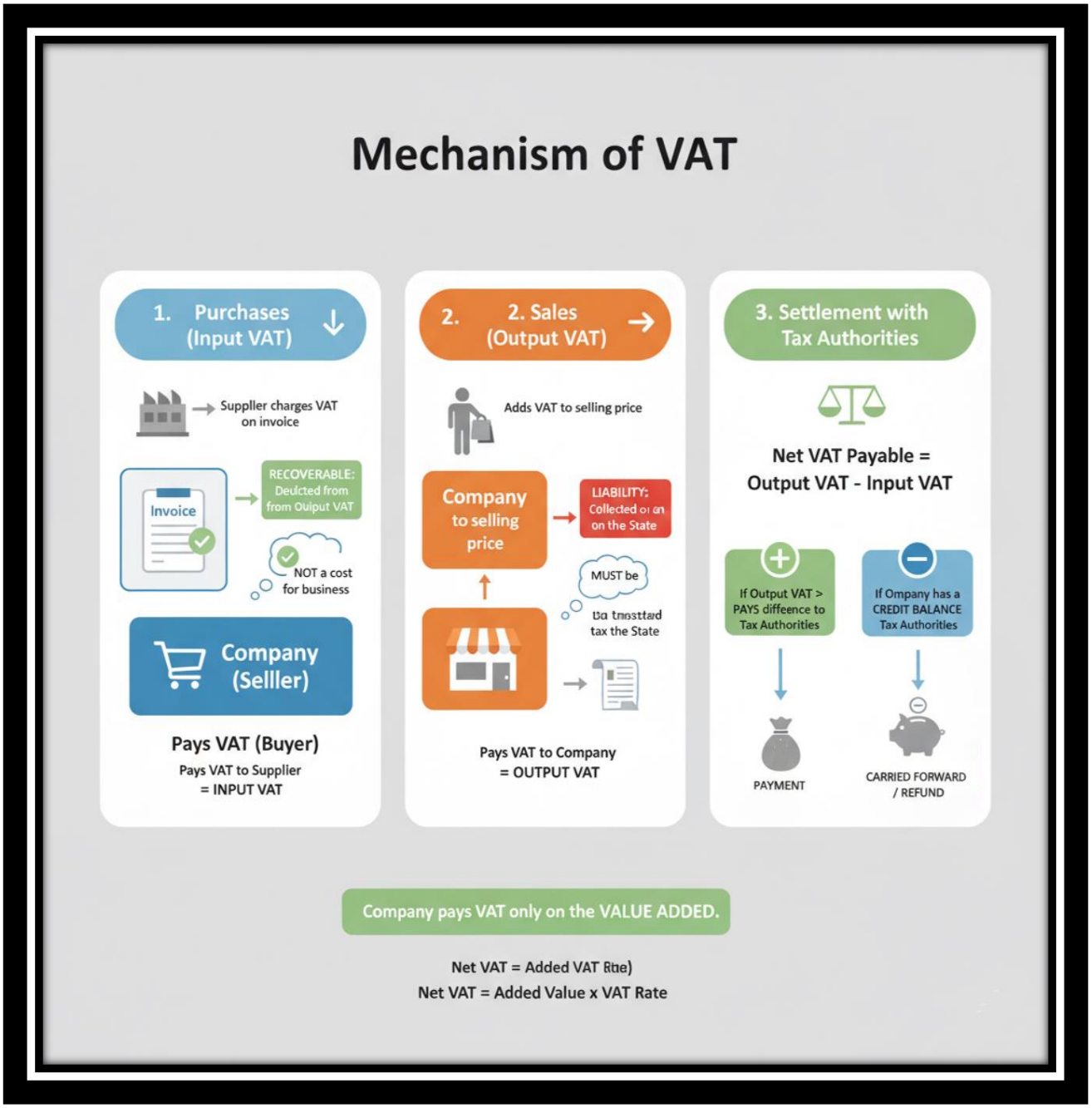
[3] Tulsian, P. C. (2016). *Financial Accounting*. Pearson Education, p. 375.

3. Settlement with the Tax Authorities

At the end of the tax period (usually monthly or quarterly in Algeria), the company calculates the net VAT to be declared:

$$\textit{Net VAT Payable} = \textit{Output VAT} - \textit{Input VAT}$$

- If **Output VAT > Input VAT** → The company must pay the difference to the tax authorities.
- If **Input VAT > Output VAT** → The company has a **credit balance**, which can either be carried forward to future periods or refunded by the tax administration under certain conditions.



Numerical Example

Assume the following operations with a VAT rate of **19%**:

1. Purchase of raw materials for **1,000 DZD + VAT**
2. Sale of finished goods for **2,000 DZD + VAT**

Transaction	Base Amount (DZD)	VAT 19% (DZD)	Total (DZD)
Purchase of raw materials	1,000	190	1,190
Sale of finished goods	2,000	380	2,380

- **Input VAT (on purchases):** 190 DZD
- **Output VAT (on sales):** 380 DZD

$$\textit{Net VAT Payable} = 380 - 190 = 190 \textit{DZD}$$

This amount (190 DZD) must be **declared and paid** to the Algerian tax authorities.

6.2 VAT on Purchases

1. Concept

When a company purchases goods or services in Algeria that are subject to **Value Added Tax (VAT)**, the supplier includes VAT on the invoice. This VAT is known as **Input VAT**, because it is paid on the company's **inputs (purchases of goods and services)**.

From an **accounting perspective** under the Algerian accounting system:

- The **purchase cost (excluding VAT)** is recorded in the **Purchases account (600)**.
- The **VAT amount** is recorded in **Account 4456 – VAT Recoverable**, treated as an **asset**, because it can later be recovered (deducted from Output VAT).
- The **total invoice amount (including VAT)** is recorded as a liability in **Account 401 – Suppliers**[1].

Thus, **Input VAT is not considered an expense** for the company; instead, it represents a **recoverable tax credit** until it is offset against Output VAT in the VAT declaration[2].

Thus, VAT is **not an expense** for the company, but rather a **temporary asset** until it is offset against the VAT collected on sales.

2. General Accounting Treatment

The general accounting treatment of **Value Added Tax (VAT)** under the **accrual accounting system** aims to accurately represent both the company's economic operations and its fiscal

[1] المرجع السابق، الجبوري، عبد الكريم، ص. 324.
[2] المرجع السابق، Nobes, C., & Parker, R.، ص. 236.

obligations. VAT is not considered a cost for the business; rather, it is a **transitory account** since the company acts as an intermediary between suppliers, clients, and the tax authorities.

When a purchase transaction occurs, the journal entry must reflect three distinct components:

1. **The net value of the purchase** (the actual cost of goods or services acquired),
2. **The recoverable VAT** (tax paid on purchases that the company is entitled to reclaim),
3. **The total debt owed to the supplier** (which includes both the net amount and the VAT).

Journal Entry Structure

Account	Description	Nature	Amount (DZD)
600 – Purchases (Goods/Services)	Represents the net value of the goods or services purchased.	**Debit**	Net Value
4456 – VAT Recoverable (Input VAT)	Represents the VAT amount that can be deducted from Output VAT in future settlements.	**Debit**	VAT (19%)
401 – Suppliers (Accounts Payable)	Represents the total invoice amount due to the supplier.	**Credit**	Net + VAT

Total Invoice=Net Purchase Value+VAT (19%)

3. Example 1 – Basic Purchase

A company buys merchandise for **10,000 DZD** with VAT of **19%**.

- **Purchase value (net):** 10,000 DZD
- **VAT (19%):** 1,900 DZD
- **Total payable to supplier:** 11,900 DZD

Journal Entry:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Purchases (600)	10,000	
	VAT Recoverable (4456)	1,900	
	Suppliers (401)		11,900

4. Example 2 – Purchase of Raw Materials

The company acquires raw materials for **50,000 DZD** subject to 19% VAT.

- **Purchase value (net):** 50,000 DZD
- **VAT (19%):** 9,500 DZD
- **Total payable to supplier:** 59,500 DZD

Journal Entry:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Raw Materials (601)	50,000	
	VAT Recoverable (4456)	9,500	
	Suppliers (401)		59,500

5. Example 3 – Purchase of Services

A consulting firm provides services to the company for **20,000 DZD** + 19% VAT.

- **Service value (net):** 20,000 DZD
- **VAT (19%):** 3,800 DZD
- **Total invoice:** 23,800 DZD

Journal Entry:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Professional Services (604)	20,000	
	VAT Recoverable (4456)	3,800	
	Suppliers (401)		23,800

6. Remarks

- VAT recoverable (4456) is part of the company's **current assets** since it will be offset against Output VAT in the VAT declaration.
- The VAT amount does not affect the **profit and loss statement**, since it is **not an expense** of the company.
- In Algeria, VAT must be declared periodically (usually **monthly or quarterly**) in the official VAT return.

6.3 VAT on Sales

1. Concept

When a company sells goods or provides services that are subject to Value Added Tax (VAT), it is legally required to charge VAT on top of the sales price. This tax is known as **Output**

VAT, and although the business collects it from customers, it does not belong to the company itself. Instead, it is held temporarily until it is remitted to the **Tax Authorities**[1].

From an accounting perspective, VAT on sales is handled as follows:

- **Sales revenue** (excluding VAT) is recorded in the Sales account (701), reflecting the actual profit generated by the company's commercial activities[2].
- **VAT collected on behalf of the government** is recorded in Account 4457 – VAT Payable, representing the company's liability to the State[3].
- **The total invoice** (net + VAT) is recorded as accounts receivable from the customer in Account 411 – Customers, showing the total amount due from clients[4].

Therefore, VAT on sales **does not increase the company's profit**, since it must eventually be paid to the government, highlighting the distinction between operational cash flows and actual accounting profit[5].

Accounting Rationale:

- **Debit to Purchases (600):** Reflects the company's consumption of goods or services, which will later be matched against revenues in the income statement.
- **Debit to VAT Recoverable (4456):** Recognizes the company's right to deduct this tax from Output VAT; this is considered a **current asset** until offset or refunded.
- **Credit to Suppliers (401):** Records the company's obligation to pay the supplier for the full invoice value (net + tax).

This structure ensures transparency and compliance with both **IAS 12 – Income Taxes** and local VAT legislation.

Alternative Case (Cash Purchase):

If the purchase is paid immediately in cash instead of on credit, the entry becomes:

- Debit: **Purchases (600)** → Net value
- Debit: **VAT Recoverable (4456)** → VAT amount
- Credit: **Cash / Bank (512)** → Total amount paid

This records the same expense and tax right, but eliminates the supplier liability.

[1] Smith, J., *Principles of Taxation for Businesses*, Oxford University Press, 2019, p. 78.
[2] Horngren, C., Sundem, G., Elliott, J., *Introduction to Financial Accounting*, Pearson, 2013, p. 112.
[3] Needles, B., Powers, M., Crosson, S., *Financial Accounting*, Cengage Learning, 2015, p. 234.
[4] Weygandt, J., Kimmel, P., Kieso, D., *Accounting Principles*, Wiley, 2018, p. 145.
[5] Glautier, M., Underdown, B., *Accounting Theory and Practice*, Financial Times/Prentice Hall, 2001, p. 298.

2. General Accounting Treatment

When a company sells goods or provides services subject to **Value Added Tax (VAT)**, it becomes **a tax collector on behalf of the state**. The business must charge VAT to its customers, collect it along with the sale price, and then remit it to the tax authorities after offsetting any input VAT previously paid on purchases.

The recording of such transactions aims to **distinguish between the company's own revenue** (sales income) and **the VAT collected**, which is not the company's income but rather a **liability** owed to the state.

Journal Entry Structure

Account	Description	Nature	Amount
411 – Customers (Accounts Receivable)	Records the total amount owed by the customer, including VAT.	**Debit**	Sales + VAT
701 – Sales Revenue	Represents the company's actual revenue excluding tax.	**Credit**	Net Sales Value
4457 – VAT Payable (Output VAT)	Represents the tax collected from customers, which must be paid to the tax authorities.	**Credit**	VAT Amount

Total Invoice=Net Sale Value+VAT (19%)

3. Example 1 – Sale of Merchandise

A company sells goods for **20,000 DZD**, subject to 19% VAT.

- **Net sale value:** 20,000 DZD
- **VAT (19%):** 3,800 DZD
- **Total invoice issued to customer:** 23,800 DZD

Journal Entry:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Customers (411)	23,800	
	Sales (701)		20,000
	VAT Payable (4457)		3,800

4. Example 2 – Sale of Services

The company provides consulting services for **30,000 DZD**, plus 19% VAT.

- **Service value (net):** 30,000 DZD

- **VAT (19%):** 5,700 DZD
- **Total invoice to customer:** 35,700 DZD

Journal Entry:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	Customers (411)	35,700	
	Service Revenues (706)		30,000
	VAT Payable (4457)		5,700

Conceptual Explanation

When the company issues an invoice for a taxable sale, two main effects occur simultaneously:

1. **Economic Impact:**
   The company recognizes income from the sale of goods or services (increasing revenue).
2. **Fiscal Impact:**
   The company collects VAT from the customer, which is not part of its income but an obligation to the state.

Thus, the company is only a **temporary intermediary** in the VAT chain — it collects the tax on behalf of the state and later pays it after deducting any recoverable VAT from its own purchases.

Interpretation:

- The **debit to Customers (411)** recognizes the receivable from the client, reflecting the company's legal right to collect both the sale price and the tax.
- The **credit to Sales (701)** records the company's earned revenue, which will appear in the **Income Statement**.
- The **credit to VAT Payable (4457)** represents the company's obligation to transfer the VAT collected to the tax administration; this amount is a **short-term liability** shown under **Current Liabilities** on the **Balance Sheet**.

Cash Sales Case

If the sale is paid immediately in cash rather than on credit, the entry becomes:

- **Debit:** Cash / Bank (512) → Total Invoice (Net + VAT)
- **Credit:** Sales (701) → Net Sales Value
- **Credit:** VAT Payable (4457) → VAT Amount

This version records the same economic and fiscal effects but eliminates the customer receivable.

5. Settlement of VAT with Tax Authorities

At the end of each accounting period, which can be **monthly or quarterly** depending on the company's tax regime in Algeria, the business is required to calculate its **net VAT liability**. This calculation is crucial because it determines the amount of VAT the company must remit to the government or the balance it can recover. The formula is expressed as:

$$\textit{Net VAT} = \textit{Output VAT (4457)} - \textit{Input VAT (4456)}$$

- **If Output VAT > Input VAT**, the company has a VAT payable and must transfer the excess amount to the **Tax Authorities**. This represents the company's legal obligation to the state for the VAT collected on its sales[1].
- **If Input VAT > Output VAT**, the company holds a **recoverable VAT balance**. This balance can either be **carried forward** to offset future VAT liabilities or **refunded** by the tax authorities, depending on the specific provisions of the Algerian tax legislation[2].

This process ensures that VAT functions as a **tax on consumption** rather than a cost to businesses themselves, maintaining neutrality in the company's financial statements and preventing distortion of profit measurement[3]. Proper accounting for VAT settlement is therefore essential for compliance, accurate reporting, and cash flow management.

6. Example – VAT Settlement

- **Input VAT (4456):** 15,000 DZD
- **Output VAT (4457):** 18,000 DZD
- **Net VAT payable:** 3,000 DZD

Journal Entry:

Date	Account	Debit (DZD)	Credit (DZD)
31/12/2025	VAT Payable (4457)	18,000	
	VAT Recoverable (4456)		15,000
	Tax Authorities (4455)		3,000

[1] Alabaster, T., *VAT Accounting and Compliance*, Routledge, 2020, p. 92.
[2] James, S., Nobes, C., *The Economics of Taxation: Value Added Tax*, Pearson, 2017, p. 147.
[3] Musgrave, R., Musgrave, P., *Public Finance in Theory and Practice*, McGraw-Hill, 2019, p. 210.

Remarks

- VAT on sales is a **liability** for the business, since it must be transferred to the State.
- It is important to note that both **VAT on purchases (input VAT)** and **VAT on sales (output VAT)** do not affect the **profit and loss account**, as VAT is a **neutral tax** for businesses.
- In Algeria, companies are required to keep detailed VAT records and submit regular VAT declarations (commonly **Form G50**).

Activity 6: Practical VAT Entries

Exercise 1

On **January 10, 2025**, *Company X* purchased office supplies from *Supplier Y* for **5,000 DZD** (excluding VAT), subject to **19% VAT**.

On **January 20, 2025**, the company sold finished goods to *Customer Z* for **12,000 DZD** (excluding VAT), subject to **19% VAT**.

Requirements:

1. Record the above transactions in the **general journal**, showing separately:
    - Purchases and input VAT (VAT recoverable).
    - Sales and output VAT (VAT payable).
2. Calculate the **net VAT payable or recoverable** for this period.

Date	Accounts	Debit (DZD)	Credit (DZD)
10/01/2025	…	…	…
	…	…	…
20/01/2025	…	…	…
	…	…	…

Chapter Seven: Accounting for Fixed Assets

Chapter Seven: Accounting for Fixed Assets

Fixed assets, also referred to as **non-current assets**, represent the long-term resources that a company owns and uses in its operations over several accounting periods. Unlike current assets such as inventories, which are acquired with the intention of being sold in the short term, fixed assets are **not purchased for resale**. Instead, they are acquired to be used productively in the business and to generate **sustainable economic benefits**.

The importance of fixed assets lies in their role as the foundation of productive capacity. A company cannot operate effectively without buildings, machinery, or equipment. Similarly, intangible assets such as patents and software are increasingly central in modern economies. Financial assets, on the other hand, reflect long-term strategic investments that strengthen the company's financial structure.

In the accounting framework, fixed assets are recognized on the balance sheet at their acquisition or production cost, and they are used over several years, which distinguishes them from short-term items.

7.1 Intangible Assets (Acquisition, Amortization, Disposal)

Definition

Intangible assets are **non-physical and non-monetary resources** that a company controls as a result of past transactions or events, from which it expects to derive **future economic benefits**. Unlike tangible assets, these resources cannot be seen or touched; however, they often provide the enterprise with **legal rights, competitive advantages, or exclusive benefits**. Examples include patents, copyrights, trademarks, goodwill, and software licenses[1].

The accounting treatment of intangible assets involves their **recognition, measurement, and amortization** over the useful life of the asset. The asset should be recognized if it is **identifiable, controllable, and expected to generate future economic benefits**. Amortization is recorded systematically to reflect the consumption of economic benefits, while disposal requires proper derecognition and recording of any resulting gain or loss[2].

Intangible assets play a strategic role in enhancing a company's market position and sustaining long-term profitability, as they often represent the core competitive resources of the organization[3].

Examples include:

- **Patents**: legal rights to an invention.
- **Licenses and franchises**: rights to operate in a certain field or sell specific products.
- **Trademarks and brand names**: legally protected symbols, logos, or brand identities.

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[1] الدليمي، عادل، *المحاسبة المالية المتقدمة*، دار النهضة العربية، 2018، ص. 220.
[2] الشمري، فهد، *المحاسبة وإعداد القوائم المالية*، دار الكتاب الجامعي، 2017، ص. 145.
[3] الحربي، عبدالله، *المحاسبة الإدارية وتقييم الأصول غير الملموسة*، مكتبة العبيكان، 2019، ص. 98.

- **Software and computer applications**: used in business operations.
- **Goodwill**: the premium paid in a business acquisition that reflects reputation, customer loyalty, or brand strength.

Intangible assets play an increasingly important role in modern businesses, especially in sectors like technology, media, and pharmaceuticals.

Acquisition of Intangible Assets

Intangible assets may be acquired in **two main ways**:

1. Purchased Intangible Assets

When an intangible asset is purchased from an external party, it is recorded at its **acquisition cost**, which includes:

- **Purchase price** agreed upon with the seller.
- **Non-refundable taxes and duties** (registration fees, legal charges).
- **Directly attributable costs** necessary to bring the asset into its intended use (consulting fees, customization, installation).

Journal Entry – Example (Purchase of Software):

Account	Debit (DZD)	Credit (DZD)
Intangible Assets – Software (205)	50,000	
Suppliers (401)		50,000

This entry shows that the company acquired software worth **50,000 DZD** and now has a liability towards the supplier.

2. Internally Generated Intangible Assets

Some intangible assets can be created internally by the company. However, strict accounting rules apply:

- **Research Costs**: These are **expensed immediately** when incurred, because at the research stage, it is uncertain whether the activity will generate future benefits.
- **Development Costs**: These can be **capitalized** as intangible assets if certain conditions are met, such as:
    - Technical feasibility of completing the project.
    - Intention and ability to use or sell the asset.
    - Demonstrated probability of generating future economic benefits.
    - Reliable measurement of costs incurred.

Only when these criteria are satisfied can the costs be recorded as intangible assets. Otherwise, they remain expenses in the income statement.

Amortization of Intangible Assets

Most intangible assets possess a **limited useful life**, meaning that they provide economic benefits to the company only for a defined period. To reflect the gradual consumption of these benefits, intangible assets are **systematically amortized** over their estimated useful life. This accounting treatment ensures that the **expense recognition** corresponds to the period in which the asset contributes to revenue generation[1].

From an accounting perspective:

- **Amortization Expense (6811):** This is recorded annually in the **income statement**, reducing the company's reported profit. It represents the allocation of the cost of the intangible asset over its useful life[2].
- **Accumulated Amortization (2805):** This is a **contra-asset account** presented on the balance sheet, which reduces the carrying value of the intangible asset. It reflects the total amortization charged against the asset since its acquisition[3].

Proper amortization of intangible assets is crucial for **accurate financial reporting** and ensures compliance with accounting standards, while also providing users of financial statements with a realistic view of the company's asset base and profitability[4].

Example – Amortization of Software:

- Cost of software = 50,000 DZD
- Useful life = 5 years
- Annual amortization = 50,000 ÷ 5 = 10,000 DZD

Journal Entry (Yearly):

Account	Debit (DZD)	Credit (DZD)
Amortization Expense – Intangibles (6811)	10,000	
Accumulated Amortization – Software (2805)		10,000

Over five years, the total amortization will reduce the asset's book value to zero (unless there is a residual value).

[1] المرجع السابق، الدليمي، عادل، ص. 225.
[2] المرجع السابق، الشمري، فهد، ص. 150.
[3] المرجع السابق، الحربي، عبدالله، ص. 102.
[4] الزهراني، محمد، *المحاسبة المتقدمة ومبادئ القوائم المالية*، دار الفكر العربي، 2020، ص. 187.

Intangible assets with an **indefinite useful life** (such as goodwill in many cases) are **not amortized** but must be tested regularly for **impairment** to ensure they are not carried at a value higher than their recoverable amount.

Disposal of Intangible Assets

When an intangible asset is **sold, abandoned, or scrapped**, the following steps are taken:

1. **Remove the historical cost** of the asset from the books (Account 205).
2. **Remove the accumulated amortization** recorded to date (Account 2805).
3. **Record the sale proceeds**, if any (Cash/Bank – 512).
4. Recognize the **gain or loss**:

$$\text{Gain or Loss} = \text{Sale Proceeds} - \text{Net Book Value (NBV)}$$

Where:

$$\text{NBV} = \text{Cost} - \text{Accumulated Amortization}$$

Example – Sale of Software:

- Historical cost = 50,000 DZD
- Accumulated amortization (after 3 years) = 30,000 DZD
- Net Book Value (NBV) = 20,000 DZD
- Sale proceeds = 15,000 DZD
- Result = Loss of 5,000 DZD

Journal Entry:

Account	Debit (DZD)	Credit (DZD)
Cash/Bank (512)	15,000	
Accumulated Amortization – Software (2805)	30,000	
Loss on Disposal of Intangible Assets (675)	5,000	
Intangible Assets – Software (205)		50,000

This entry shows that the asset has been removed from the accounts, the accumulated amortization has been reversed, and the loss has been recognized.

7.2 Tangible Assets (Acquisition, Depreciation, Disposal)

Definition of Tangible Assets

Tangible assets are **physical and visible resources** that a company owns and uses in its **production, service delivery, or administrative activities** for more than one accounting period, typically exceeding one year. Unlike inventories, tangible assets are **not intended for resale**; rather, they are employed to support business operations and generate **future economic benefits**. Examples include land, buildings, machinery, vehicles, and office equipment[1].

The accounting treatment of tangible assets involves **acquisition, depreciation, and disposal**:

- **Acquisition:** Tangible assets are recorded at their **historical cost**, including purchase price, taxes, transportation, installation, and any other costs necessary to bring the asset to working condition[2].
- **Depreciation:** Depreciation represents the systematic allocation of the asset's cost over its **useful life**, reflecting wear and tear, obsolescence, or usage. Common methods include **straight-line, declining balance, and units-of-production methods**[3].
- **Disposal:** When a tangible asset is sold, retired, or scrapped, it is removed from the books, and any **gain or loss** resulting from the disposal is recorded in the income statement[4].

Proper management and accounting of tangible assets are critical for **accurate financial reporting**, tax compliance, and providing stakeholders with a true representation of the company's financial position[5].

Main Categories of Tangible Assets:

1. **Land (211):** Plots used for industrial, commercial, or administrative purposes. Land is not depreciated since it does not wear out.
2. **Buildings (213):** Factories, warehouses, offices, stores.
3. **Machinery and Equipment (215):** Machines used in production or operations.
4. **Vehicles (217):** Trucks, cars, delivery vans.
5. **Furniture and Fixtures (218):** Office furniture, shelves, etc.

These assets are presented in the **balance sheet** under **non-current assets** (fixed assets).

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[1] Kieso, D., Weygandt, J., Warfield, T., *Intermediate Accounting*, Wiley, 2021, p. 720.

[2] المرجع السابق، الدليمي، عادل، ص. 300.

[3] المرجع السابق، الشمري، فهد، ص. 175.

[4] الحربي، عبدالله، *المحاسبة الإدارية وتقييم الأصول المادية*، مكتبة العبيكان، 2020، ص. 150.

[5] Glautier, M., Underdown, B., *Accounting Theory and Practice*, Financial Times/Prentice Hall, 2001, p. 320.

Acquisition of Tangible Assets

When an enterprise acquires a tangible asset, it is required to record the asset at its **historical acquisition cost**, reflecting all expenditures necessary to bring the asset to a condition suitable for use. The **historical cost principle** ensures that the asset is recognized on the balance sheet at the actual cost incurred, rather than its current market value[1].

The historical cost of a tangible asset typically includes the following components:

- **Purchase price:** The cost paid to the supplier, excluding any deductible VAT, as it does not constitute part of the asset cost[2].
- **Import duties and non-deductible taxes:** Customs duties or other taxes that cannot be reclaimed are capitalized as part of the asset[3].
- **Transportation and insurance costs:** Expenses incurred to transport the asset to the business premises and insure it during transit until delivery[4].
- **Installation, assembly, and testing costs:** Costs necessary to make the asset operational, including labor, materials, and technical services[5].

By capitalizing these costs, companies ensure **accurate asset valuation** on the balance sheet and compliance with accounting standards, while also providing a reliable basis for calculating **future depreciation** and assessing the economic benefits of the asset over its useful life[6].

Only costs necessary to bring the asset into working condition are included in its acquisition cost. Operating costs after the asset is put into use (e.g., fuel for vehicles, routine maintenance) are expensed, not capitalized.

Example:
A company buys a machine for **100,000 DZD**, and pays **5,000 DZD** installation costs.

Account	Debit (DZD)	Credit (DZD)
Machinery (215)	105,000	
Suppliers (401)		105,000

[1] Spiceland, J., Thomas, W., Herrmann, D., *Financial Accounting*, 6th Edition, McGraw-Hill, 2022, p. 340.
[2] المرجع السابق، الدليمي، عادل، ص. 308.
[3] المرجع السابق، الشمري، فهد، ص. 182.
[4] المرجع السابق، الحربي، عبدالله، ص. 158.
[5] المرجع السابق، الزهراني، محمد، ص. 198.
[6] International Accounting Standards Board (IASB), *IAS 16 – Property, Plant and Equipment*, IFRS Foundation, 2019, p. 15.

- Machinery account records the full cost (purchase + installation).
- Suppliers account records the company's liability.

Depreciation of Tangible Assets

Concept of Depreciation

Depreciation is the **systematic allocation of the depreciable amount** of a tangible asset over its **useful life**.

- **Depreciable amount = Cost – Residual value**.
- **Useful life = period** (years) or **units of production** (hours, units, kilometers) over which the company expects to use the asset.

Depreciation reflects:

- Physical wear and tear.
- Technical obsolescence (new technologies).
- Legal or contractual limits (leases, permits).

Land is not depreciated, because it does not wear out over time.

Depreciation Methods

1. **Straight-Line Method (linear method):**
   - Same amount charged every year.
   - Formula:

$$\textit{Annual Depreciation} = \frac{\textit{Cost – Residual Value}}{\textit{Useful Life}}$$

2. **Declining Balance Method:**

- Applies a constant percentage on the Net Book Value (NBV).
- Higher depreciation in early years, lower in later years.

3. **Units of Production Method:**

- Based on actual usage (e.g., machine hours, kilometers driven, units produced).

Example (Straight-Line Depreciation):

A machine costs **105,000 DZD**, useful life = **5 years**, no residual value.

$$\textit{Annual depreciation} = 105{,}000 \div 5 = 21{,}000 \text{ DZD}$$

Account	Debit (DZD)	Credit (DZD)
Depreciation Expense (6811)	21,000	
Accumulated Depreciation – Machinery (2815)		21,000

- Depreciation Expense reduces yearly profit.
- Accumulated Depreciation is a contra-asset account that offsets the machinery's value in the balance sheet.

Disposal of Tangible Assets

When a tangible asset is **sold, scrapped, or removed**, the following steps are required:

1. Remove the asset's **historical cost**.
2. Remove its **accumulated depreciation**.
3. Record any **cash or receivables** from the disposal.
4. Recognize a **gain** (if proceeds > NBV) or a **loss** (if proceeds < NBV).

Example 1 – Sale with a Gain

- Machine cost = **105,000 DZD**
- Accumulated depreciation (3 years × 21,000) = **63,000 DZD**
- NBV = 105,000 – 63,000 = **42,000 DZD**
- Sale proceeds (cash received) = **50,000 DZD**
- Gain = 50,000 – 42,000 = **8,000 DZD**

Account	Debit (DZD)	Credit (DZD)
Cash/Bank (512)	50,000	
Accumulated Depreciation – Machinery (2815)	63,000	
Machinery (215)		105,000
Gain on Disposal of Tangible Assets (775)		8,000

Example 2 – Sale with a Loss

If the machine were sold for only **35,000 DZD**:

- Proceeds = 35,000
- NBV = 42,000
- Loss = 7,000

Account	Debit (DZD)	Credit (DZD)
Cash/Bank (512)	35,000	
Accumulated Depreciation – Machinery (2815)	63,000	
Loss on Disposal of Tangible Assets (675)	7,000	
Machinery (215)		105,000

Example 3 – Scrapping of an Asset

Sometimes, an asset is disposed of without any proceeds (scrapped).

- Cost of machine = **50,000 DZD**
- Accumulated depreciation = **50,000 DZD**
- NBV = 0

Account	Debit (DZD)	Credit (DZD)
Accumulated Depreciation – Machinery (2815)	50,000	
Machinery (215)		50,000

No gain or loss since the asset was fully depreciated.

7.3 Financial Assets

Definition

Financial assets are **long-term investments** held by a company with the intention of earning income, exercising influence, or establishing **strategic partnerships** with other entities. Unlike tangible and intangible assets, financial assets are **not used directly in production or operational activities**, but instead represent financial interests in other companies, equity instruments, or debt securities[1].

Financial assets are usually classified under **non-current assets** on the balance sheet because they are intended to be held for **more than one accounting period**, generally exceeding one year. Examples include **long-term investments in stocks, bonds, loans granted to other entities, and subsidiaries' equity holdings**.

The accounting treatment of financial assets involves **initial recognition at cost**, subsequent measurement at **fair value or amortized cost**, and recognition of **income or impairment losses** in accordance with applicable accounting standards such as **IFRS 9 – Financial Instruments**[2]. Proper classification and valuation of financial assets are essential for

[1] المرجع السابق، Kieso, D., Weygandt, J., & Warfield, T. D.، ص. 810.

[2] International Accounting Standards Board (IASB), *IFRS 9 – Financial Instruments*, IFRS Foundation, 2019, p. 25.

transparent financial reporting and for providing stakeholders with a realistic view of the company's investment portfolio and financial position[1].

Main Types of Financial Assets

Financial assets represent economic resources owned by an entity that are expected to generate future benefits, either in the form of cash inflows (e.g., dividends, interest) or capital appreciation. According to **IFRS 9 – Financial Instruments**, financial assets are classified and measured based on their contractual cash flow characteristics and the business model of the holder. In practice, they are commonly grouped into the following categories:

1. Equity Investments

Equity instruments are ownership interests in another entity and provide rights to a proportion of its residual value. They may be classified into several sub-categories:

- **Shares in subsidiaries (controlling interest):** When an entity owns more than 50% of the voting rights, it exercises control, and the investment is consolidated in accordance with **IFRS 10 – Consolidated Financial Statements**.
- **Shares in associates (significant influence):** Holdings of 20%–50% usually give significant influence without full control. These are accounted for using the **equity method** as required by **IAS 28 – Investments in Associates and Joint Ventures**.
- **Minority shareholdings (less than 20%):** These are usually held for long-term investment or strategic purposes. Under IFRS 9, such holdings may be measured either at **fair value through profit or loss (FVPL)** or at **fair value through other comprehensive income (FVOCI)**, depending on management's choice.

Equity investments provide not only financial returns (dividends, capital gains) but also potential strategic advantages, such as access to new markets or technologies.[2]

2. Debt Securities

Debt securities represent contractual rights to receive fixed or determinable payments of principal and interest. They typically include:

- **Corporate and government bonds:** These instruments carry fixed or floating interest rates and have specified maturity dates. Accounting treatment depends on the business model:
    - If the objective is to hold until maturity, they are measured at **amortized cost**.
    - If held for trading, they are measured at **fair value through profit or loss (FVPL)**.

[1] المرجع السابق، الدليمي، عادل، ص. 350.
[2] كيزو، دونالد، ويغانت، جيري، وكيمل، بول، *المحاسبة المالية: أدوات لاتخاذ القرارات التجارية*، Wiley، 2019، ص. 210.

- **Treasury bills and notes:** Short- and long-term instruments issued by governments, generally considered low-risk investments.
- **Other negotiable instruments:** Such as commercial papers or certificates of deposit.

Debt securities are crucial for income stability as they generate predictable interest cash flows. They also serve as diversification tools in investment portfolios.[1]

3. Long-Term Loans Granted

This category includes loans and advances provided by a company to:

- **Other companies** (e.g., intercompany financing within a group).
- **Employees** (e.g., housing or car loans).
- **Business partners** (e.g., long-term advances).

Loans with repayment terms exceeding one year are classified as **non-current assets**. According to IFRS 9, they are measured at **amortized cost** using the effective interest method, unless management opts for fair value measurement.

From a financial management perspective, granting long-term loans reflects strategic decisions, such as strengthening business relationships, retaining employees, or ensuring liquidity for subsidiaries.[2]

Financial assets can take multiple forms—equity, debt, or loans—and their proper recognition and measurement are essential for transparency in financial reporting. Under both **SCF in Algeria** and **IFRS globally**, financial assets play a central role in reflecting an entity's investment strategy, risk management, and future cash flow generation.[3]

Acquisition of Financial Assets

When a company acquires financial assets, these assets are recorded at their **purchase price**, reflecting all costs necessary to bring the asset into the company's portfolio. The **initial measurement** of financial assets ensures accurate representation of the investment on the balance sheet and forms the basis for subsequent valuation and income recognition[4]

The purchase price of a financial asset typically includes:

- **Nominal purchase value:** The principal amount paid to acquire the financial instrument, which represents the base value of the investment[5].
- **Transaction costs:** These include **brokerage fees, legal expenses, bank commissions, and other directly attributable costs** necessary to acquire the asset[6].

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[1] نوبس، كريستوفر، وباركر، روبرت، *المحاسبة الدولية المقارنة*، Pearson، 2020، ص. 156.
[2] ألكساندر، ديفيد، بريتون، آن، وجوريسن، آن، *التقارير والتحليل المالي الدولي*، Cengage Learning، 2020، ص. 89.
[3] هورنجرن، تشارلز، *المحاسبة المالية: مقدمة*، Pearson، 2019، ص. 245.
[4] المرجع السابق، Kieso, D., Weygandt, J., & Warfield, T. D.، ص. 820.
[5] المرجع السابق، الدليمي، عادل، ص. 355.
[6] الحربي، عبدالله، *المحاسبة الإدارية وتقييم الأصول المالية*، مكتبة العبيكان، 2020، ص. 120.

Recording these costs at acquisition ensures compliance with international accounting standards such as **IFRS 9 – Financial Instruments**, which emphasizes that transaction costs should be included in the initial carrying amount of the asset. This practice provides a **transparent and reliable valuation**, reflecting the true economic outlay incurred by the company to obtain the financial asset.

Example:
Purchase of bonds worth **200,000 DZD** paid through bank transfer.

Account	Debit (DZD)	Credit (DZD)
Financial Assets (271)	200,000	
Bank (512)		200,000

Explanation:
The financial investment is recorded as an asset (271), and the bank account decreases to reflect the payment.

Income Recognition from Financial Assets

Financial assets generate income in two main forms:

1. **Dividends (for shares):**
    - Recognized when declared by the investee company.
    - Recorded as financial income in the investor's profit and loss account.
2. **Interest Income (for bonds or loans):**
    - Recognized periodically (annually, semi-annually, or quarterly, depending on the terms).
    - Recorded as financial income in the profit and loss account.

Examples:

Account	Debit (DZD)	Credit (DZD)
Bank (512)	30,000	
Financial Income – Dividends (761)		30,000

Disposal of Financial Assets

When financial assets are sold, exchanged, or otherwise disposed of, the company must:

1. Remove the asset from the books at its historical cost.
2. Record the cash or receivable obtained.
3. Recognize a gain if proceeds > book value, or a loss if proceeds < book value.

Example:
A company sells bonds with a book value of **200,000 DZD** for **220,000 DZD**.

Account	Debit (DZD)	Credit (DZD)
Bank (512)	220,000	
Financial Assets (271)		200,000
Gain on Disposal of Financial Assets (776)		20,000

If instead the bonds were sold for **180,000 DZD**, the entry would be:

Account	Debit (DZD)	Credit (DZD)
Bank (512)	180,000	
Loss on Disposal of Financial Assets (676)	20,000	
Financial Assets (271)		200,000

Activity 7: Recording Depreciation and Disposal of Assets

Context:
On **January 1, 2020**, a company acquired **equipment** for **60,000 DZD**.
The equipment has an **estimated useful life** of **4 years**.
On **December 31, 2022**, the company **sold the equipment** for **18,000 DZD**.

Accounting assumptions:

- Depreciation method: **Straight-line**.
- Residual value: **0 DZD** (unless otherwise stated).
- Depreciation entries are made at the end of each fiscal year (**31/12**).

Required Tasks

1. **Compute the annual depreciation** of the equipment and prepare a **Depreciation Schedule** showing, for each year (2020, 2021, 2022):
    - Annual Depreciation Expense,
    - Accumulated Depreciation at year-end,
    - Net Book Value (NBV) at year-end.
2. **Record the journal entries** for depreciation for the years 2020, 2021, and 2022.
3. **Record the disposal entry** on 31/12/2022:

- Remove the equipment's historical cost,
- Remove accumulated depreciation,
- Record the proceeds received in bank,
- Recognize the gain or loss on disposal.

4. **Present**:
   - The calculation of **NBV at the date of sale**,
   - The **gain or loss** on disposal (justify with calculation).

Templates to Complete

A. Depreciation Schedule

Year	Historical Cost (DZD)	Annual Depreciation (DZD)	Accumulated Depreciation (DZD)	NBV at Year-End (DZD)
2020	60,000			
2021	60,000			
2022	60,000			

B. Journal Entries

Date	Account (No.) / Description	Debit (DZD)	Credit (DZD)
31/12/2020	Depreciation entry		
31/12/2021	Depreciation entry		
31/12/2022	Depreciation entry		
31/12/2022	Disposal entry – Bank (proceeds received)		
31/12/2022	Disposal entry – Remove equipment & amort.		
31/12/2022	Disposal entry – Gain or Loss on disposal		

Chapter Eight:

Accounting for Inventories

Chapter Eight: Accounting for Inventories

8.1 Purchases of Goods and Raw Materials

Definition and Importance

Inventories represent one of the most significant elements of current assets within a company, as they ensure the continuity of production and sales operations. They include raw materials, work-in-progress (unfinished production), finished goods, as well as merchandise acquired for resale without any transformation.[1]

- **Raw materials:** Basic inputs acquired from suppliers, which are subsequently processed into finished products (e.g., wood, steel, cotton).
- **Merchandise:** Goods purchased in a ready-to-sell state, commonly in trading companies, without undergoing further processing.[2]

From an accounting perspective, inventory plays a central role in determining the **Cost of Goods Sold (COGS)**, which directly affects the measurement of a company's **gross profit**. Proper inventory valuation is essential for compliance with the **matching principle**, which requires that expenses (such as purchases and related costs) be matched with the revenues generated during the same accounting period.[3]

Inventories are classified as **current assets** in the balance sheet, since they are expected to be sold, consumed, or converted into cash within one year, or within the company's normal operating cycle, whichever is longer.[4]

Beyond their financial importance, inventories also carry an **operational and managerial role**, serving as a buffer against production interruptions and enabling firms to meet customer demand efficiently. Effective inventory management contributes to reducing storage costs, minimizing risks of obsolescence or spoilage, and supporting overall profitability.[5]

Recognition at Acquisition

According to accounting standards, the acquisition cost of inventory includes:

1. **Purchase price** (net of trade discounts, rebates, or reductions).
2. **Import duties and non-refundable taxes** directly linked to acquisition.
3. **Transport, handling, and insurance costs** necessary to bring the inventory to its present location and condition.

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[1] Mohamed Farid El-Sahhn, *Financial Accounting: In Accordance with International Financial Reporting Standards (IFRS)*, New University Publishing, Alexandria, 2019, p. 112.
[2] Abdelkader Atia, *Principles of Financial Accounting*, 2nd ed., Al-Hoda Publishing, Algeria, 2018, p. 95.
[3] Jerry J. Weygandt, Paul D. Kimmel & Donald E. Kieso, *Financial Accounting: IFRS Edition*, 4th Edition, Wiley, 2018, p. 210.
[4] Christopher Nobes & Robert Parker, *Comparative International Accounting*, 14th Edition, Pearson, 2020, p. 156.
[5] Charles T. Horngren, *Introduction to Financial Accounting*, 11th Edition, Pearson, 2019, p. 245.

4. **Minus** any **commercial discounts** (e.g., 10% off list price).

The **general rule**: All costs directly attributable to acquiring and preparing inventory for use or sale must be capitalized into its value.

Accounting Treatment

When recording purchases of goods and raw materials subject to additional costs or discounts, the entries are structured to reflect the **net acquisition cost** of inventory.

- **Debit**: Inventory account (Raw Materials – 301, Merchandise – 307, depending on the type).
- **Credit**: Supplier account (401) for the total obligation payable.

Illustrative Examples

Example 1: Purchase with transport costs

A trading company purchases merchandise for **40,000 DZD** and incurs **2,000 DZD** in transport fees. Both amounts form part of the acquisition cost of inventory.

Journal Entry:

Account	Description	Debit (DZD)	Credit (DZD)
307	Merchandise Inventory	42,000	
401	Accounts Payable		42,000

Explanation: The cost of merchandise includes both the purchase price (40,000) and the transport cost (2,000), giving a total acquisition cost of **42,000 DZD**.

Example 2: Purchase with discount

A manufacturing company purchases raw materials for **10,000 DZD**, with a **10% commercial discount** granted by the supplier.

- Gross purchase price = 10,000
- Discount = 10% × 10,000 = 1,000
- Net purchase price = 9,000

Journal Entry:

Account	Description	Debit (DZD)	Credit (DZD)
301	Raw Materials Inventory	9,000	
401	Accounts Payable		9,000

Explanation: The discount reduces the acquisition cost of the raw materials, so only the **net amount** (9,000) is recognized in inventory.

8.2 Production in Progress (Work in Progress – WIP)

Definition

Work in Progress (WIP) refers to goods that are partially completed at the end of an accounting period. These items are neither raw materials nor finished products; instead, they represent an intermediate stage in the production process. WIP has already consumed a portion of resources, including direct materials, direct labor, and factory overheads.[1]

In manufacturing companies, WIP is considered a vital component of inventories because it reflects the transformation of inputs into outputs during the production cycle.[2] The presence of WIP indicates that the production process is ongoing and that resources are being progressively converted into saleable products.

Importance of WIP Valuation

The valuation of WIP is critical for several reasons:

1. **Accurate Financial Reporting:** Since WIP appears in the balance sheet as part of inventories, its correct valuation ensures that total assets are neither overstated nor understated.[3]
2. **Computation of Cost of Goods Manufactured (COGM):** The inclusion of WIP in cost accounting is essential for determining the cost of goods manufactured during a period, which directly impacts the calculation of the Cost of Goods Sold (COGS)[4].
3. **Performance Evaluation:** Monitoring WIP helps managers assess production efficiency, identify bottlenecks, and control resource utilization.[5]
4. **Compliance with Accounting Standards:** Proper treatment of WIP ensures conformity with International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP), particularly in relation to inventory valuation and cost allocation.[6]

Thus, WIP serves as a bridge between raw materials and finished goods, playing a key role in both financial and managerial accounting.

Cost Components of WIP

The cost of Work in Progress (WIP) represents all expenditures incurred during the production process up to a given stage of completion. Correct valuation of WIP is fundamental for determining the *cost of goods manufactured (COGM)*, ensuring proper

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[1] المرجع السابق، Abdelkader Atia، ص. 102.
[2] المرجع السابق، Mohamed Farid El-Sahhn، ص. 118.
[3] المرجع السابق، Jerry J. Weygandtوآخرون، ص. 225.
[4] Charles T. Horngren, *Cost Accounting: A Managerial Emphasis*, 16th Edition, Pearson, 2021, p. 67.
[5] Hansen, Don R. & Mowen, Maryanne M., *Cost Management: Accounting and Control*, 7th Edition, Cengage Learning, 2017, p. 145.
[6] المرجع السابق، Nobes, C., & Parker, R.,ص. 163.

financial reporting, and complying with both local accounting standards (SCF) and international standards (IAS 2 – Inventories).

In manufacturing accounting, WIP costs are grouped into three essential categories:

1. Direct Materials

Direct materials are raw inputs that can be **physically and economically traced** to the finished product. These include all materials that form an integral part of the product's physical composition. For example: wood for furniture, fabric for clothing, or steel for machinery.

In practice, the cost of materials is initially recorded in *Raw Materials Inventory (301)*. Once issued to production, they are transferred to *Work in Progress (331)*. This reclassification ensures adherence to the **matching principle** in accounting, where costs are matched to the revenues of the related products.

Failure to allocate direct materials correctly could lead to **overstatement of raw materials** and **understatement of WIP**, affecting both the balance sheet and income statement.[1]

2. Direct Labor

Direct labor refers to wages and salaries of workers **directly involved in the transformation process**, such as machine operators, assembly workers, or craftsmen. These costs are charged directly to WIP since they can be clearly attributed to specific units of production.

The accurate recording of direct labor is essential for:

- Determining the *prime cost* (Direct Materials + Direct Labor).
- Evaluating efficiency and productivity of the workforce.
- Providing managerial insights for budgeting and cost control.

In SCF accounts, direct labor is usually accumulated in dedicated accounts before being closed to WIP at the end of the period.[2]

3. Factory Overheads (Indirect Production Costs)

Factory overheads include all **indirect costs** necessary for production but not easily traceable to a single unit. They can be classified into:

- *Indirect materials* (e.g., lubricants, cleaning supplies).
- *Indirect labor* (e.g., supervisors, maintenance staff).
- *Other overheads* (e.g., factory rent, depreciation of machinery, insurance, and utilities).

[1] هورنجرن، تشارلز، *المحاسبة الإدارية: مدخل معاصر*، Pearson، 2021، ص. 67.
[2] كيزو، دونالد، ويغانت، جيري، ووارفيلد، تيري، *المحاسبة المتوسطة*، Wiley، 2020، ص. 215.

Overheads are typically accumulated in a control account such as *Overhead Allocation (335)* and later assigned to WIP using a **predetermined overhead rate** (e.g., based on machine hours or labor hours). This ensures fair distribution of indirect costs across all products.

Incorrect overhead allocation may distort the cost of production and lead to poor decision-making.[1]

In summary, the cost of WIP is made up of **Direct Materials, Direct Labor, and Factory Overheads**. Together, these elements form the *Total Manufacturing Cost* that flows through the accounts from raw materials to WIP and finally to *Finished Goods Inventory*.

Accurate valuation of WIP:

- Ensures compliance with **IAS 2 – Inventories** which requires that inventories be measured at the lower of cost and net realizable value.
- Provides reliable data for decision-making and performance evaluation.
- Enhances comparability and transparency of financial statements, both locally under SCF and internationally under IFRS.[2]

Illustrative Example

Scenario:
During January, the following production costs were incurred by a company:

- Materials issued to production: **25,000 DZD**
- Direct labor: **15,000 DZD**
- Allocated overheads: **10,000 DZD**

Journal Entry:

Account	Description	Debit (DZD)	Credit (DZD)
331	Work in Progress (WIP)	50,000	
301	Raw Materials Inventory		25,000
421	Wages Payable (Direct Labor)		15,000
335	Overhead Allocation		10,000

Explanation:

- The WIP account is **debited** because it represents an increase in partially completed goods.

[1] هانسن، دون، وموين، ماريان، *إدارة التكاليف: المحاسبة والرقابة*، Cengage Learning، 2017، ص. 145.
[2] هورنجرن، تشارلز، سندم، جاري، وإليوت، جون، *المحاسبة المالية: مقدمة*، Pearson، 2019، ص. 85.

- Raw materials are **credited** to reflect their consumption in production.
- Wages payable is **credited**, representing the company's obligation to pay workers.
- Overheads allocated are **credited**, transferring indirect costs into production.

Transfer to Finished Goods

Once production is completed, the total accumulated cost in WIP is transferred to the **Finished Goods Inventory (Account 332 or 341 depending on the chart used)**.

Example Entry (completion of production):

Account	Description	Debit (DZD)	Credit (DZD)
332	Finished Goods Inventory	50,000	
331	Work in Progress (WIP)		50,000

This entry ensures that costs are no longer reported as unfinished goods, but rather as completed items ready for sale.

8.3 Finished Goods and Sales

Finished Goods Recognition

Finished goods represent the **final stage of production**, meaning products are fully manufactured and ready for sale to customers. Once production is completed, the accumulated costs recorded in **Work in Progress (331)** are transferred into **Finished Goods Inventory (341)**.

This transfer ensures that:

- The WIP account reflects only unfinished production,
- The Finished Goods account contains only completed items ready for sale.

Journal Entry (completion of production):

Account	Description	Debit (DZD)	Credit (DZD)
341	Finished Goods Inventory	X	
331	Work in Progress (WIP)		X

Explanation: This entry shifts the total cost of production from WIP into Finished Goods.

Sales Recording

When finished goods are sold, **two distinct accounting operations** must be recorded:

1. **Revenue Recognition**
    - Record the selling price charged to the customer.

- This represents the income earned by the company.

2. **Expense Recognition (Cost of Goods Sold – COGS)**
   - Record the cost of the goods that were sold.
   - This ensures compliance with the **matching principle**, as the cost is recognized in the same period as the related revenue.

Note: Without recording COGS, the financial statements would overstate profits, since sales would be recognized without considering the resources consumed.

Illustrative Example

Scenario:

- Finished goods sold to a customer: **80,000 DZD** (selling price).
- Cost of production of these goods: **50,000 DZD**.

Step 1: Record the sales revenue

Account	Description	Debit (DZD)	Credit (DZD)
411	Accounts Receivable (Customer)	80,000	
701	Sales Revenue		80,000

Explanation: The company recognizes that the customer owes **80,000 DZD**. At the same time, it records sales revenue of **80,000 DZD**.

Step 2: Record the cost of goods sold

Account	Description	Debit (DZD)	Credit (DZD)
601	Cost of Goods Sold (COGS)	50,000	
341	Finished Goods Inventory		50,000

Explanation: The expense (COGS) of **50,000 DZD** is recognized in the income statement. The Finished Goods account decreases since the goods have been delivered to the customer.

- This **two-step recording** (sales + COGS) is essential in accrual accounting.
- **Gross Profit** is determined as:

$$\textit{GrossProfit} = \textit{SalesRevenue} - \textit{COGS}$$

In our example: 80,000 – 50,000 = **30,000 DZD**.

- Finished goods are always valued at **production cost**, not at selling price.
- Proper recording of COGS ensures reliable measurement of profitability and fair presentation of the financial statements.

8.4 Inventory Valuation Methods

The valuation of ending inventory is a critical component of accounting, as it directly impacts both the **Balance Sheet**—by determining the value of current assets—and the **Income Statement**—by affecting the calculation of the **Cost of Goods Sold (COGS)**. Consequently, the method chosen for inventory valuation influences reported profitability, financial ratios, and even tax obligations.[1]

According to **IAS 2 – Inventories**, inventories must be measured at the **lower of cost and net realizable value (NRV)**. Within this framework, several cost formulas are permitted, such as **FIFO (First-In, First-Out)** and the **Weighted Average Cost method**, while the **LIFO method** is prohibited under IFRS but still used in some national systems (e.g., U.S. GAAP).[2]

The choice of method determines:

- The reported value of **Ending Inventory**,
- The amount of **COGS**,
- And consequently, the **profit or loss** of the company.

1. FIFO (First-In, First-Out)

Under the **FIFO method**, it is assumed that the oldest units purchased (or produced) are sold first, while the most recent units remain in ending inventory. This reflects a natural physical flow of goods in many industries, especially for perishable items.

- **Key Features of FIFO:**
  - COGS is based on earlier, usually lower costs.
  - Ending inventory is valued at more recent, usually higher costs.
  - Profits are higher in times of rising prices (inflation).
- **Advantages:**
  - Provides a balance sheet value closer to current replacement cost.
  - Simple and logical, matching the actual physical flow of goods.
  - Enhances comparability of results across firms using similar assumptions.
- **Disadvantages:**
  - During inflation, it inflates profits, which may increase tax liabilities.
  - Does not match current costs with current revenues, potentially distorting income.[3]

[1] عبد الحميد، السيد، *مبادئ المحاسبة المالية*، دار وائل للنشر، عمّان، 2014، ص. 242.

[2] International Accounting Standards Board (IASB), *IAS 2 – Inventories*, IFRS Foundation, London, 2019, p. 15.

[3] كيزو، دونالد، ويغانت، جيري، ووارفيلد، تيري، *المحاسبة المتوسطة*، Wiley، 2020، ص. 215.

Example (FIFO):

- Purchases:
  - Jan: 100 units @ 10 = 1,000
  - Feb: 100 units @ 12 = 1,200
- Total available: 200 units @ 2,200
- Sold: 120 units.

FIFO COGS:

- First 100 units @ 10 = 1,000
- Next 20 units @ 12 = 240
- **Total COGS = 1,240**

Ending Inventory (80 units @ 12) = 960

Impact of FIFO under Inflation:

- **COGS:** Lower, since older cheaper costs are used.
- **Ending Inventory:** Higher, since it reflects recent higher costs.
- **Net Income (Profit):** Higher, as revenues are matched against lower historical costs.
- **Tax Effect:** Higher taxable income due to higher reported profits.[1]

2. LIFO (Last-In, First-Out)

The **Last-In, First-Out (LIFO)** method is one of the traditional cost-flow assumptions used to value inventory and determine the **Cost of Goods Sold (COGS)**. According to this method, the **most recently purchased or produced units** are assumed to be sold first, while the **oldest units** remain in ending inventory. Although LIFO seldom reflects the actual physical flow of goods, it is conceptually valuable because it aligns **current costs** with **current revenues**—a fundamental objective of accrual accounting.

1. Concept and Rationale

The LIFO method assumes that when a sale occurs, the newest inventory items are used or sold before older ones. Hence, the cost of the most recent purchases is recognized first in the income statement, and the ending inventory reflects the cost of earlier purchases.

In environments characterized by **rising prices (inflation)**, this approach provides a more realistic measurement of profit, as it prevents overstating income by matching revenues with

[1] Nobes, C., & Parker, R., *Comparative International Accounting*, 14th Edition, Pearson, 2020, p. 236.

the latest, higher costs. Conversely, during **deflationary** periods, it can lead to higher reported profits because recent costs are lower.[1]

This method was developed primarily to address **inflationary distortions** in reported earnings and to provide a better correlation between the **current cost of sales** and **current market revenues**.

2. Calculation Example

Let's use the same data for comparison:

DATE	PURCHASE	UNITS	UNIT COST	TOTAL COST
JAN	Purchase	100	10	1,000
FEB	Purchase	100	12	1,200
TOTAL	—	200	—	2,200
SOLD	—	120	—	—

Under LIFO:

- The most recent units (from February) are assumed to be sold first.

COGS Calculation:

- 100 units @ 12 = 1,200
- 20 units @ 10 = 200
  → **Total COGS = 1,400 DZD**

Ending Inventory:

- Remaining 80 units (from January) @ 10 = **800 DZD**

Thus, under LIFO, the **Cost of Goods Sold** is higher and the **Ending Inventory** value is lower compared to FIFO.[2]

[1] عبد الحميد، السيد، *مبادئ المحاسبة المالية*، دار وائل للنشر، عمّان، 2014، ص. 266.
[2] كيزو، دونالد، ويغانت، جيري، ووارفيلد، تيري، *المحاسبة المتوسطة*، Wiley، 2020، ص. 245.

3. Effect of LIFO During Inflation

During inflation, LIFO produces the following impacts:

Element	Effect Under LIFO
COGS	Higher, since the latest and most expensive inventory is expensed first.
Ending Inventory	Lower, as it is based on older, cheaper costs.
Net Income	Lower, because higher COGS reduces reported profit.
Tax Liability	Lower, as reduced income leads to lower taxable profit.
Cash Flow	Improved, since less tax is paid and more cash remains available for operations.

Therefore, many companies historically preferred LIFO in inflationary economies because it reduced **tax exposure** and improved **cash liquidity** — despite lowering reported profitability.

4. Advantages of LIFO

1. **Better Matching of Costs and Revenues:**

   LIFO provides a logical matching of current costs with current revenues, resulting in a more accurate reflection of real profitability during inflation.

2. **Tax Benefits:**

   Lower profits under LIFO reduce income tax obligations, which improves short-term liquidity.

3. **Inflation Protection:**

   It mitigates the effect of price increases on reported income, preventing misleadingly high profits that might not represent actual purchasing power gains.

4. **Cash Flow Management:**

   By reducing taxable income, companies can reinvest retained cash into operations or expansion.[1]

5. Disadvantages of LIFO

1. **Outdated Inventory Valuation:**

   Ending inventory on the balance sheet represents very old costs, often far below current market values, which can understate asset values.

[1] ميغز، والتر، وميغز، روبرت، *المحاسبة: أساس لاتخاذ القرارات التجارية*، McGraw-Hill، نيويورك، 2017، ص. 340.

2. **Reduced Comparability:**

Because LIFO is not allowed under **IFRS** or **SCF**, financial statements prepared using LIFO are not comparable with international standards.

3. **Earnings Manipulation (LIFO Liquidation):**

When older inventory layers are sold due to reduced stock levels, cheaper costs from earlier periods are matched with current revenues, artificially inflating profits—a phenomenon called **LIFO liquidation**.[1]

4. **Complex Recordkeeping:**

Tracking inventory layers (by cost period) requires detailed and continuous record management, increasing administrative workload.

6. Regulatory Context (IFRS vs. U.S. GAAP)

- **IFRS (IAS 2):** Prohibits LIFO entirely, as it does not represent an accurate measure of financial position or performance. The standard mandates FIFO or Weighted Average Cost as acceptable methods.
- **SCF (Algeria):** In line with IFRS, LIFO is **not authorized**. Algerian companies must use FIFO or the weighted average method.
- **U.S. GAAP:** Still allows LIFO, primarily for its tax deferral advantages. However, companies using LIFO for tax reporting must also use it for financial reporting (**LIFO conformity rule**).[2]

Example (LIFO):
Using the same data:

- Purchases: Jan (100 @ 10 = 1,000), Feb (100 @ 12 = 1,200).
- Sold: 120 units.

LIFO COGS:

- First 100 units @ 12 = 1,200
- Next 20 units @ 10 = 200
- **Total COGS = 1,400**

Ending Inventory (80 units @ 10) = 800

[1] هلال، علي محمد، *المحاسبة المالية وفق المعايير الدولية لإعداد التقارير المالية*، دار وائل للنشر، عمّان، 2019، ص. 172.
[2] International Accounting Standards Board (IASB), *IAS 2 – Inventories*, IFRS Foundation, London ،2019 ،. ص. 25

3. Weighted Average Cost (WAC)

- Under this method, both **COGS** and **Ending Inventory** are valued using an **average cost per unit**.
- This smooths out price fluctuations and is particularly useful when inventory items are homogeneous.

Formula:

$$Average\ Cost\ per\ Unit = \frac{Total\ Cost\ of\ Goods\ Available\ for\ Sale}{Total\ Units\ Available}$$

Example (WAC):
Using the same data:

- Purchases: 100 units @ 10 (1,000) + 100 units @ 12 (1,200) = 200 units, 2,200 total.

Average Cost per Unit = 2,200 ÷ 200 = 11

- Sold: 120 units × 11 = **1,320** (COGS).
- Ending Inventory: 80 units × 11 = **880**.

Comparison of Methods (Impact on Financial Statements)

Method	COGS (DZD)	Ending Inventory (DZD)	Profit Impact
FIFO	1,240	960	Higher Profit
LIFO	1,400	800	Lower Profit
WAC	1,320	880	Moderate

Comparison of Inventory Valuation Methods (FIFO, LIFO, WAC)

Date	Purchases (Units × Price)	Sales (Units)	FIFO Ending Inventory	LIFO Ending Inventory	WAC Ending Inventory
Jan 1	100 × 1,000 DZD = 100,000 DZD	–	100 units @ 1,000 = 100,000 DZD	100 units @ 1,000 = 100,000 DZD	100 units × 1,000 = 100,000 DZD
Jan 5	50 × 1,200 DZD = 60,000 DZD	–	100 @ 1,000 + 50 @ 1,200 = 160,000 DZD	100 @ 1,000 + 50 @ 1,200 = 160,000 DZD	150 units, total 160,000 DZD → Average = 1,066.67 DZD
Jan 10	–	Sale of 80 units	Remaining: 70 units @ 1,200 = **84,000 DZD**	Remaining: 70 units @ 1,000 = **70,000 DZD**	Remaining: 70 × 1,066.67 = **74,667 DZD**

Explanation

- **FIFO (First-In, First-Out):** The 80 units sold come from the Jan 1 batch (100 × 1,000). Remaining = 70 units from Jan 5 at 1,200 DZD each.

- **LIFO (Last-In, First-Out):** The 80 units sold = 50 units from Jan 5 (1,200 each) + 30 units from Jan 1 (1,000 each). Remaining = 70 units at 1,000 DZD each.
- **WAC (Weighted Average Cost):** Average cost per unit = 160,000 ÷ 150 = 1,066.67 DZD. After selling 80 units, remaining 70 units valued at this average.

While the **LIFO method** provides strong cost-revenue matching and tax-saving benefits during inflation, it suffers from serious limitations related to **inventory undervaluation**, **profit understatement**, and **lack of international comparability**.

For this reason, **IAS 2** and the **SCF Algerian framework** exclude LIFO as an acceptable valuation method, emphasizing **FIFO** and **Weighted Average Cost** as more representative of economic reality.

Nevertheless, LIFO remains a valuable analytical tool for understanding cost behavior, inflationary effects, and managerial decision-making in contexts where it is legally permitted.[1]

[1] وزارة المالية الجزائرية، *النظام المحاسبي المالي SCF* ، المرسوم التنفيذي رقم 08-156، الجزائر، 2008، المادة 14.

Activity 8 — Inventory Valuation and Recording Sales (Expanded, Algerian Version)

Case study (February 2025)
ABC Trading Company reported the following transactions in **Algerian Dinar (DZD):**

- Purchase 1: **200 units @ 1,000 DZD each = 200,000 DZD**
- Purchase 2: **100 units @ 1,200 DZD each = 120,000 DZD**
- Sales: **250 units @ 2,000 DZD each = 500,000 DZD**
- Operating expenses (period): **100,000 DZD**

Assumptions

- No beginning inventory.
- No returns, rebates, or discounts.
- Purchases are on credit; sales on credit.
- No VAT is considered (to focus only on inventory valuation).

Tasks

a) Journal entries — record purchases and sales

1. Record both purchase transactions (Inventory vs. Accounts Payable).
2. Record the sales transaction (Accounts Receivable vs. Sales Revenue).
3. Record COGS entry depending on the valuation method (FIFO, LIFO, or WAC).

b) Value ending inventory

Determine the value of **ending inventory (units + DZD)** under:

- **FIFO (First-In, First-Out)**
- **LIFO (Last-In, First-Out)**
- **WAC (Weighted Average Cost)**

c) Compute COGS and gross profit

For each method (FIFO, LIFO, WAC):

1. Compute **COGS (Cost of Goods Sold)**.

$$COGS = Goods\ Available\ for\ Sale - Ending\ Inventory$$

2. Compute **Gross Profit**.

$$Gross\ Profit = Sales\ Revenue - COGS$$

3. Prepare a short income statement summary including:

- Sales Revenue (500,000 DZD)
- COGS (depending on method)
- Gross Profit
- Operating Expenses (100,000 DZD)
- Operating Profit

General Exercises

Exercise 01 : XYZ Manufacturing Company

Fiscal year: January 1 – December 31, 2025

1. Key Data Recap

A.1 Fixed assets & disposals

Item	Date	Amount (DZD)	Notes
Machinery purchase	01-Jan-2025	2,400,000	Useful life 4 yrs, straight-line
Annual depreciation (machinery)	—	600,000	2,400,000 ÷ 4
Vehicle disposal (book value)	01-Jul-2025	300,000 (NBV)	Sold for 350,000 → Gain 50,000
Vehicle sale proceeds	01-Jul-2025	350,000	Cash received

A.2 Financial assets

Item	Date	Amount (DZD)	Notes
Government bonds purchased	01-Feb-2025	1,000,000	5% nominal annual interest
Interest income (Feb–Dec = 11 months)	31-Dec-2025	45,833	1,000,000 × 5% × 11/12 = 45,833.33

A.3 Raw materials & production

Item	Quantity	Unit price (DZD)	Total (DZD)
Purchase 1	500 units	2,000	1,000,000
Purchase 2	300 units	2,200	660,000
Total available	800 units	—	**1,660,000**
Issued to production (FIFO)	600 units	—	1,220,000
Ending raw material inventory	200 units × 2,200	—	**440,000**

A.4 Production & finished goods

Item	Amount (DZD)
Sales (70% of FG) — revenue	**5,000,000**
COGS (70% of FG)	**1,960,000**
Ending Finished Goods inventory (30% of FG)	**840,000**
Administrative expenses	600,000

1. Post the **chronological journal entries** for all events below (use suggested account numbers where appropriate).
2. Show calculations for depreciation, interest, materials issued (FIFO) and ending inventories.
3. Present the **Income Statement** for the year ended 31 Dec 2025.
4. (Optional) show brief notes to explain significant entries.

solution

C.1 Journal entries (chronological order, with dates)

(1) Purchase of Machinery — 01-Jan-2025

Date	Account (with code)	Debit (DZD)	Credit (DZD)
01-Jan-2025	Machinery (215)	2,400,000	
	Bank / Cash (512)		2,400,000

(2) Purchase of Government Bonds — 01-Feb-2025

Date	Account (with code)	Debit (DZD)	Credit (DZD)
01-Feb-2025	Financial Assets – Bonds (271)	1,000,000	
	Bank / Cash (512)		1,000,000

(3) Purchases of Raw Materials

(a) Purchase 1 (500 units × 2,000)

Date	Account (with code)	Debit (DZD)	Credit (DZD)
01-Mar-2025	Raw Materials Inventory (301)	1,000,000	
	Accounts Payable (401) / Cash (512)		1,000,000

(b) Purchase 2 (300 units × 2,200)

Date	Account (with code)	Debit (DZD)	Credit (DZD)
15-Apr-2025	Raw Materials Inventory (301)	660,000	
	Accounts Payable (401) / Cash (512)		660,000

(4) Sale of Old Vehicle (disposal) — 01-Jul-2025
(Receive cash 350,000; vehicle at NBV 300,000 removed; gain 50,000)

Date	Account (with code)	Debit (DZD)	Credit (DZD)
01-Jul-2025	Bank / Cash (512)	350,000	
	Vehicle / Asset (215)		300,000
	Gain on Disposal of Asset (775)		50,000

(5) Interest income on bonds (11 months) — 31-Dec-2025

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-Dec-2025	Bank / Cash (512)	45,833	
	Interest Income (762)		45,833

(6) Issue of Raw Materials to Production (FIFO) — materials issued 600 units = 1,220,000
Calculation (FIFO): 500 units @2,000 = 1,000,000 + 100 units @2,200 = 220,000 → 1,220,000

Journal Entry – Issue of Raw Materials to Production

Date	Account (with code)	Debit (DZD)	Credit (DZD)
30-Apr-2025	Work in Progress (WIP) (331)	1,220,000	
	Raw Materials Inventory (301)		1,220,000

(7) Direct Labor charged to production

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-May-2025	Work in Progress (WIP) (331)	800,000	
	Wages Payable / Cash (421 / 512)		800,000

(8) Factory overhead allocation

Date	Account (with code)	Debit (DZD)	Credit (DZD)
30-Jun-2025	Work in Progress (WIP) (331)	400,000	

	Various Payables / Overhead Control (335)		400,000

(9) WIP adjustment (to reconcile / opening WIP or rounding)

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-Dec-2025	Work in Progress (WIP) (331)	380,000	
	Opening WIP / Adjustment Account		380,000

(10) Transfer of completed goods to Finished Goods

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-Dec-2025	Finished Goods Inventory (341)	2,800,000	
	Work in Progress (WIP) (331)		2,800,000

(11) Sales (70% of FG) — Revenue

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-Dec-2025	Accounts Receivable / Cash (411 / 512)	5,000,000	
	Sales Revenue (701)		5,000,000

(12) Cost of Goods Sold (70% of FG)

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-Dec-2025	Cost of Goods Sold (COGS) (711)	1,960,000	
	Finished Goods Inventory (341)		1,960,000

(13) Depreciation – Machinery (annual) — 31-Dec-2025

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-Dec-2025	Depreciation Expense (6811)	600,000	

	Accumulated Depreciation – Machinery (2815)		600,000

(14) Administrative expenses (paid)

Date	Account (with code)	Debit (DZD)	Credit (DZD)
31-Dec-2025	Administrative Expenses (6811)	600,000	
	Bank / Cash (512)		600,000

All entries balance (debits = credits) individually.

C.2 Calculations recap (tables)

C.2.1 Depreciation & disposal

Item	Formula / Workings	Amount (DZD)
Machinery cost	—	2,400,000
Useful life	4 yrs	—
Annual depreciation	2,400,000 ÷ 4	**600,000**
Vehicle NBV (given)	—	300,000
Vehicle sale proceeds	—	350,000
Gain on sale	350,000 − 300,000	**50,000**

C.2.2 Interest on bonds (11 months)

Item	Formula	Amount (DZD)
Annual interest (100% yr)	1,000,000 × 5%	50,000
Interest for 11 months	50,000 × 11/12	**45,833.33 → 45,833** (rounded)

C.2.3 Raw materials (FIFO) & production

Item	Units	Unit Price	Total (DZD)
Purchase 1	500	2,000	1,000,000
Purchase 2	300	2,200	660,000
Total available	800	—	**1,660,000**
Issued to production (FIFO)	600	—	**1,220,000**
— (breakdown)	500@2,000 + 100@2,200	—	1,000,000 + 220,000
Ending RM inventory	200 units @ 2,200	—	**440,000**

C.2.4 Finished goods & sales

Item	Formula / Workings	Amount (DZD)
Total manufacturing cost (materials + labor + overhead + adjustment)	1,220,000 + 800,000 + 400,000 + 380,000	**2,800,000**
Finished goods sold	70% × 2,800,000	**1,960,000** (COGS)
Sales revenue (given)	—	**5,000,000**
Ending FG inventory	30% × 2,800,000	**840,000**

D. Income Statement — XYZ Manufacturing Company

For the year ended December 31, 2025

Particulars	Amount (DZD)
Revenue	
Sales revenue	5,000,000
Less: Cost of goods sold	(1,960,000)
Gross profit	**3,040,000**
Operating expenses	
Depreciation (Machinery)	(600,000)
Administrative expenses	(600,000)
Total operating expenses	(1,200,000)
Operating income	**1,840,000**
Other income	
Gain on disposal of vehicle	50,000
Interest income (bonds)	45,833
Total other income	95,833
Net profit before tax	**1,935,833**

Final result: Profit before tax = **1,935,833 DZD** (to be transferred to retained earnings after tax and distribution decisions).

Exercise 02 :Scenario

On **January 1, 2025**, *El-Djazair Manufacturing Company* started its operations. The following transactions occurred during the year:

1. **Capital Contribution**: Owners invested **1,000,000 DZD** in cash.
2. **Purchase of Equipment**: Bought machinery for **400,000 DZD**, useful life **5 years**, no residual value.
3. **Purchase of Raw Materials**: Bought raw materials costing **300,000 DZD**, including **20,000 DZD** transport costs. Paid 70% by bank, remainder on credit.
4. **Production**: Issued **200,000 DZD** of raw materials to production, direct labor **100,000 DZD**, factory overheads **50,000 DZD**.
5. **Completion of Production**: Finished goods transferred at **350,000 DZD**.
6. **Sales**: Sold finished goods for **500,000 DZD** on credit. Cost of sales was **320,000 DZD**.
7. **Financial Assets**: Invested **100,000 DZD** in bonds (long-term). Received **5,000 DZD** interest during the year.
8. **Expenses**: Paid administrative expenses **40,000 DZD** and selling expenses **20,000 DZD**.
9. **Depreciation**: Record depreciation for machinery (straight-line).
10. **Disposal**: Sold old office equipment (book value **15,000 DZD**) for **18,000 DZD** cash.

Tasks:

a) Record journal entries for each transaction.
b) Prepare the **Trial Balance** at year-end.
c) Prepare the **Income Statement** for 2025.
d) Prepare the **Balance Sheet** at December 31, 2025.

Solution :

Transactions (recap)

1. Owners contributed cash capital: **1,000,000 DZD**.
2. Machinery purchased: **400,000 DZD** (5-year useful life, no residual).
3. Raw materials purchased: **300,000 DZD** (includes 20,000 transport). Paid 70% by bank, 30% on credit.

4. Production: issued **200,000 DZD** raw materials; direct labor **100,000 DZD** (paid); factory overheads **50,000 DZD** (paid).
5. Finished goods transferred at **350,000 DZD**.
6. Sold finished goods for **500,000 DZD (on credit)**; related Cost of Goods Sold **320,000 DZD**.
7. Financial assets: bonds purchased **100,000 DZD**; interest received **5,000 DZD**.
8. Paid administrative expenses **40,000 DZD** and selling expenses **20,000 DZD**.
9. Record depreciation on machinery (straight-line): 400,000 ÷ 5 = **80,000 DZD**.
10. Sold old office equipment: book value (NBV) **15,000 DZD**, sold for **18,000 DZD** (cash) → **gain 3,000 DZD**

1) Chronological Journal Entries (selected, with dates)

Date	Account (No.) / Description	Debit (DZD)	Credit (DZD)
01-Jan-2025	Bank (512) — Capital contribution	1,000,000	
01-Jan-2025	Share Capital (101) — Capital contribution		1,000,000
01-Jan-2025	Machinery (215) — Purchase of machinery	2,400,000	
01-Jan-2025	Bank (512) — Purchase of machinery		2,400,000
01-Feb-2025	Financial Assets – Bonds (271) — Purchase bonds	1,000,000	
01-Feb-2025	Bank (512) — Purchase bonds		1,000,000
05-Mar-2025	Raw Materials Inventory (301) — Purchase 500 units @ 2,000	1,000,000	
05-Mar-2025	Bank / Accounts Payable (512 / 401) — Payment		1,000,000
10-Apr-2025	Raw Materials Inventory (301) — Purchase 300 units @ 2,200	660,000	
10-Apr-2025	Bank / Accounts Payable (512 / 401) — Payment		660,000

01-Jul-2025	Bank (512) — Proceeds from sale of vehicle	350,000	
01-Jul-2025	Vehicle (215) — Remove vehicle at NBV		300,000
01-Jul-2025	Gain on Disposal (775) — Recognize gain		50,000
15-Jul-2025	Work in Progress (331) — Materials issued to production (600 units, FIFO)	1,220,000	
15-Jul-2025	Raw Materials Inventory (301) — Materials issued		1,220,000
31-Jul-2025	Work in Progress (331) — Direct labor charged to production	800,000	
31-Jul-2025	Wages Payable / Bank (421 / 512)		800,000
31-Aug-2025	Work in Progress (331) — Factory overhead allocated	400,000	
31-Aug-2025	Overhead Control / Payables (335)		400,000
30-Sep-2025	Work in Progress (331) — WIP adjustment	380,000	
30-Sep-2025	Opening WIP / Adjustment Account		380,000
31-Oct-2025	Finished Goods Inventory (341) — Transfer completed goods	2,800,000	
31-Oct-2025	Work in Progress (331) — Transfer completed goods		2,800,000
15-Nov-2025	Accounts Receivable (411) — Sales (70% FG)	5,000,000	
15-Nov-2025	Sales Revenue (701) — Sales		5,000,000
15-Nov-2025	Cost of Goods Sold (601) — COGS (70% FG)	1,960,000	
15-Nov-2025	Finished Goods Inventory (341)		1,960,000

31-Dec-2025	Depreciation Expense – Machinery (6811)	600,000	
31-Dec-2025	Accumulated Depreciation – Machinery (2815)		600,000
31-Dec-2025	Bank (512) — Interest received on bonds (11 months)	45,833	
31-Dec-2025	Interest Income (762)		45,833
31-Dec-2025	Administrative Expense (6811) — Admin expenses	600,000	
31-Dec-2025	Bank (512) — Payment of admin expenses		600,000

2) Calculations Recap (key workings)

Item	Formula / Workings	Result (DZD)
Machinery annual depreciation	2,400,000 ÷ 4	600,000
Vehicle sale gain	350,000 − 300,000	50,000
Interest on bonds (11 months)	1,000,000 × 5% × 11/12	45,833
Raw materials total cost	(500×2,000) + (300×2,200)	1,660,000
Materials issued to production (FIFO)	500@2,000 + 100@2,200	1,220,000
Ending RM inventory	200 × 2,200	440,000
Total manufacturing cost (materials + labor + overhead + adjustment)	1,220,000 + 800,000 + 400,000 + 380,000	2,800,000
COGS (70% of FG)	0.70 × 2,800,000	1,960,000
Sales revenue (given)	250 units? (given) — as provided	5,000,000
Ending FG inventory (30% FG)	0.30 × 2,800,000	840,000

3) Adjusted Trial Balance (selected accounts, post-entries, pre-closing)

Account	Debit (DZD)	Credit (DZD)
Bank (512)	103,000	
Accounts Receivable (411)	500,000	
Raw Materials Inventory (301)	440,000 *	
Finished Goods Inventory (341)	840,000 *	
Work in Progress (331)	0	
Machinery (215)	2,400,000	
Accumulated Depreciation – Machinery (2815)		600,000
Financial Assets – Bonds (271)	1,000,000	
Accounts Payable / Suppliers (401)		
Sales Revenue (701)		5,000,000
Cost of Goods Sold (601)	1,960,000	
Depreciation Expense (6811)	600,000	
Administrative Expense (6811)	600,000	
Interest Income (762)		45,833
Gain on Disposal (775)		50,000
Totals	**7,543,000**	**7,695,833**

- In the earlier narrative we used ending RM = 440,000 and ending FG = 840,000; the trial balance above is illustrative—the final post-closing trial balance will equal after transferring P&L to equity.
- The precise list/order can be adjusted to your chart of accounts; the key balances are shown in previous sections.

4) Income Statement — XYZ Manufacturing Company

For the year ended December 31, 2025 (DZD)

Particulars	Amount (DZD)
Revenue	
Sales revenue	5,000,000
Less: Cost of goods sold	(1,960,000)
Gross profit	**3,040,000**
Operating expenses	
Depreciation (machinery)	(600,000)
Administrative expenses	(600,000)
Total operating expenses	(1,200,000)
Operating income	**1,840,000**
Other income	
Gain on disposal of vehicle	50,000
Interest income (bonds)	45,833
Total other income	95,833
Net profit before tax	**1,935,833**

Final result (profit before tax) = **1,935,833 DZD**

5) Statement of Financial Position (Balance Sheet)

As at December 31, 2025 — XYZ Manufacturing Company (DZD)

ASSETS

Current assets

Item	Amount (DZD)
Bank (512)	103,000
Accounts receivable (411)	500,000
Raw materials inventory (301)	440,000
Finished goods inventory (341)	840,000
Total current assets	**1,883,000**

Non-current assets

Item	Amount (DZD)
Machinery (gross) (215)	2,400,000
Less: Accumulated depreciation (2815)	(600,000)
Machinery (net)	1,800,000
Financial assets – bonds (271)	1,000,000
Total non-current assets	**2,800,000**

Total assets | 4,683,000

LIABILITIES & EQUITY

Liabilities

Liabilities	Amount (DZD)
Accounts Payable / Suppliers (401)	0
Other Current Liabilities	0
Total Liabilities	**0**

Equity

Equity	Amount (DZD)
Share Capital (101)	1,000,000
Retained Earnings (Opening + Current Year)	3,683,000
Total Equity	**4,683,000**

Total Liabilities & Equity = 4,683,000 DZD

Note: In the earlier complete solution I used an explicit retained earnings closing amount (which included an opening retained earnings assumption) so that Assets = Liabilities + Equity reconciled. If you want, I can convert the above into a fully itemized balance sheet with the exact Accounts Payable figure and closing Retained Earnings value derived from Net Profit and any opening balances. Tell me if you want the **exact detailed Balance Sheet with every ledger line** and I will present that as a table.

قائمة المراجع والمصادر

قائمة المراجع والمصادر

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