

ACCOUNTING

Egyptian Baccalaureate

2nd Year

Part One

11

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Accounting

Egyptian Baccalaureate

2nd Year

Advised by

INTERNATIONAL BACCALAUREATE®

The International Baccalaureate™

has reviewed the pedagogical and assessment approaches underpinning this textbook.

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Introduction

Accounting is often mistaken for arithmetic.
Students imagine columns of numbers, calculators, ledgers, and mechanical rules about debits and credits. While these tools are part of the discipline, they are not its essence. Accounting is not primarily about calculation. It is about clarity.
In every society, economic life depends on trust. Businesses borrow money, investors commit capital, employees work for wages, and governments collect taxes. None of these relationships can function without reliable information about financial performance and financial position. Accounting exists to provide that reliability.
At its core, accounting is a system for measuring economic reality. It records what a business owns, what it owes, what it earns, and what it spends. But beyond recording, it interprets. It organizes transactions into a structure that allows meaningful conclusions to be drawn.
Without accounting, profit would be guesswork. Growth would be illusion. Financial success could not be distinguished from temporary cash flow.

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Accounting therefore performs two fundamental functions.
First, it creates order. Every financial transaction is classified and recorded using consistent principles. This prevents confusion and ensures that financial information can be compared over time.
Second, it creates accountability. Managers must justify their decisions. Owners must evaluate performance. External stakeholders must assess risk. Accounting makes these evaluations possible.
In this sense, accounting is not simply a technical subject — it is a discipline of responsibility.
Textbook Front Pages 3
The Egyptian Baccalaureate approaches accounting not as memorization of procedures, but as structured reasoning. Students will learn how financial systems are built, how transactions affect financial position, and how disciplined rules prevent distortion.
Throughout this course, you will not merely learn how to prepare accounts. You will learn how to think in financial terms.
You will learn to ask:
* What changed as a result of this transaction? • Who provided the resources?
* Has value truly been created?
* Does the financial statement reflect reality?
These questions define the accountant's mindset.
Accounting is sometimes called the "language of business." This metaphor is accurate. Like any language, it has vocabulary, grammar, and structure. But more importantly, it has meaning. It allows economic activity to be communicated clearly and evaluated intelligently.
By the end of this unit, you will understand that accounting is not about memorizing rules. It is about understanding the logic behind those rules — and recognizing why they matter.
Because in every economy, transparency is strength. And accounting is the foundation of transparency.

ACCOUNTING IS SOMETIMES CALLED THE "LANGUAGE OF BUSINESS."

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JUSTIFY AND REASONING WITH EVIDENCE (JRE): PURPOSE, STRUCTURE, AND ROLE IN THE EGYPTIAN BACCALAUREATE

Purpose of Justify and Reasoning with Evidence

Justify and Reasoning with Evidence (JRE) is a core requirement of the Egyptian Baccalaureate. It is designed to assess a learner's ability to think independently, reason carefully, evaluate evidence, and justify conclusions in response to complex financial, institutional, and ethical questions.

Unlike subject examinations that assess procedural accuracy or technical preparation of financial statements, the JRE evaluates how learners apply accounting knowledge to form balanced and defensible judgments. It measures disciplined reasoning rather than mechanical calculation, and structured explanation rather than unsupported opinion.

The JRE reflects the Egyptian Baccalaureate principle that accountability is demonstrated through explanation. In Accounting, this means explaining financial decisions, interpreting performance responsibly, evaluating alternative treatments, and justifying conclusions using structured financial reasoning.

Nature of JRE Questions

Each year, students respond to one prescribed JRE question selected from a nationally released set. In the context of Accounting, these questions are:conceptually demanding rather than technically specialized,

- conceptually demanding rather than computational,
- open to multiple defensible interpretations,
- grounded in real financial, ethical, governance, or reporting dilemmas,
- and designed to require structured financial reasoning rather than personal belief.

A strong JRE response in Accounting demonstrates the ability to:

- define and frame a financial or reporting issue clearly,
- interpret accounting information accurately,
- weigh competing treatments or decisions,
- evaluate assumptions, risks, and implications,
- and reach a justified conclusion supported by evidence and accounting principles.

There are no single correct answers. Quality is judged by clarity of reasoning, coherence of argument, ethical awareness, and disciplined use of financial evidence.

Relationship Between Subjects and the JRE

The JRE is assessed independently, but it is deeply connected to subject learning.

Accounting plays a central role in preparing students for the JRE because it develops habits of precision, integrity, and structured judgment. Through the study of Accounting, learners acquire:

- conceptual understanding of assets, liabilities, equity, income, and expenditure,
- the ability to interpret financial statements critically,
- structured frameworks for evaluating financial performance and position,
- and awareness of ethical responsibilities in financial reporting.

Accounting teaches that numbers are not neutral; they reflect choices, judgments, estimates, and assumptions. Understanding this equips students to evaluate financial information thoughtfully and responsibly.

These intellectual habits directly support the disciplined reasoning expected in the JRE.

Unit-Linked JRE Preparation

To support the progressive development of judgment and reasoning skills, this textbook includes JRE-style prompts aligned to each unit of study.

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JRE TIP!

How to Unpack and Answer JRE Questions (Judgment, Reasoning, and Evidence)

JRE questions are designed to test how you think, not how much you memorize.
They ask you to make a judgment, explain your reasoning, and support it with evidence.
Use the steps below to approach every *JRE question* with confidence.

Step 1: Read the Question Slowly

Do not rush to answer.
Underline or mentally note:

- What decision, opinion, or conclusion the question is asking for
- Any keywords such as *evaluate, justify, compare, explain, to what extent*

Ask yourself:
"What am I being asked to decide or argue?"

Step 2: Make a Clear Judgment

Your judgment is your position.
It should be:

- Clear
- Direct
- One or two sentences maximum

Avoid vague answers like:

- "It depends"
- "There are many opinions"

Instead, state your view clearly.
Example:
"Using renewable energy is more sustainable for Egypt's long-term development than relying on fossil fuels."

Step 3: Explain Your Reasoning

Reasoning explains why your judgment makes sense.
Good reasoning:

- Connects ideas logically
- Uses cause and effect
- Shows understanding, not opinion

Use linking words such as:

- because
- therefore
- as a result
- this leads to

Ask yourself:
"Why does my judgment make sense?"

Step 4: Support with Evidence

Evidence proves that your reasoning is valid.
Evidence can include:

- Facts or data from the curriculum
- Examples studied in class
- Scientific principles
- Historical events
- Economic or social explanations

Evidence should be:

- Relevant
- Accurate
- Clearly linked to your reasoning

Do not list facts randomly.
Always explain how the evidence supports your point.

Step 5: Check Your Structure

Before submitting your answer, quickly check:

- Did I clearly state a judgment?
- Did I explain my reasoning logically?
- Did I use evidence from what I studied?
- Is my answer organized and easy to follow?

If the answer flows from:
judgment → reasoning → evidence, you are on the right track.

Simple JRE Answer Template

You can use this structure when practicing:
Judgment:
I believe that…
Reasoning:
This is because…
Evidence:
For example… This shows that…

Common Mistakes to Avoid

Writing long introductions
Repeating the question
Listing facts without explanation
Giving opinions without evidence
Memorizing model answers
Remember: clarity is stronger than length.

Final Tip

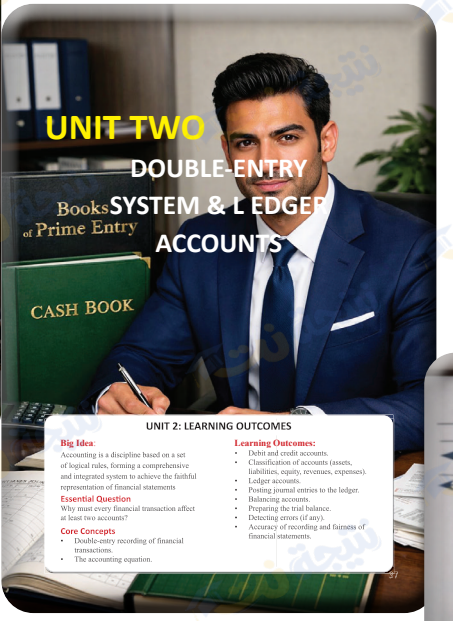
JRE questions reward thinking clearly, not writing more.
A short, well-structured answer will always score higher than a long, unfocused one.

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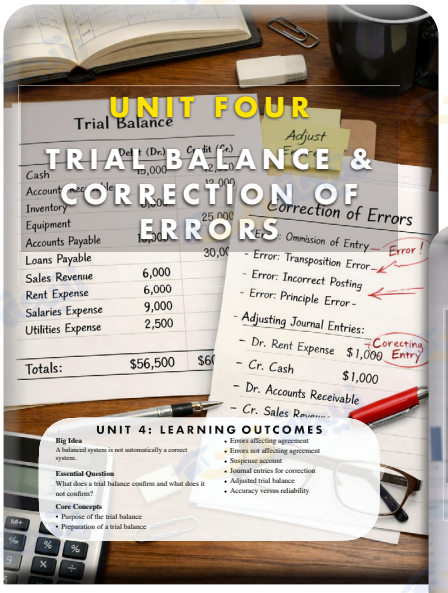
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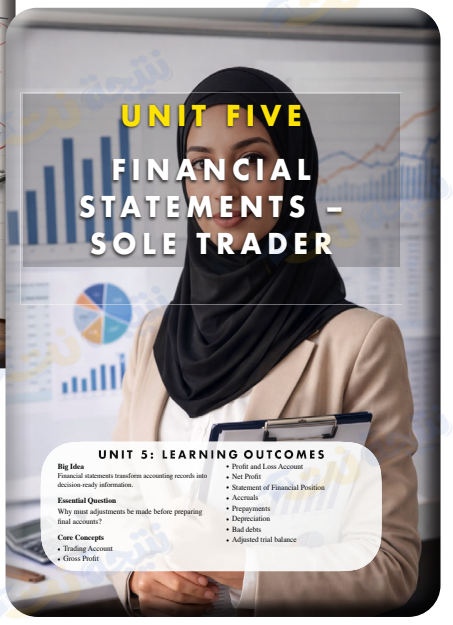
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UNIT ONE

WHY ACCOUNTING EXISTS

UNIT 1: LEARNING OUTCOMES

Big Idea

Accounting helps people make informed financial decisions.

Essential Question:

Why can't businesses survive without reliable financial information?

Core Concepts

• What accounting is and why it matters.

• Who uses accounting information (owners, investors, banks, government)

The accounting equation:

Assets = Liabilities + Capital

Key principles:

prudence, accruals, matching, consistency

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UNIT BIG IDEA

Accounting supports confidence in financial information. Without reliable financial information, businesses may collapse, investors may lose confidence, and the economy may weaken.

ESSENTIAL QUESTION

Why does every successful business depend on accounting?

UNIT OPENER CASE

Mariam opens a small bakery in Alexandria.

She buys ovens, flour, sugar, and hires two workers.

After three months, she feels busy — but she doesn't't know:

- Is she making profit?
- Does she owe money?
- Can she expand?

She has receipts… but does not have any system

Exercise Formative Check

1. Why might a business fail even if it has many customers?
2. Who besides Mariam might care about her financial records?

THINK!

Is Mariam running a business — or just baking?

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Section One: What Is Accounting?

Definition

Accounting is the process of recording, summarizing, and presenting financial transactions in the form of reports.

Accounting answers three key questions:

- What assets does the business own?
- What liabilities does the business owe?
- Is the business generating a profit?



Who Uses Accounting Information?

Accounting information serves various stakeholders, each with different interests:

- Owners: To determine whether their investment is growing.
- Managers: To monitor performance and control costs.
- Employees: To assess the stability of the business and the security of their jobs and salaries.
- Banks and Lenders: To evaluate the business's ability to repay its debts.
- Government Authorities: To ensure compliance with laws and the accuracy of tax reporting.
- Customers: To assess the financial position of the business before entering into transactions or contracts.

Although these stakeholders have different interests, they share a common need: access to relevant financial information. Therefore, accounting information must be objective, consistent, and based on established accounting principles. If the information is unclear or manipulated, decisions become unreliable, and the economy may be adversely affected.

Accounting as an Information System

To ensure order and accuracy, accounting relies on a structured framework. Every financial transaction affects at least two elements of the financial system. This relationship is expressed through the fundamental accounting equation:

Exercise

Formative Check

Identify the main user:

1. A bank reviewing a loan request → _____
2. A shareholder deciding whether to buy shares → _____
3. The tax authority → _____

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Exercise
Connecting to the Text

1. Why is it important that accounting follows agreed principles rather than allowing each business to record transactions in its own way?
2. A company expects to receive a large payment next month but has not yet received the cash. According to the accrual principle, should this income be recorded now or later? Explain your reasoning.

Assets=Liabilities+Owner's Equity

This equation is not merely a mathematical formula; it represents the foundation upon which the entire accounting system is built.
It reflects the financial equilibrium of a business. Every asset owned by the business has been financed either through borrowing (liabilities) or through the owner's investment (owner's equity). Understanding this balance is the starting point for studying accounting.

CORE ACCOUNTING PRINCIPLES

Accounting does not operate randomly; rather, it is governed by a set of concepts and principles that ensure fairness and comparability.
Accounting Principles
Prudence (Conservatism) Principle
This principle requires the exercise of caution when preparing financial information. Potential losses should be recognized as soon as they are foreseeable, whereas profits should only be recognized when they have been realized.
Matching Principle
This principle requires that expenses be recognized in the same accounting period as the revenues they help generate. As a result, profit is measured accurately and fairly.
Consistency Principle
This principle requires the use of the same accounting policies and methods across different accounting periods, enabling fair and meaningful comparisons of financial results over time.
These principles are not merely formal procedures; they serve as safeguards that ensure the faithful representation and reliability of financial statements.

Accounting Measurement Bases:

Accrual Basis:

Under the accrual basis, revenues and expenses are recorded when they are earned or incurred, regardless of when cash is received or paid.

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Cash Basis:

Under the cash basis, financial transactions are recorded only when cash is actually received or paid.

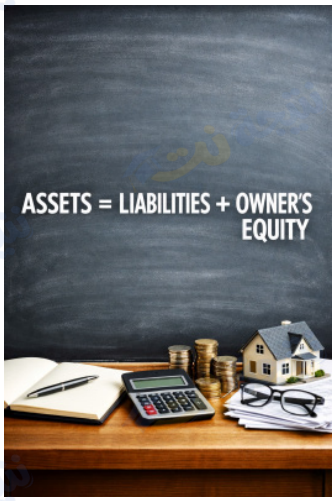
Accounting Principles with Examples

Principle	Core Idea	Why It Matters
Prudence	Do not overstate profit or assets	Prevents misleading optimism
Accrual	Record when earned/ incurred	Reflects real performance
Matching	Align expenses with related revenue	Ensures accurate profit calculation
Consistency	Use same methods over time	Enables comparison

Principle	Example
Prudence	A business expects some customers will not pay, so it records a bad debt expense instead of assuming all money will be collected
Accrual	A company delivers goods in December but gets paid in January, so it records the revenue in December
Matching	The cost of producing goods is recorded in the same period the goods are sold, not when they were made
Consistency	A company uses the same depreciation method every year, allowing financial results to be compared fairly

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SECTION 2: THE ACCOUNTING EQUATION AND THE STRUCTURE OF FINANCIAL POSITION



Accounting is the interpreter of financial transactions. Before students learn how to record transactions, they must understand the framework within which these transactions take place. Every entity or company—regardless of its size or type of activity—can be understood through one fundamental relationship.

Assets = Liabilities + Owner's Equity

THIS EQUATION IS NOT A FORMULA TO MEMORIZE. IT IS A REPRESENTATION OF FINANCIAL REALITY.

This equation is not something to memorize, but rather a representation of financial reality. It means that a company has assets and obligations. These assets are referred to as Assets. Assets include cash, buildings, equipment, inventory, and amounts receivable from customers. They are items that have economic value, and non-current assets are expected to generate future economic benefits.

However, no entity can own assets without a source of financing. Every asset is financed by one of two sources: either funds invested by the owner (Owner's Equity) or funds borrowed (Liabilities).

Liabilities represent obligations of the entity toward external parties, such as bank loans, amounts payable to suppliers, and any debts that must be settled.

Owner's Equity represents the owner's interest in

Exercise
Formative Check

1. Why might a business fail even if it has many customers?
2. Who besides Mariam might care about her financial records?

THINK!

Why cannot a business have assets without a source of financing?

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the business. It includes the initial investment plus accumulated profits, minus withdrawals.
This equation reflects a permanent state of balance: what the business owns must always equal the sources that finance it.
This balance is not optional; it must be maintained after every financial transaction.

UNDERSTANDING THE LOGIC OF BALANCE

Consider a simple example.

If the owner invests EGP 100,000 in cash to start a business, the entity acquires cash (an asset). At the same time, the owner obtains a claim on the business of the same value (owner's equity).

Assets increase, and owner's equity increases, while the accounting equation remains balanced.

If the entity then borrows EGP 50,000 from a bank, cash increases again. However, this increase is matched by an increase in liabilities, not in equity.

Once again, the accounting equation remains in balance. The accounting equation does not represent a single moment in time only; rather, it reflects an ongoing relationship that must hold after every financial transaction.

For this reason, accounting is built as an organized and precise system: every transaction affects at least two elements, and no change occurs in isolation.

Element	Definition	Key Question
Assets	Resources owned by the business that provide future benefit	What does the business own?
Liabilities	Obligations owed to external parties	What does the business owe?
Owner's Equity	The owner's claim after liabilities	What is the owner's stake?

THE EFFECT OF TRANSACTIONS

Every transaction produces one of the following effects:
- An increase in one asset and a decrease in another asset
- An increase in assets and an increase in liabilities
- An increase in assets and an increase in equity
- A decrease in assets and a decrease in liabilities
- A decrease in assets and a decrease in equity

Notice something important. The equation never breaks. The total on the left side always equals the total on the right side.
This is not coincidence. It is design.
Understanding this structure prepares students for the double entry system in the next section. Before learning debits and credits, students must first understand what is changing and why. Accounting is not about memorizing which side to write on. It is about recognizing how financial structure responds to economic events.

Exercise
Connecting to the Text

1. If a business purchases equipment using cash, how does this affect the accounting equation?
2. If a business receives a bank loan, which elements of the equation increase?
3. Why is owner's equity considered a claim rather than a physical resource?
4. How does understanding the accounting equation prepare you for learning the double entry system?

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SECTION 3: THE DOUBLE ENTRY SYSTEM AND THE LOGIC OF RECORDING



The accounting equation explains structure.
The double entry system explains movement.
If every transaction changes at least two elements of the accounting equation, then a recording system must exist that captures both effects clearly and consistently.
The double entry system is that mechanism.
It is not an arbitrary rule that every transaction requires two entries. It is a logical necessity. Since the equation must remain balanced, every change on one side must be matched by a corresponding change elsewhere.
Double entry accounting therefore enforces discipline. It prevents incomplete recording. It ensures that financial statements reflect the full effect of each economic event.
This system has been used for centuries because it works. It preserves balance and makes error detection possible.

Exercise Formative Check

1. Why does every transaction require two entries rather than one?
2. How does the double entry system protect the balance of the accounting equation?
3. Why would a single entry system create risk or confusion?

DEBIT AND CREDIT: MEANING WITHIN STRUCTURE

Students often focus on the words debit and credit as if they automatically mean increase or decrease. This is incorrect.
Debit and credit do not mean good or bad. They do not mean gain or loss. They simply indicate the side of an account where an entry is recorded.
Whether a debit increases or decreases an account depends on the type of account.
Assets increase on the debit side and decrease on the credit side.

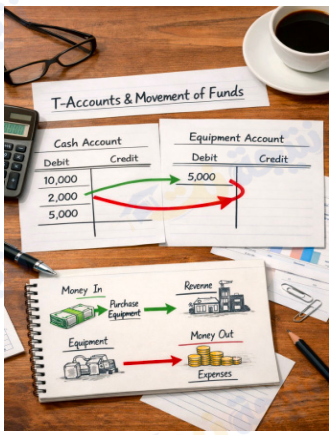
THINK!

Why do assets increase on the debit side?

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Liabilities increase on the credit side and decrease on the debit side.
Owner's equity generally increases on the credit side and decreases on the debit side.
The logic reflects the accounting equation. The left side of the equation, assets, increases with debits. The right side of the equation, liabilities and equity, increases with credits.
This structure is consistent and systematic. Once understood, it eliminates confusion.
Memorization without logic leads to mistakes. Understanding the relationship between the equation and debit credit rules leads to mastery.

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T-ACCOUNTS AND THE VISUALIZATION OF MOVEMENT

To record financial transactions clearly, accountants use accounts, where each account represents a specific element such as cash, bank loans, capital, or equipment.

One of the simplest ways to represent an account is the T-account format, where the left side represents the Debit side and the right side represents the Credit side.

When a financial transaction occurs, its effects are recorded in at least two different accounts. The total debits must equal the total credits, regardless of the number of accounts on each side.

Example: If a business purchases equipment for cash, the Equipment account increases while the Cash account decreases.

Since equipment is an asset, it increases on the debit side. Cash is also an asset, so it decreases on the credit side. Therefore:

Two sides, the same value—complete balance.

The T-account helps students visualize the movement within accounts instead of memorizing abstract rules.

Exercise
Formative Check

1. What is the purpose of a T-account?
2. In a cash purchase of equipment, which accounts are affected?
3. What does it mean to balance an account?
4. How does double entry assist in detecting errors

THINK!

Why is balancing accounts important before preparing financial statements?

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BALANCING ACCOUNTS AND PREPARING FOR ACCURACY



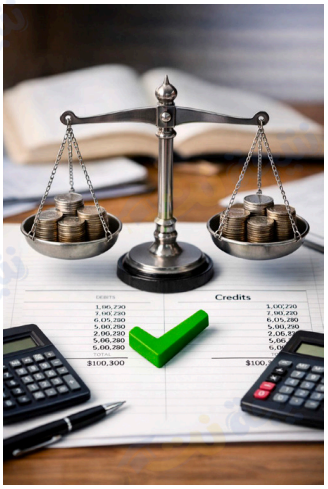
At the end of the financial period, accounts are closed or balanced. This means calculating the difference between total debits and total credits in each account, and this difference represents the remaining balance of the account.

If total debits equal total credits in all accounts of the trial balance, the system is internally consistent. This forms the basis for preparing the financial statements in the next stage.

Balancing accounts is not merely a technical procedure; it is a verification process used to ensure that the accounting system is functioning correctly. It confirms that the accounting structure has been properly maintained.

Therefore, the double-entry system achieves two objectives at the same time: recording financial transactions and detecting errors through balance. For this reason, it remains the fundamental basis for preparing financial statements.

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SECTION 4: THE TRIAL BALANCE AND THE DETECTION OF ERRORS

Accurate recording of transactions is essential, but it is not sufficient. The recording process in the journal and posting to the ledger requires a method to verify the correctness of the system, and this is where the Trial Balance plays its role.

After transactions are recorded in the journal, posted to the ledger accounts, and those accounts are balanced, the next step is to present the balances in an organized form: debit balances are listed in one column and credit balances in another, and the total of each column is calculated (Trial Balance by balances). If the total of the debit side equals the total of the credit side, the accounts are in balance.

Balance means that every financial transaction has two sides—a debit side matched by a credit side of equal value. However, this does not guarantee that every transaction has been recorded correctly. Therefore, the Trial Balance is a control tool, not a complete assurance that all accounting records are error-free.

Preparing the Trial Balance

The Trial Balance is prepared through logical steps:

1. Balance each account in the ledger.
2. Determine whether each account has a debit or credit balance.
3. Transfer these balances into the Trial Balance under the appropriate column.

Example:

• Asset accounts (such as cash and equipment) normally have debit balances.

• Liability and equity accounts normally have credit balances.

After listing all balances, the two columns are totaled:

• If they are equal, it indicates no arithmetical errors.

• If they are not equal, an error exists that must be investigated.

The Trial Balance is an important preliminary step before preparing the financial statements.

Exercise Formative Check

1. What is the main purpose of preparing a trial balance?
2. What does a balanced trial balance confirm about the double entry system?
3. What are the steps involved in preparing a trial balance?

THINK!

Why does equal debit and credit totals not guarantee that all transactions are correct?

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TYPES OF ERRORS IN ACCOUNTING



Even with double entry, errors can occur.
Some errors prevent the trial balance from balancing.
Others do not.
Errors that usually cause imbalance include:

- Recording only one side of a transaction.
- Recording unequal debit and credit amounts.
- Mathematical mistakes when balancing accounts.

However, some errors do not affect the equality of debits and credits.

Type of Error	Meaning	Example
Error of Omission	A transaction is completely forgotten and not recorded	A credit sale is made but not entered in the accounting records at all
Error of Commission	The correct amount is recorded but in the wrong account of the same type	Cash received from Ahmed is recorded in Ali's account instead of Ahmed's
Error of Principle	A transaction is recorded in the wrong category (capital vs revenue)	Buying a machine is recorded as an expense instead of an asset
Compensating Error	Two or more errors cancel each other out numerically	Sales are overstated by 1,000 EGP and expenses are also overstated by 1,000 EGP, so profit appears correct

These errors are more dangerous because the trial balance will still agree.
This reinforces an important idea. Accounting requires judgment, not only mechanics.

SUSPENSE ACCOUNTS AND CORRECTION OF ERRORS

If the trial balance does not balance, accountants do not abandon the system. They investigate.
Sometimes, to proceed with preparing financial statements while the error is being located, a temporary account is created. This is called a suspense account.
The difference between the debit and credit totals is entered into this account to force balance temporarily.
The suspense account is not a solution. It is a signal. It indicates that something must be corrected.

Exercise
Formative Check

1. What types of errors will cause the trial balance not to balance?
2. Why are errors of omission difficult to detect through a trial balance?
3. What is the purpose of a suspense account?
4. Why is a suspense account considered temporary?
5. What must happen after a suspense account is created?
6. How does correcting errors protect financial integrity?

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Once the error is identified, a correcting journal entry is made. This entry adjusts the affected accounts and eliminates the suspense balance.

Correction reinforces discipline. It ensures that the final financial statements are reliable.

Accounting is therefore not only about recording events. It is about correcting deviations from structure.

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SECTION 5: FROM TRIAL BALANCE TO FINANCIAL STATEMENTS

All previous sections have prepared us for this moment.

- Transactions were recorded.
- Accounts were balanced.
- Errors were checked.
- The trial balance confirmed internal consistency.

Now the question becomes:

WHAT DOES THE BUSINESS ACTUALLY LOOK LIKE?

Financial statements transform account balances into organized information. They answer two main questions:

1. Has the business made a profit?
2. What is its financial position at the end of the period?

For a sole trader or sole proprietorship, this information is presented through three interrelatedstatements/accounts:

- Trading Account
- Profit and Loss Account
- Statement of Changes in Capital (Equity)
- Statement of Financial Position

Each statement/account depends on the one before it.

Trading Account: Measuring Gross Profit or Loss

The Trading Account focuses on the core activity of the business and measures gross profit or gross loss.

Gross profit is calculated as:

Gross Profit = Sales Revenue − Cost of Goods Sold

Sales Revenue represents the amount received from selling goods or providing services.

Cost of Goods Sold (COGS) appears only in trading (commercial) businesses and refers to the direct cost of purchasing or producing the goods sold. In service businesses, it is replaced by operating or service costs incurred to generate revenue.

Gross Profit indicates how efficiently the business manages its core operations. A higher gross profit means that the business is selling its products with a higher margin above cost.

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Review Questions

1. What does gross profit measure?
2. Why are indirect expenses not included in the Trading Account?
3. What might a low gross profit indicate about a business?

THE PROFIT AND LOSS ACCOUNT: MEASURING NET PROFIT

The income statement starts with gross profit or loss, and then operating expenses are deducted. Operating expenses include items such as rent, salaries, insurance, utilities (electricity and water), and depreciation.

After deducting these expenses from gross profit, we arrive at Net Profit.

Net profit represents the final result of the entity's performance during the period.

- If expenses exceed gross profit, a net loss is incurred.
- Net profit increases owner's equity.
- Net loss decreases owner's equity.

This linkage confirms that financial statements are not separate from the accounting equation; rather, they explain the changes within it.

Review Questions

1. What is the difference between gross profit and net profit?
2. Why does net profit affect owner's equity?

Statement of Financial Position (Balance Sheet)

The Statement of Financial Position presents the accounting equation in a structured form at a specific date.

It includes:

1. Assets: the resources owned by the business.
2. Liabilities: the obligations of the business toward external parties.
3. Owner's Equity: the owner's residual interest in the business.

Assets are usually classified into current and non-current assets. Current assets

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include cash and items expected to be converted into cash within one year or less. Non-current assets include long-term resources such as buildings and equipment. Similarly, liabilities are classified into current and non-current liabilities depending on their maturity dates.

Owner's equity includes capital, plus net profit, minus withdrawals.

The statement must be balanced, meaning that:

Assets = Liabilities + Owner's Equity

If this equality is not achieved, it indicates an error.

Thus, the Statement of Financial Position confirms both the financial position and the financial condition of the business

Review Questions

1. Why must the Statement of Financial Position always balance?
2. How does net profit affect the capital shown in this statement?
3. Why are assets classified as current and non current?
4. What information does this statement provide that the Profit and Loss Account does not?

FROM TRIAL BALANCE TO FINANCIAL STATEMENTS
PART I: FULLY WORKED EXAMPLE

Below is the trial balance of Omar Trading as at 31 December:

Account	Debit (EGP)	Credit (EGP)
Cash	25,000	
Equipment	60,000	
Inventory	15,000	
Purchases	70,000	
Rent Expense	10,000	
Salaries Expense	12,000	
Utilities Expense	3,000	
Bank Loan		20,000
Capital		55,000
Sales		120,000
Drawings	5,000	

Required:

- (a) Verify whether the two sides of the Trial Balance are balanced.
- (b) If they are not balanced, determine the impact of this discrepancy on the

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financial statements:

1. Trading Account
2. Profit and Loss Account
3. Statement of Changes in Capital
4. Statement of Financial Position

Solution:

- This Trial Balance is not internally balanced, as the total of the debit side = 200,000 does not equal the total of the credit side = 195,000.
- Therefore, there is a discrepancy, and its impact on the financial statements is as follows:

STEP 1: TRADING ACCOUNT

For the year ended 31 December

Dr		Cr	
Purchases	70,000	Sales	120,000
Gross Profit c/d	50,000		
Total	120,000	Total	120,000

Gross Profit = 50,000

This measures operational performance before indirect expenses.

STEP 2: PROFIT AND LOSS ACCOUNT

For the year ended 31 December

Debit		Credit	
Rent Expense	10,000	Gross Profit b/d	50,000
Salaries Expense	12,000		
Utilities Expense	3,000		
Net Profit	25,000		
Total	50,000	Total	50,000

Net Profit = 25,000

This represents final earnings after operating costs.



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STEP 3: STATEMENT OF CHANGES IN CAPITAL

	Amount (EGP)
Opening Capital	55,000
Add: Net Profit	25,000
Less: Drawings	(5,000)
Closing Capital	75,000

Notice how profit increases equity, while drawings reduce it.

STEP 4: STATEMENT OF FINANCIAL POSITION

As at 31 December

Assets

	Amount (EGP)
Cash	25,000
Equipment	60,000
Inventory	15,000
Total Assets	100,000

Liabilities and Equity

	Amount (EGP)
Bank Loan	20,000
Capital	75,000
Total Liabilities and Equity	95,000

We notice something important. The totals still do not balance. Total Assets equal 100,000, while Liabilities plus Equity equal 95,000.

Students must now investigate.

This indicates missing working capital information. In a real scenario, this imbalance would signal incomplete data, such as accounts receivable or accounts payable not listed in the simplified trial balance.

This reinforces a central lesson: financial statements must reconcile with the accounting equation. Any imbalance demands investigation.

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PART II: GUIDED APPLICATION EXERCISE

Now, you apply the process.

Trial Balance of Salma Stores

As at 31 December

Account	Debit (EGP)	Credit (EGP)
Cash	18,000	
Equipment	40,000	
Inventory	12,000	
Purchases	50,000	
Rent Expense	8,000	
Salaries Expense	10,000	
Bank Loan		15,000
Capital		45,000
Sales		90,000
Drawings	4,000	

Required:

A- Verify whether the two sides of the Trial Balance are balanced.

B- If they are not balanced, determine the impact on the financial statements:

- Trading Account
- Profit and Loss Account
- Statement of Changes in Capital
- Statement of Financial Position

C- Is the Statement of Financial Position balanced?

Solution:

- Is this Trial Balance balanced?

.....

.....

- B- In case of imbalance, determine its effect on each of the following:

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TASK 1: PREPARE THE TRADING ACCOUNT

Trading Account

For the year ended 31 December

Debit	Amount (EGP)	Credit	Amount (EGP)
Purchases		Sales	
Gross Profit c/d			
Total Assets	100,000		



TASK 2: PREPARE THE PROFIT AND LOSS ACCOUNT

Profit and Loss Account

For the year ended 31 December

Debit	Amount (EGP)	Credit	Amount (EGP)
Rent Expense		Gross Profit b/d	
Salaries Expense			
Net Profit			
Total		Total	

TASK 3: CALCULATE CLOSING CAPITAL

Statement of Changes in Capital

	Amount (EGP)
Opening Capital	
Add: Net Profit	
Less: Drawings	
Closing Capital	

TASK 4: PREPARE THE STATEMENT OF FINANCIAL POSITION

Statement of Financial Position

As at 31 December

Assets

	Amount (EGP)
Cash	
Equipment	
Inventory	
Total Assets	

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Liabilities and Equity

	Amount (EGP)
Bank Loan	
Capital	
Total Liabilities and Equity	

TASK 5: FINAL CHECK

1. Does the Statement of Financial Position balance?

Total Assets = _____

Total Liabilities and Equity = _____

2. Balanced? Yes / No

If not balanced, explain why: .....

.....

.....

.....

.....

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SECTION 6
JUSTIFY AND REASONING WITH EVIDENCE (JRE)

Does the double entry system guarantee financial truth, or does it only guarantee internal consistency?

Accounting is built on structure, discipline, and verification.

But an important question remains:

Does following rules guarantee financial truth?

This section invites you to move beyond procedure and evaluate the principles underlying accounting practice.

UNDERSTANDING THE QUESTION

This question requires careful reasoning.

The double entry system ensures that for every debit there is a credit. It preserves balance in the accounting equation. However, a balanced system does not automatically ensure that:

- All transactions were recorded
- Assets were valued correctly
- Losses were recognized honestly
- Judgments were applied ethically

You are not being asked whether double entry is useful. You are being asked whether it guarantees truth.

This distinction is critical.

Understanding the Question

This question requires careful reasoning.

The double entry system ensures that for every debit there is a credit. It preserves balance in the accounting equation. However, a balanced system does not automatically ensure that:

- All transactions were recorded
- Assets were valued correctly
- Losses were recognized honestly
- Judgments were applied ethically

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You are not being asked whether double entry is useful. You are being asked whether it guarantees truth.

This distinction is critical.

Key Concepts You May Use

In developing your response, you may refer to:

• The accounting equation

• The role of the trial balance

• Types of accounting errors

• Prudence and accrual principles

• The purpose of financial reporting

You may argue that:

• Structure enforces discipline and reduces manipulation

or

• Structure alone cannot prevent misrepresentation

Both positions are defensible if supported with reasoning.

EXPECTATIONS FOR A STRONG RESPONSE

A high-quality JRE response should:

1. Clearly define what is meant by "financial truth."
2. Explain how the double entry system functions.
3. Evaluate its strengths and limitations.
4. Present counterarguments.
5. Reach a justified and coherent conclusion.

Your argument must be analytical, not emotional.

Your reasoning must be structured, not descriptive.

WRITING FRAMEWORK FOR THE JRE

Section	What You Should Do	Guiding Focus
Introduction	Define what is meant by "financial truth" and clearly state your position.	What does financial truth mean? Does double entry guarantee it?
Argument 1	Explain how the double entry system promotes reliability and internal control.	How does balance and structure reduce errors and improve accuracy?
Argument 2	Discuss limitations or weaknesses of the double entry system.	Can errors, omissions, or unethical judgments still occur?

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Counterargument	Present and respond to an opposing viewpoint.	Why might someone argue that double entry does guarantee truth? Do you agree?
Conclusion	Reach a reasoned and balanced judgment supported by your analysis.	After evaluating both sides, what is your final position and why?

ASSESSMENT CRITERIA

Your essay will be evaluated on:

Criterion	What is Assessed
Conceptual Understanding	Accurate explanation of accounting systems
Analytical Depth	Ability to evaluate strengths and limitations
Logical Structure	Clear progression of reasoning
Use of Evidence	Application of principles from Unit 1
Justified Conclusion	Clear and defensible final position

JUSTIFY AND REASONING WITH Evidence (JRE)

MARKING RUBRIC

Total Marks: 20

Criterion	**Excellent (4)**	**Good (3)**	**Developing (2)**	**Limited (1)**
Conceptual Understanding	Demonstrates precise and accurate understanding of double entry, accounting principles, and financial truth. Uses terminology correctly throughout.	Shows clear understanding with minor inaccuracies.	Basic understanding present but contains conceptual gaps or minor confusion.	Limited or incorrect understanding of key accounting concepts.
Analytical Depth	Critically evaluates strengths and limitations with insight. Demonstrates mature reasoning and clear differentiation between internal consistency and financial truth.	Provides clear evaluation with some depth, though analysis may not be fully developed.	Some attempt at evaluation, but largely descriptive. Limited depth.	Minimal evaluation. Response is mostly descriptive or unsupported opinion.
Use of Evidence from Unit ١	Integrates relevant principles such as prudence, accrual, trial balance, and error types effectively to support argument.	Refers to relevant concepts but may not fully integrate them into reasoning.	Limited reference to unit concepts. Evidence is weak or loosely connected.	Little or no reference to relevant accounting principles.
Structure and Coherence	Argument is logically structured. Clear progression from introduction to conclusion. Counterargument addressed effectively.	Mostly clear structure. Minor lapses in flow or coherence.	Structure present but inconsistent. Ideas may lack logical progression.	Disorganized. Ideas unclear or poorly connected.
Judgment and Conclusion	Conclusion is balanced, justified, and clearly derived from prior reasoning. Demonstrates independent thought.	Conclusion is clear but may lack full justification.	Conclusion present but weak or not fully supported by analysis.	Conclusion unclear, unsupported, or missing.

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Mark Interpretation
18–20 marks: Exceptional reasoning. Demonstrates intellectual maturity and strong accounting insight.
14–17 marks: Strong analytical performance with minor weaknesses.
10–13 marks: Adequate understanding but limited analytical depth.
6–9 marks: Basic comprehension with significant weaknesses.
0–5 marks: Limited understanding and insufficient reasoning.

Practical Case: Double-Entry Rule
The following transactions took place at Hanaa Stores during October:
• On the 1st of the month, goods were sold for EGP 100,000 in cash.
• On the 5th, goods were purchased on account for EGP 50,000 from Ghada Stores.
• On the 7th, various expenses of EGP 20,000 were paid in cash.
• On the 15th, machinery and equipment were purchased for EGP 250,000, half in cash and the remainder on account.
• On the 20th, amounts due to Ghada Stores were paid in cash.
Required:
Analyze the above transactions to determine the debit and credit accounts according to the double-entry rule.

Solution

Date	Transaction	Debit Account	Amount	Credit Account	Amount
1/10	Cash sale	Cash	100,000	Sales	100,000
5/10	Credit purchase	Purchases	50,000	Creditors – Ghada Stores	50,000
7/10	Payment of expenses	Expenses	20,000	Cash	20,000
15/10	Purchase of equipment	Equipment	250,000	Cash	125,000
				Creditors	125,000
20/10	Payment to creditors	Creditors – Ghada Stores	50,000	Cash	50,000

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UNIT TWO

DOUBLE-ENTRY SYSTEM & L EDGER ACCOUNTS

UNIT 2: LEARNING OUTCOMES

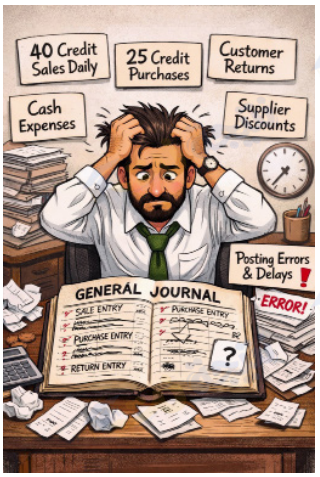
Big Idea:
Accounting is a discipline based on a set of logical rules, forming a comprehensive and integrated system to achieve the faithful representation of financial statements

Essential Question
Why must every financial transaction affect at least two accounts?

Core Concepts
- Double-entry recording of financial transactions.
- The accounting equation.

Learning Outcomes:
- Debit and credit accounts.
- Classification of accounts (assets, liabilities, equity, revenues, expenses).
- Ledger accounts.
- Posting journal entries to the ledger.
- Balancing accounts.
- Preparing the trial balance.
- Detecting errors (if any).
- Accuracy of recording and fairness of financial statements.

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UNIT BIG IDEA

Every financial transaction has two effects. The double-entry system ensures that these effects are recorded accurately, consistently, and in balance. This unit explores how accuracy in recording leads to the faithful representation of financial statements.

Accounting is not merely a list of rules; it is a logical system designed to achieve the faithful representation of financial statements

ESSENTIAL QUESTION

What is the difference between understanding debit and credit mechanically and understanding them conceptually?

UNIT OPENER CASE

CASE STUDY: WHEN GROWTH CREAT ES COMPL EXI T Y

Mariam owns a small electronics store in Alexandria. During her first year, she recorded transactions informally in a notebook. She recorded cash received from customers and any payments made to suppliers. At the end of the year, she believed her business was profitable because her cash balance had increased.

In the second year, her business expanded. She began purchasing inventory on credit and also sold goods to customers who would pay later. She also purchased new equipment through a bank loan. By

1. Why does transaction volume create risk?
2. How might grouping similar transaction reduce errors?
3. What risks arise if returns are not recorded separately?
4. Why might small cash expenses require special control?

THINK!

Does specialization increase accuracy in accounting systems?

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the end of the second year, Mariam had higher sales than ever before. However, she became concerned, as suppliers were demanding payment and the bank was requesting documentation. She could not determine:

* How much she owed to suppliers

* How much customers owed her

* The true result of her operations (profit or loss)

* The extent to which she could expand her business in the future

An analysis of the case shows the failure of her informal transaction recording system.

Mariam consulted an accountant who introduced her to the double-entry accounting system . Every transaction was recorded in two aspects. Purchases affected inventory cost and creditors. Credit sales affected revenue and debtors. The loan affected cash and liabilities.

Within a few months, Mariam was able to answer all her questions with confidence.

The difference was not in the number of transactions, but in the existence of a sound accounting system.

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SECTION1: INTRODUCTION TO BOOKS OF PRIME ENTRY



Accounting is not a collection of separate journal entries; rather, it is a system based on relationships.

At the heart of this system lies a simple yet powerful idea: every transaction has two effects. This idea is known as the double-entry principle.

When a business receives something, it must either give something in return, reduce something, or incur an obligation. Economic events do not occur in isolation; instead, they create movement within the structure established in the first unit.

The accounting equation reminds us:

Assets = Liabilities + Owner's Equity

If one element changes, at least one other element must also change.

Therefore, the double-entry principle is not merely an accounting invention; it reflects the economic reality of financial transactions.

Why is the double-entry principle important?

Imagine a business purchasing equipment for cash:

- The business receives equipment.
- The business pays cash.

One asset increases (equipment), while another asset decreases (cash). Total assets remain unchanged, and the equation stays balanced.

Now imagine the business purchases equipment on credit:

- Assets increase (equipment).
- Liabilities increase (creditors).

Once again, the equation remains balanced. Without the double-entry principle, this balance would collapse, and financial statements would fail to fairly represent the financial position of the entity.

Exercise
Formative Check

1. Why does transaction volume create recording challenges?
2. What risks increase when the general journal becomes crowded?

THINK!

How can grouping similar transactions improve control?

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Economic Transactions and Their Effects

Every business transaction can be analyzed using three guiding questions:



1. What did the business receive or become entitled to receive?
2. What did the business give or become obligated to give?
3. Which accounts are affected?

For example, if a customer pays cash for goods, the business receives cash. In return, it gives up inventory and recognizes revenue.

Several accounts move at the same time. Understanding this movement before recording is essential. Students who master analysis rarely struggle in identifying debits and credits.

Applying the Double-Entry Principle

The double-entry principle exists to record daily transactions. Each transaction is entered in at least two accounts. One side reflects what has been received, while the other reflects what has been given or obligated, ensuring that total debits equal total credits.

Students must understand that double-entry is not merely a technical trick; it is the formal expression of accounting balance.

In the next section, we will translate this principle into the logic of debits and credits.

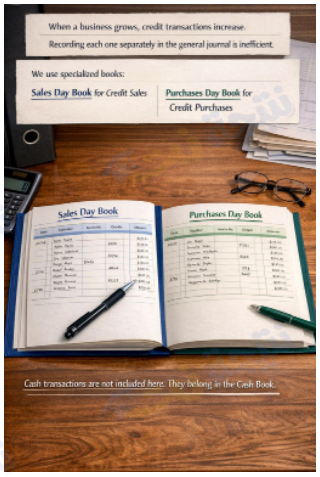
Exercise
Formative Check

1. What are the three guiding questions used to analyze a transaction?
2. Why is transaction analysis important before recording journal entries?
3. How can failure to analyze a transaction lead to errors?

THINK!

happen if transactions were recorded without ocumentation?

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SECTION2

THE LOGIC OF DEBIT AND CREDIT

While the double-entry principle explains why every financial transaction affects at least two accounts, the terms debit and credit determine where these effects are recorded. Students often experience conceptual confusion due to memorization; it is important to understand that "debit" does not necessarily mean increase , and "credit" does not necessarily mean decrease . Both represent the two sides of an account, while whether an increase or decrease occurs depends entirely on the nature and classification of the account. Understanding this distinction is essential.

The relationship between the accounting equation and Debit/Credit:

Recall the accounting equation:

Assets = Liabilities + Owner's Equity

The left side of the equation represents assets , while the right side represents liabilities and owner's equity .
The recording system reflects the relationship between the accounting equation and debit/credit as follows:

- Assets increase on the debit side .
- Liabilities increase on the credit side .
- Owner's equity increases on the credit side .

Why? Because the debit side represents one side of the accounting equation, while the credit side represents the other , ensuring that the system remains in balance.

Exercise
Formative Check

1. Why do debit and credit not automatically mean increase or decrease?
2. How does the accounting equation explain the debit and credit rule?
3. Why does the debit side reflect an increase in assets??

THINK!

"Why do liabilities increase on the credit side?

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Classification of Accounts

To apply the debit and credit rules correctly, accounts must be classified.

There are five main categories:

1. Assets
2. Liabilities
3. Owner's Equity
4. Revenue
5. Expenses

Revenue increases owner's equity because profit increases the owner's claim on the business. Expenses decrease owner's equity because they reduce profit.

This means:

- Revenue increases on the credit side .
- Expenses increase on the debit side .

Equation:

Owner's Equity =

Capital + Revenue − Expenses − Drawings

Basic Debit and Credit Rules

Account Type	Increase	Decrease
Assets	Debit	Credit
Liabilities	Credit	Debit
Owner's Equity	Credit	Debit
Revenue	Credit	Debit
Expenses	Debit	Credit

These rules are not random; they result from the structure of the accounting equation. Students who memorize this table without understanding its logic are more likely to make mistakes, while those who understand the equation rarely do.

Applying the Debit and Credit Rule through Analysis

Before recording any transaction, it must be analyzed systematically

Self-Check Questions

1. Why do revenues increase owner's equity?
2. Why are expenses recorded on the debit side?
3. How does profit link revenues and owner's equity?
4. Which side reduces liabilities?
5. Why are revenues credited?
6. How does understanding the structure of debit and credit reduce the need for memorization?

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Practical Case

A business purchases goods for cash.

1. Transaction Analysis:

Question	Analysis
What did the business receive?	Inventory
What did the business give?	Cash
Which accounts are affected?	Inventory and Cash

2. Direction of Change:

Account	Type	Change
Inventory	Asset	Increase
Cash	Asset	Decrease

3. Applying Debit and Credit Rule:

Account	Type	Rule Applied	Entry
Inventory	Asset	Assets increase → Debit	Debit
Cash	Asset	Assets decrease → Credit	Credit

Final Entry:

Debit	Credit
Inventory	Cash

Review Questions

1. Why is transaction analysis necessary before recording entries?
2. Why is inventory debited in this transaction?
3. Why is cash credited?
4. How does correct classification help determine the final entry?

Remember the structure of the debit and credit system:

1. Identify what has changed and classify the account.
2. Apply the rule logically, not through guessing or memorization, but through understanding the structure of the system.

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General Journal

The general journal is the book where transactions are recorded chronologically using the double-entry system. It is the first step in the accounting cycle after transaction analysis.

Each journal entry must include:

- At least one debit account
- At least one credit account
- Maintenance of the accounting equation (Assets = Liabilities + Owner's Equity).

Each journal entry includes:

1. Date
2. Accounts affected
3. Debit amount
4. Credit amount
5. Brief description of the transaction

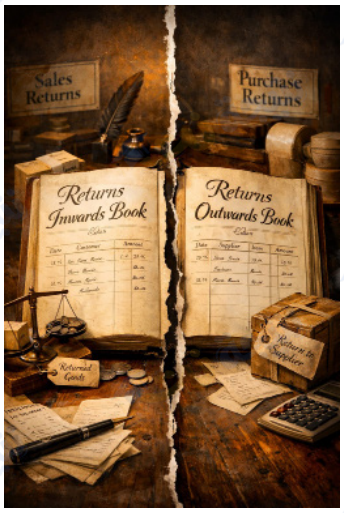
Example:

Date	Debit	Credit	Description



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SECTION 3 : Ledger Accounts and Posting Transactions



Accounting principles work together to present an accurate financial picture. The double-entry principle explains why each transaction affects at least two accounts, while debit and credit rules determine how these effects are classified on the correct side of the account. Then comes the role of the "ledger", which organizes these effects. The ledger is the comprehensive record that brings together all the accounts of the business. Each account records all transactions related to a specific element (such as cash, inventory, sales, and loans).

If the journal records transactions chronologically, the ledger organizes them systematically. Without the ledger, financial transactions remain scattered. With the ledger, each account shows a summary of its financial effects.

Structure of the Ledger Account:

A ledger account is usually presented in a "T-account format":

- The left side records "debits"
- The right side records "credits"

Accounts are posted from journal entries over time. At the end of the period, each account is balanced to determine its remaining balance (if any).

Practical Example: Ledger Accounts

Assume the following transactions for Noor Trading Company "during January".

1. The owner invested EGP 100,000 in cash into the business.
2. Equipment was purchased for EGP 40,000 cash.
3. Goods were purchased on credit for EGP 25,000.
4. Goods were sold for EGP 30,000 cash.
5. Rent of EGP 5,000 was paid in cash.
6. EGP 10,000 was paid to the supplier as part of a credit purchase.

We will now post these transactions into the ledger accounts.

Exercise
Formative Check

1. Why must reversals be recorded separately?
2. Why does the separation of books strengthen accuracy and control?

THINK!

Can businesses operate effectively without a ledger?

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Identifying Affected Accounts

Before posting, each transaction is analyzed. This skill remains essential.

We now post directly into "T-accounts"

Cash Account:

Debit	Amount	Credit	Amount
Capital	100,000	Equipment	40,000
Sales	30,000	Rent Expense	5,000
Debtors	10,000		

Total Debit 130,000

Total Credit 55,000

Balance: 75,000 (Debit)

Equipment Account

Debit	Amount	Credit	Amount
Cash	40,000		

Balance: 40,000 (Debit)

Inventory Account

Debit	Amount	Credit	Amount
Cash	25,000		

Balance: 25,000 (Debit)

Creditors Account

Debit	Amount	Credit	Amount
Cash	10,000	Inventory	25,000

Balance: 15,000 (Credit)

Capital Account

Debit	Amount	Credit	Amount
Cash	100,000		

Balance: 100,000 (Credit)

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Sales Account

Debit	Amount	Credit	Amount
		Cash	30,000

Balance: 30,000 (Credit)

Rent Expense Account

Debit	Amount	Credit	Amount
Cash	5,000		

Balance: 5,000 (Debit)

Balancing the Accounts

- After posting all transactions:
- Assets reflect current resources
- Liabilities reflect remaining obligations
- Revenues and expenses show the period's result
- Capital reflects the owner's investment

We are now ready to prepare the "Trial Balance"

Notice how different this is from Unit 1: we are no longer explaining why the double-entry system exists - we are now applying the system.

Review Questions

1. Why must every transaction be recorded in two accounts?
2. What is the final balance of the Cash account?
3. Why does the Creditors account still have a credit balance?
4. How does recording multiple transactions increase complexity compared to a single transaction?

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SECTION 4

Trial Balance and Error Detection



After posting transactions to the ledger, the next step is balancing the accounts. This process is the foundation for moving from the ledger to the trial balance, where closing balances are extracted and presented in debit and credit columns.

Although equality between total debits and total credits reflects arithmetic accuracy and adherence to the double-entry system, it does not guarantee the complete absence of errors. Technical and control errors—such as omission errors or misclassification—may still exist behind this numerical balance. Therefore, it is essential to distinguish between accounting balance and actual reliability of financial data to ensure the quality and credibility of financial statements.

1. Preparing the Trial Balance

Using the ledger balances from Section 3:

Account	Debit Balances	Credit	Balances
Cash	75,000	Creditors	15,000
Equipment	40,000	Capital	100,000
Inventory	25,000	Sales	30,000
Rent Expense	5,000		

Trial Balance as of January 31

Account	Debit	Credit
Cash	75,000	
Equipment	40,000	
Inventory	25,000	
Rent Expense	5,000	
Creditors		15,000
Capital		100,000
Sales		30,000
Total	145,000	145,000

We notice that the trial balance is balanced, meaning the system is internally consistent.

1. What does the balancing of the Trial Balance confirm?
2. Why does rent expense appear in the debit column?
3. Why do sales appear in the credit column?

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2. Error Detection and Identification

A. Errors That Affect Trial Balance Equality

Assume the following errors occurred during posting:

Rent expense of 5,000 was recorded as a credit instead of a debit.

A payment of 10,000 to a supplier was recorded only in cash, without recording creditors.

Equipment was recorded as 4,000 instead of 40,000.

We now analyze the effect of each error:

1. Recording Rent Expense on the Credit Side Instead of Debit (Technical Error)

If rent expense is incorrectly recorded as a credit of 5,000 instead of a debit:

Debit total decreases by 5,000

Credit total increases by 5,000

The trial balance will not balance, and the difference becomes 10,000.

This type of error is detectable immediately because the difference is divisible by 2, indicating a reversal of entry direction.

2. One-Sided Posting (Omission / Partial Error)

If cash is credited by 10,000 without recording the corresponding debit in creditors:

Credit side exceeds debit side by 10,000

The trial balance will not balance. This violates the double-entry principle and is easily detectable, as the difference equals the missing amount.

3. Incorrect Amount Entry (Recording Error)

If equipment is recorded as 4,000 instead of 40,000:

Debit side is understated by 36,000

The trial balance will not balance unless a similar compensating error occurs elsewhere.

This is a non-compensating error.

B. Errors That Do Not Affect Trial Balance Equality

Classification (Technical Error)

If rent expense is correctly recorded as a debit of 5,000, but posted to the equipment account instead of the rent expense account:

The trial balance remains balanced

However, accounts are misclassified, affecting financial reporting accuracy

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Effect: Classification Error

The total of both debit and credit sides remains correct, and the trial balance stays balanced. However, the accounting classification is incorrect. This is a fundamental error, and it cannot be detected by the trial balance.

Review Questions

1. What errors immediately cause the trial balance to be out of balance?
2. What is a technical error?
3. Why is classification as important as balancing?
4. Why might some errors remain undetected even if the trial balance is balanced?

Practical Exercise (Case Study)

The following is an unbalanced trial balance:

Account	Debit	Credit
Cash	65,000	
Equipment	40,000	
Inventory	25,000	
Rent Expense	5,000	
Creditors		15,000
Capital		100,000
Sales		30,000

Difference: 20,000

Required:

1. Identify possible sources of error .....
2. Suggest correcting journal entries .....
3. Rebalance the trial balance .....

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SECTION 5

Integrated Practical Application

You are now the accountant.

The following transactions relate to "Amal Trading Company" during March.

Business Scenario

Amal started a wholesale trading business. During March, the following transactions occurred:

1. The owner invested "EGP 150,000 cash" in the business.
2. Equipment was purchased for "EGP 60,000 cash" .
3. Goods were purchased on credit for "EGP 40,000" .
4. Goods were sold for "EGP 50,000 cash" .
5. Goods were sold on credit for "EGP 30,000" .
6. EGP "15,000 was paid to suppliers" .
7. Salaries of "EGP 8,000 were paid in cash" .
8. EGP "10,000 was collected from a customer" for credit sales.

1. Transaction Analysis Table

Entry	Debit Account	Amount	Credit Account	Amount
1				
2				
3				
4				
5				
6				
7				
8				

2. General Journal

Date	Debit	Credit	Description
1 March			
2 March			
3 March			
4 March			
5 March			
6 March			

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3 Ledger Accounts

Date	Debit	Credit	Description

Cash Account

Date	Debit	Credit	Description

Equipment

Date	Debit	Credit	Description

Inventory

Date	Debit	Credit	Description

Creditors

Date	Debit	Credit	Description

Accounts Receivable (Debtors)

Date	Debit	Credit	Description

Capital

Date	Debit	Credit	Description

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Sales

Date	Debit	Credit	Description

Salaries Expense

Date	Debit	Credit	Description

4. Trial Balance (31 March)

Account	Debit	Credit
Cash		
Equipment		
Inventory		
Accounts Receivable		
Creditors		
Capital		
Sales		
Salaries Expense		
Totals		

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SECTION 6

JUSTIFY AND REASONING WITH EVIDENCE (J R E)

Accounting systems rely on accuracy, discipline in posting, and verification of internal balance.

In this unit, you have:

- Recorded transactions
- Posted them to the ledger accounts
- Balanced the accounts
- Prepared the trial balance
- Detected errors

But an important question remains:

Does internal balance in accounting guarantee the faithful representation of financial statements?

Understanding the Question

This question requires careful thinking.

A trial balance is balanced when total debits equal total credits. This confirms internal consistency, but equal totals do not necessarily mean that:

- All transactions have been recorded
- Accounts have been classified correctly
- Estimates were reasonable
- No errors have occurred
- Technical errors have been avoided

Internal consistency means that the structure of the system is balanced. Faithful representation of accounting information means that it is reliable for decision-making. Although these two ideas are related, they are not identical. The issue is not whether internal consistency is important, but whether it is sufficient. This distinction is very important.

A clear definition of the concepts of “internal consistency” and “faithful representation of accounting information” :

- Explain how the trial balance verifies the integrity of the accounting system structure.
- Evaluate situations in which the faithful representation of accounting information may fail.
- Discuss differing viewpoints.
- Reach a justified and coherent conclusion.
- Your discussion should be analytical rather than descriptive.
- It should go beyond simply repeating definitions.

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Writing Framework For The JRE

Section	What You Should Do	Guiding Focus
Introduction	Define specialization in accounting and present your position.	Does division improve control?
Argument 1	Explain how specialization strengthens organization and reduces error.	Efficiency and clarity
Argument 2	Discuss how multiple books may create fragmentation or oversight risk.	Coordination challenges
Counterargument	Respond to the opposite position.	Is specialization always beneficial?
Conclusion	Reach a justified judgment.	Does specialization ultimately strengthen or weaken control?

Justify and Reasoning with Evidence (J R E)

Marking Rubric

Total Marks: 20

Criterion	Excellent (4)	Good (3)	Developing (2)	Limited (1)
Conceptual Understanding	Precise understanding of posting, trial balance, and error types	Clear understanding with minor gaps	Basic understanding	Limited or incorrect understanding
Analytical Depth	Insightful evaluation of reliability vs structure	Clear evaluation	Some evaluation but mostly descriptive	Minimal evaluation
Use of Unit 2 Evidence	Integrates ledger, posting, and error examples effectively	Refers to relevant examples	Limited application	Little reference to unit concepts
Structure and Coherence	Logical progression and strong counterargument	Mostly clear structure	Weak flow	Disorganized
Judgment and Conclusion	Balanced, justified, and independent conclusion	Clear but limited justification	Weak or underdeveloped	Unsupported or missing

Mark Interpretation

- 18–20 marks: Exceptional reasoning. Demonstrates intellectual maturity and strong accounting insight.
- 14–17 marks: Strong analytical performance with minor weaknesses.
- 10–13 marks: Adequate understanding but limited analytical depth.
- 6–9 marks: Basic comprehension with significant weaknesses.
- 0–5 marks: Limited understanding and insufficient reasoning.

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Practical Case: Double-Entry Principle and Ledger Acco Case Data:

Al Noor Trading Company started its operations during January 2026. The following transactions occurred:

Transaction	Amount (EGP)
Owner invested cash in the business	100,000
Purchased furniture for cash	20,000
Purchased inventory on credit	30,000
Sold goods for cash	40,000
Paid part of creditors	10,000
Paid rent expense	5,000

Required:

1. Record journal entries
2. Post to the ledger accounts
3. Prepare the trial balance
4. Analyze: Does a balanced trial balance mean that financial statements reflect reality faithfully?

(1) Journal Entries:

Debit	Credit	Description
Cash		100,000
Capital	100,000	
Owner investment		
Furniture		20,000
Cash	20,000	
Cash purchase of furniture		
Inventory		30,000
Creditors	30,000	
Credit purchase of inventory		
Cash		40,000
Sales	40,000	
Cash sales		
Creditors		10,000
Cash	10,000	
Rent payment		
Rent Expense		5,000
Cash	5,000	

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(2) Ledger Posting:

Cash Account

Debit	Credit	Debit	Credit
100,000	Capital	20,000	Furniture
40,000	Sales	10,000	Creditors
		5,000	Rent Expense
Balance	105,000		

Capital Account

Debit	Credit	Debit	
	Cash	100,000	Cash

Furniture Account

Debit	Credit	Debit	
		20,000	Cash

Inventory Account

Debit	Credit	Debit	
		30,000	Creditors

Creditors Account

Debit	Credit	Debit	
10,000	Cash	30,000	
20,000	Balance		

Sales Account

Debit	Credit	Debit	
		40,000	Cash

Rent Expense Account

Debit	Credit	Debit	
		5,000	Cash

(3) Trial Balance:

Account	Debit	Credit
Cash	105,000	
Furniture	20,000	
Inventory	30,000	
Creditors		20,000
Capital		100,000
Sales		40,000
Rent Expense	5,000	
Total	160,000	160,000

The trial balance is balanced.

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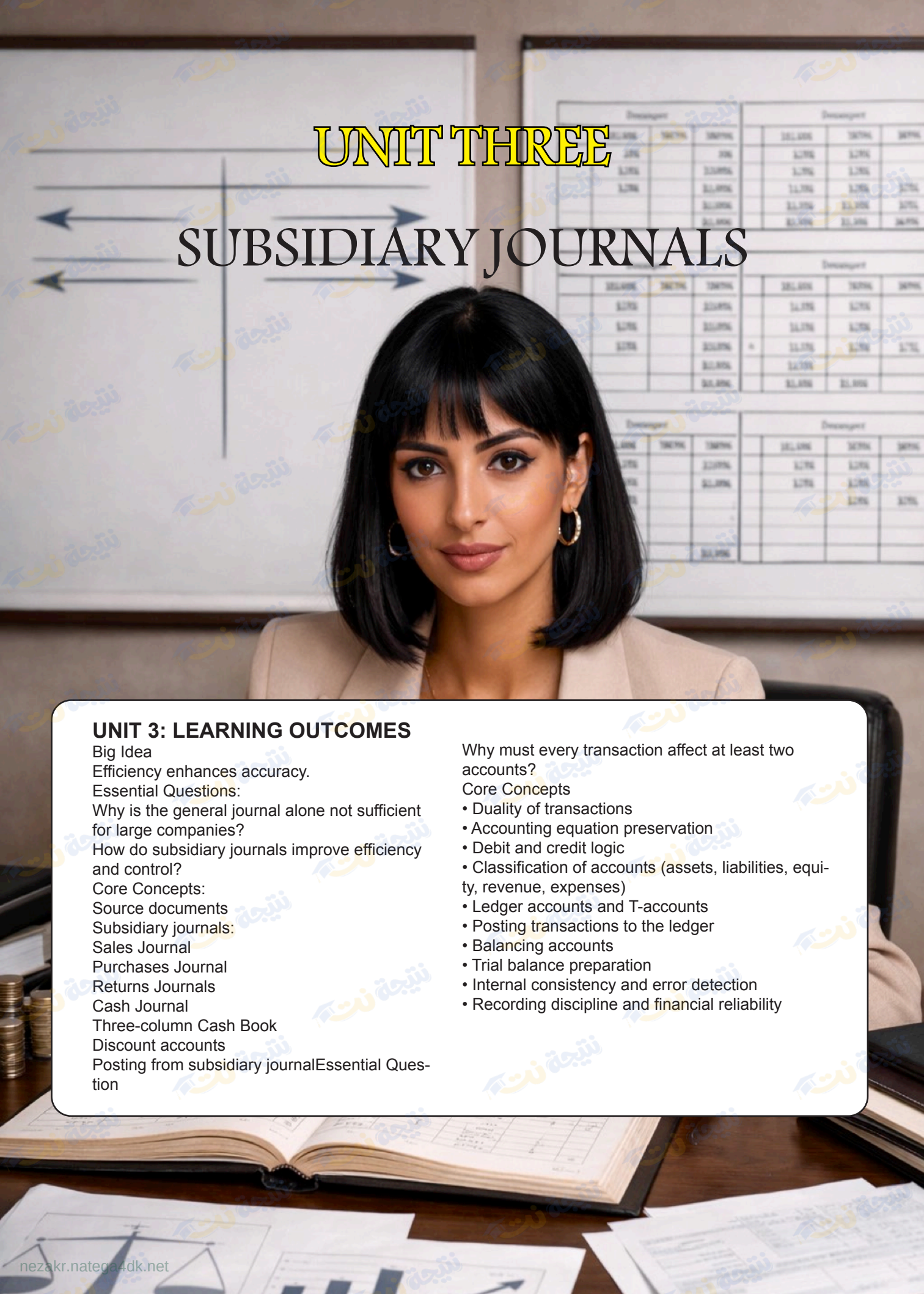
(4) Analysis (JRE):

- Internal consistency in accounting refers to the equality of debit and credit totals according to the double-entry system. It is a necessary condition for the integrity of the accounting system, but it is not sufficient to guarantee faithful representation of financial statements.
- A balanced trial balance only proves that the accounting system is mathematically balanced. However, it does not confirm that all transactions have been recorded correctly or fairly.
- Faithful representation means that financial statements accurately and fairly reflect the economic reality of the business. Although a balanced trial balance indicates an organized accounting system, it does not necessarily ensure that financial information is free from errors or misstatements.

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UNIT THREE

SUBSIDIARY JOURNALS



UNIT 3: LEARNING OUTCOMES

Big Idea
Efficiency enhances accuracy.
Essential Questions:
Why is the general journal alone not sufficient for large companies?
How do subsidiary journals improve efficiency and control?
Core Concepts:
Source documents
Subsidiary journals:
Sales Journal
Purchases Journal
Returns Journals
Cash Journal
Three-column Cash Book
Discount accounts
Posting from subsidiary journalEssential Question
Why must every transaction affect at least two accounts?
Core Concepts
• Duality of transactions
• Accounting equation preservation
• Debit and credit logic
• Classification of accounts (assets, liabilities, equity, revenue, expenses)
• Ledger accounts and T-accounts
• Posting transactions to the ledger
• Balancing accounts
• Trial balance preparation
• Internal consistency and error detection
• Recording discipline and financial reliability

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UNIT BIG IDEA

Opening Situation for the Unit

Case Study: When Business Growth Leads to Increased Complexity

Hassan owns a wholesale food distribution company.

In his first year, he recorded every transaction directly in the general journal. This approach was suitable when the number of transactions was small.

In his third year, the business expanded significantly:

40 credit sales transactions per day

25 credit purchase transactions

Multiple sales returns from customers

Discounts from suppliers

Frequent small cash expenses

The general journal became overloaded, errors increased, and posting was delayed, which could lead to delays in preparing and issuing financial statements.

Solution Introduced by the Accountant

The accountant introduced subsidiary journals:

Credit sales were recorded in the Sales Journal

Credit purchases were recorded in the Purchases Journal

Sales returns were recorded separately

Purchase returns were recorded separately

Small expenses were recorded in a Petty Cash Journal

Within a few months, processing became faster and more accurate.

The volume of transactions did not change — only the system did.

Connecting to the Text
Formative Discussion

1. Why does a large volume of transactions increase the level of complexity?
2. How can grouping similar transactions reduce errors?
3. What are the risks if returns are not recorded in separate records?
4. Why do small cash expenses require a separate petty cash journal?

THINK!

Does the use of subsidiary journals increase the accuracy of the accounting system?

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SECTION 1: INTRODUCTION TO SUBSIDIARY JOURNALS



PREVIOUSLY, YOU LEARNED HOW TO RECORD TRANSACTIONS IN THE GENERAL JOURNAL AND POST THEM TO THE LEDGER ACCOUNTS.

THIS SYSTEM WORKS EFFICIENTLY WHEN THE VOLUME OF TRANSACTIONS IS SMALL.

HOWEVER, AS BUSINESSES GROW, RECORDING EACH TRANSACTION INDIVIDUALLY IN A SINGLE JOURNAL BECOMES INEFFICIENT.

WHEN DOZENS OR EVEN MORE SIMILAR TRANSACTIONS OCCUR DAILY, THE ACCOUNTING SYSTEM MUST ADAPT. THEREFORE, SUBSIDIARY JOURNALS WERE DEVELOPED FOR THIS PURPOSE.

THEY ARE SPECIALIZED JOURNALS THAT GROUP SIMILAR TRANSACTIONS TOGETHER BEFORE POSTING THEM TO THE LEDGER.

THEY INCREASE EFFICIENCY WITHOUT AFFECTING CONTROL.

WHY IS THE GENERAL JOURNAL NO LONGER SUFFICIENT?

IMAGINE A BUSINESS THAT PERFORMS:

30 CREDIT SALES TRANSACTIONS DAILY

20 CREDIT PURCHASE TRANSACTIONS DAILY

MULTIPLE RETURNS

FREQUENT SMALL CASH PAYMENTS

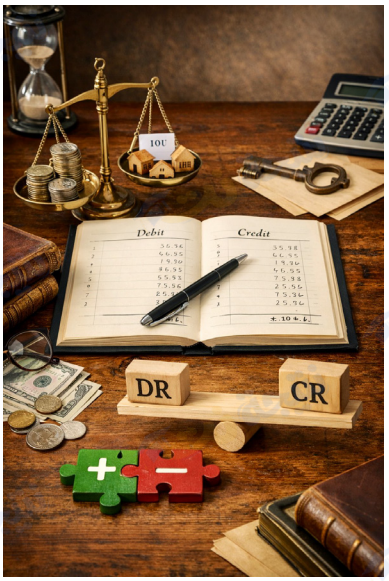
Exercise
Formative Check

1. **Does a large volume of transactions lead to difficulties in recording?**
2. **Do risks increase when the general journal becomes crowded?**

MINI REFLECTION!

How can grouping similar transactions improve control?

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IF EACH TRANSACTION IS RECORDED SEPARATELY IN THE GENERAL JOURNAL, THE JOURNAL BECOMES LONG AND REPETITIVE. POSTING FROM SUCH A JOURNAL INCREASES THE RISK OF:

- OMISSION
- REPETITION
- POSTING ERRORS
- DELAYS IN UPDATING ACCOUNTS

EFFICIENCY IS NOT JUST CONVENIENCE; IT IS A TOOL FOR CONTROL.

SUBSIDIARY JOURNALS REDUCE REPETITION BY ORGANIZING TRANSACTIONS BY TYPE.

Exercise
Formative Check

1. What is meant by the "initial entry"?
2. How are subsidiary journals related to the general ledger?
3. Why are transactions grouped by type before posting?
4. Why are source documents essential in accounting?
5. How do source documents support the reliability of the system?

THINK!
What happens if transactions are recorded without source documents?

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SECTION 1: Sales Journal and Purchases Journal



As a business grows, credit transactions increase.
Credit sales and credit purchases are often the most common transactions in a business.
Recording each transaction individually in the general journal is inefficient.
Instead, businesses use specialized journals:

- Sales Journal for credit sales.
- Purchases Journal for credit purchases.

These journals record credit transactions only .
Cash transactions are not recorded here. They are recorded in the Cash Book , which we will study later.

Sales Journal

The Sales Journal records all credit sales of goods .

Important Clarification:

- It records only credit sales of goods purchased for resale .
- Cash sales are not recorded in the Sales Journal; they are recorded in the Cash Book and summarized in the General Journal.
- Sales of fixed assets are not recorded in the Sales Journal; they are recorded in the General Journal.

Each entry is supported by a sales invoice .
At the end of the period, the total of the Sales Journal is posted to the Sales Account in the ledger.
Individual customer amounts are posted to their respective Accounts Receivable (Debtors) Accounts .
This separation provides both overall control and tracking of individual accounts .

Exercise
Formative Check

1. Why does the Sales Journal record only credit sales ?
2. Why are individual customers' accounts posted separately?

THINK!
How does this system improve efficiency compared with Unit 2?

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Exercise
Formative Check

1. Why does the Sales Journal record only credit sales?
2. Why are customers' accounts posted separately?
3. Why is only the total posted to the Sales Account?
4. How does this system improve efficiency compared with Unit 2?

How does this system improve efficiency compared with Unit 2?

Format of the Sales Journal

Date	Invoice No.	Customer Name	Details	Amount

Worked Example – Sales Journal

During April, the following credit sales transactions occurred:

3 April – Goods sold to Karim for 12,000 (Invoice No. 101).

6 April – Goods sold to Salma for 8,000 (Invoice No. 102).

9 April – Goods sold to Omar for 10,000 (Invoice No. 103).

Required:

1. Prepare the Sales Journal .

2. Post from the Sales Journal to the Subsidiary Ledger .

3. Show the effect on the General Ledger .

Solution

Sales Journal

Date	Invoice No.	Customer Name	Details	Amount
3 April	101	Karim	Credit Sale	12,000
6 April	102	Salma	Credit Sale	8,000
9 April	103	Omar	Credit Sale	10,000
Total				30,000

THINK!
What happens if transactions are recorded without source documents?

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Posting is carried out in two stages:

1. Each customer's account is debited individually.
2. The total sales amount is credited to the Sales Account.

Customer Accounts – Karim.

Debit	Amount	Credit	Amount
Sales	12,000		

Customer Accounts – Salma

Debit	Amount	Credit	Amount
Sales	8,000		

Customer Accounts – Omar

Debit	Amount	Credit	Amount
Sales	10,000		

General Ledger – Accounts Receivable Account

Debit	Amount	Credit	Amount
Sales	30,000		

General Ledger – Sales Account

Debit	Amount	Credit	Amount
		30,000	Total Accounts Receivable

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Purchases Journal

The Purchases Journal records all credit purchases of goods acquired for resale . It does not record:

- Cash purchases
- Purchases of fixed assets

Every entry must be supported by a supplier's purchase invoice.

At the end of the period:

- Individual suppliers' accounts are credited.
- The total is posted as a debit to the Purchases Account.

Format of the Purchases Journal

Date	Invoice No.	Supplier Name	Details	Amount (EGP)
Total				

Worked Example: Purchases Journal

5 April – Goods purchased from Nile Company for 15,000 (Invoice No. 501)

8 April – Goods purchased from Delta Trading Company for 20,000 (Invoice No. 502)

Required:

- Prepare the Purchases Journal.
- Post to the subsidiary ledger accounts of Nile Company and Delta Trading Company.

Solution

Purchases Journal

Date	Invoice No.	Supplier Name	Details	Amount (EGP)
5 April	501	Nile Company	Credit Purchase	15,000
8 April	502	Delta Trading Company	Credit Purchase	20,000
Total				35,000

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Posting from the Purchases Journal

Purchases Account

Debit	Amount	Credit	Amount
35,000	Total Suppliers (Accounts Payable)		

Accounts Payable – Nile Company

Debit	Amount	Credit	Amount
		15,000	Purchases

Accounts Payable – Delta Trading Company

Debit	Amount	Credit	Amount
		20,000	Purchases

Review Questions

1. Why are purchases of fixed assets excluded from the Purchases Journal?
2. Why is the total posted to the Purchases Account while suppliers are posted individually?
3. How does grouping transactions contribute to stronger control?
4. What would happen if credit purchases were recorded in the Cash Book instead?

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Section 3: Returns Journals and Trade Discount
In business, not all transactions proceed smoothly.
Customers may return goods.
Businesses may return goods to suppliers.
These reversing transactions must be recorded clearly and separately.
If returns are mixed with normal sales or purchases, the accounts will be distorted.
To maintain clarity, separate journals are used:
Sales Returns Journal for goods returned by customers.
Purchases Returns Journal for goods returned to suppliers.
This separation enhances accuracy and control.
Sales Returns Journal
The Sales Returns Journal records goods returned by customers after a credit sale has taken place.
It is also known as the Credit Sales Returns Journal because it relates directly to credit sales previously recorded.
Returns may occur because of:
Damaged goods
Defective goods
Incorrect delivery
When goods are returned, part of the original sales transaction must be reversed.
When a return occurs:
Revenue decreases because the business no longer earns the full value of the sale.
The customer's account decreases because the amount owed is reduced.
Each sales return transaction is supported by a credit note issued to the customer.
This document provides formal evidence of the adjustment and ensures that the accounting records are accurate and verifiable.

Exercise
Formative Check

1. Why must reversing transactions be recorded separately?
2. How does the separation of journals enhance accuracy and control?

THINK!
Why is each sales return supported by a credit note issued to the customer?

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Format of the Sales Returns Journal

Date	Credit Note No.	Customer Name	Details	Amount
Total				

Worked Example – Sales Returns

12 April – Karim returned goods worth 2,000 (Credit Note No. 201).

Completed Sales Returns Journal

Date	Credit Note No.	Customer Name	Details	Amount
12 April	201	Karim	Sales Returns	2,000
Total				2,000

Posting from the Sales Returns Journal

Posting is made as follows:

1. The Sales Returns Account (total) is debited.
2. The individual customer's account is credited.

Sales Returns Account

Debit	Amount	Credit	Amount
2,000	Customers (Accounts Receivable)		

Accounts Receivable – Karim

Debit	Amount	Credit	Amount
		2,000	Sales Returns

Accordingly, sales revenue is reduced, and the customer's outstanding balance is reduced

Check Your Understanding
1. Why is a separate Sales Returns Account necessary?
2. Why is the customer's account credited?
3. What would happen if returns were deducted directly from sales?
4. Purchases Returns Journal

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The Purchases Returns Journal records goods returned to suppliers.
It is also known as the Credit Purchases Returns Journal.
When goods are returned to suppliers:
Purchases decrease.
The amount owed to the supplier decreases.
Each transaction must be supported by a debit note sent to the supplier.
Format of the Purchases Returns Journal

Date	Debit Note No	Supplier Name	Details	Amount
Total				

Worked Example – Purchases Returns
15 April – Goods worth 3,000 were returned to Nile Company (Debit Note No. 301).
Completed Purchases Returns Journal

Date	Debit Note No	Supplier Name	Details	Amount
15 April	301	Nile Company	Purchases Returns	3,000
Total				3,000

Posting from the Purchases Returns Journal
The Purchases Returns Account (total) is credited.
The supplier's account is debited.
Purchases Returns Account

Debit	Amount	Credit	Amount
		Total Accounts Payable	3,000

Accounts Payable – Nile Company

Debit	Amount	Credit	Amount
Purchases Returns	3,000		

Accordingly, the company's liability is reduced, and purchases are adjusted to exclude the returned portion.

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Trade Discounts

A trade discount is a reduction in the listed price of goods, usually granted to wholesalers or regular customers.

Important Principle

Trade discounts are not recorded in the accounting records.

Only the net amount after the trade discount is recorded.

Why?

Because a trade discount is simply a price adjustment, not an actual expense.

It can be viewed as a nominal or non-real discount; therefore, it is not recorded in the books. In addition, no prior conditions are attached to granting it, which is why it is sometimes called an unconditional discount.

Check Your Understanding

1. Why are purchases returns recorded on the credit side?
2. Why is the supplier's account debited for purchases returns?
3. How do returns improve the accuracy of profit measurement?

Example – Trade Discount

List price of goods: 20,000

Trade discount: 10%

Discount amount = 2,000

Net invoice value = 18,000

Only 18,000 is recorded in the Sales Journal or Purchases Journal.

Cash Discount (Prompt Payment Discount)

A cash discount is a reduction granted to the buyer to encourage payment before the agreed due date.

Important Principle

Cash discounts are explicitly recorded in the accounting records.

For the seller, it is recorded as Discount Allowed and is treated as an expense.

For the buyer, it is recorded as Discount Received and is treated as revenue.

Why?

Because a cash discount is a conditional discount, not a nominal one.

Check Your Understanding

1. Why are trade discounts not recorded separately while cash discounts are?
2. How does recording only net amounts simplify accounting for trade discounts?
3. What would happen if trade discounts were recorded as expenses?

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It is linked to a future event—prompt payment. Since we do not know with certainty whether the customer will pay on time, the full invoice is recorded first. When the condition (early payment) is met, the discount is recognized as a financial reward for the buyer and a financial sacrifice by the seller.

Example – Cash Discount

Credit purchase value: 60,000

Payment terms: 10% discount if payment is made within one week

Payment made within the allowed period:

Discount amount = 6,000

Amount actually paid = 54,000

Entries in the Buyer's Books

Recording the Purchase

Date	Debit	Credit	Description
	60,000		
		60,000	

Purchases 60,000 Accounts Payable Recording the purchase

Payment of the Amount Due

Date	Debit	Credit	Description
	60,000		
		54,000	Cash
		6,000	Discount Received

60,000 Accounts Payable (Suppliers)

Settlement of suppliers' balance

Entries in the Seller's Books

Recording the Credit Sale

Date	Debit	Credit	Description
	60,000		
		54,000	Cash
		6,000	Discount Received

60,000 Accounts Receivable 60,000 Sales Recording the credit sale

Collection of the Sale Proceeds

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Date	Debit	Credit	Description	
	54,000		Cash	
	6,000		Discount Allowed	
		60,000	Accounts Receivable	Collection of sales proceeds

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Exercise Formative Check

1. Why must reverse transactions be recorded separately?
2. How does separating journals improve accuracy and control?

Section 4: Cash Book and Petty Cash Book

Cash transactions occur daily in most businesses.

Money is received from customers.

Payments are made to suppliers.

Expenses are paid.

Bank deposits are made.

If these transactions are recorded only in the general journal, the process will be slow and repetitive.

To increase efficiency and maintain stronger control over cash, some companies use a cash book (for cash receipts and payments).

Nature of the Cash Book

The cash book is one of the original books of entry, but it is also part of the ledger, which makes it unique.

Unlike the sales or purchases journal, which are only used to prepare entries for posting, the cash book performs two roles:

A journal for recording cash and bank transactions

A ledger account for cash and bank

This reduces duplication and increases control.

Check your understanding

1. Why does the cash book combine both a journal and a ledger?
2. Why do companies need special control over cash transactions?

THINK!

How does the cash book improve efficiency compared to the general journal?

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Types of Cash Books

There are three main types:

- Single-column cash book.
- Double-column cash book.
- Three-column cash book.

The three-column cash book is the most common and most comprehensive.

It includes:

- Cash column
- Bank column
- Discount column

We will focus on the three-column cash book.

Three-Column Cash Book

The three-column cash book records:

- Cash received and paid
- Bank transactions
- Discounts allowed and received

It has two sides:

- The debit side records cash receipts.
- The credit side records cash payments.

1. What distinguishes the three-column cash book from the single-column and double-column cash books?

2. Why is the three-column cash book considered the most comprehensive form?

THINK!

Why are receipts recorded on the debit side and payments on the credit side in the cash book?

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Three-Column Cash Book Format

Three-Column Cash Book

(Receipts Side)

Date	Details	Discount Allowed	Cash	Bank
Total				

(Payments Side)

Date	Details	Discount Received	Cash	Bank
Total				

Solved Example – Three-Column Cash Book

Transactions for May:

May 1 – Opening balance: Cash 20,000 and Bank 50,000

May 3 – Received 10,000 from Karim, discount allowed 500

May 5 – Paid 15,000 to supplier by cheque, discount received 1,000

May 8 – Paid salaries 6,000 cash

Completed Three-Column Cash Book

Receipts Side

May 1 – Opening balance: Bank 50,000 | Cash 20,000

May 3 – Karim: Bank 9,500 | Discount allowed 500

Total: Bank 50,000 | Cash 29,500 | Discount allowed 500

Payments Side

May 5 – Supplier: Bank 15,000 | Discount received 1,000

May 8 – Salaries: Cash 6,000

May 31 – Closing balance: Bank 35,000 | Cash 23,500

Total: Bank 50,000 | Cash 29,500 | Discount received 1,000

The balances are then carried forward to determine the cash and bank balances at the end of the period.

Test your knowledge

Why is discount allowed recorded on the debit side?

Why is discount received recorded on the credit side?

How does the cash book reduce the need for separate ledger accounts for cash and bank?

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Why is accuracy especially important in recording cash?

Petty Cash Book

Large companies make many small payments, such as:

Stationery and printing materials

Transportation

Postage

Cleaning supplies

Recording every small payment in the main cash book can cause confusion in the workflow.

To control small expenses efficiently, companies use a petty cash book.

This system improves control and prevents misuse.

Format of the Petty Cash Book:

Date	Details	Postage	Stationery	Transport	Others
Total					

Each column is totaled and then posted to expense accounts.

Example:

On 1 May, the following petty expenses were paid:

Postage: 500

Stationery: 800

Transport: 200

Date	Details	Postage	Stationery	Transport	Others
1/5	Petty cash expenses	500	800	200	200
Total					1500

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In this unit, you learned how businesses move from a single general journal to specialized subsidiary journals:

- Sales Journal
- Purchases Journal
- Returns Journals
- Cash Book
- Petty Cash Book

This organization increases efficiency.

However, an important question now arises:
“Does the use of specialized subsidiary journals enhance control, or does it create new challenges?”

Understanding the question:
The journals are divided into homogeneous, specialized groups (subsidiary journals) in addition to the general journal, which leads to greater accuracy and fewer errors.

However, specialization also means:

- Keeping different journals separately
- Some companies may maintain certain journals while omitting others (using the general journal without subsidiary journals)
- Posting occurs at different stages

You are not required to decide whether subsidiary journals are useful.
Rather, you are required to evaluate whether dividing journals into specialized books enhances control, or whether it creates new weaknesses.

Does organization reduce errors?
Or does dividing the journals create new weaknesses?

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A high-quality JRE answer should include the following:

- A definition of what is meant by “subsidiary journals” and “control”.
- An explanation of how subsidiary journals work.
- An evaluation of strengths and weaknesses.
- Consideration of challenges of coordination and supervision.
- A balanced and justified conclusion.

Your response should go beyond merely describing the journals.
It should also analyze the implications of separating them and their impact on the faithful representation of financial statements / accounting information.

Section	What You Should Do	Guiding Focus
Introduction	Definition of subsidiary journals and expressing an opinion on them	Does dividing journals improve control?
Argument 1	Explain how dividing journals enhances organization and reduces errors	Efficiency and clarity
Argument 2	Discuss how having too many journals may lead to fragmentation or duplication	Coordination challenges
Counterargument	Response to the opposing argument	Responding to the opposing view: Are subsidiary journals always beneficial?
Conclusion	Reaching a justified judgment	Do subsidiary journals enhance control or weaken it in the end?

Case study on “Maintaining the General Journal and Subsidiary Journals”

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The following transactions related to sales, purchases, and related activities occurred in Bilal Stores during March:

1 March: Purchased goods on account from Mansour Stores for 50,000 EGP.
5 March: Purchased goods on account from Meligy Stores for 20,000 EGP.
7 March: Returned part of the purchased goods from the beginning of the month worth 5,000 EGP.
10 March: Returned part of the goods purchased on 5 March worth 2,000 EGP.
15 March: Sold goods on account to Gabriel Stores for 25,000 EGP.
18 March: Gabriel Stores returned goods worth 3,000 EGP.
20 March: Sold goods on account to Gamal Stores for 30,000 EGP.
25 March: Gamal Stores returned goods worth 2,500 EGP.

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Required:

1. Record the above transactions in the general journal and give your opinion regarding the level of control.
2. Re-record the above transactions in subsidiary journals and give your opinion regarding the level of control.

General Journal

1 March
Dr Purchases 50,000
Cr Creditors (Mansour Stores) 50,000
Purchase of goods on account

5 March
Dr Purchases 20,000
Cr Creditors (Meligy Stores) 20,000
Purchase of goods on account

7 March
Dr Creditors (Mansour Stores) 5,000
Cr Purchases Returns 5,000
Return of part of purchased goods

10 March
Dr Creditors (Meligy Stores) 2,000
Cr Purchases Returns 2,000
Return of part of purchased goods

15 March
Dr Debtors – Gabriel Stores 25,000
Cr Sales 25,000
Sale of goods on account

18 March
Dr Sales Returns 3,000
Cr Debtors – Gabriel Stores 3,000
Return of part of sold goods

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20 March
Dr Debtors – Gamal Stores 30,000
Cr Sales 30,000
Sale of goods on account

25 March
Dr Sales Returns 2,500
Cr Debtors – Gamal Stores 2,500
Return of part of sold goods

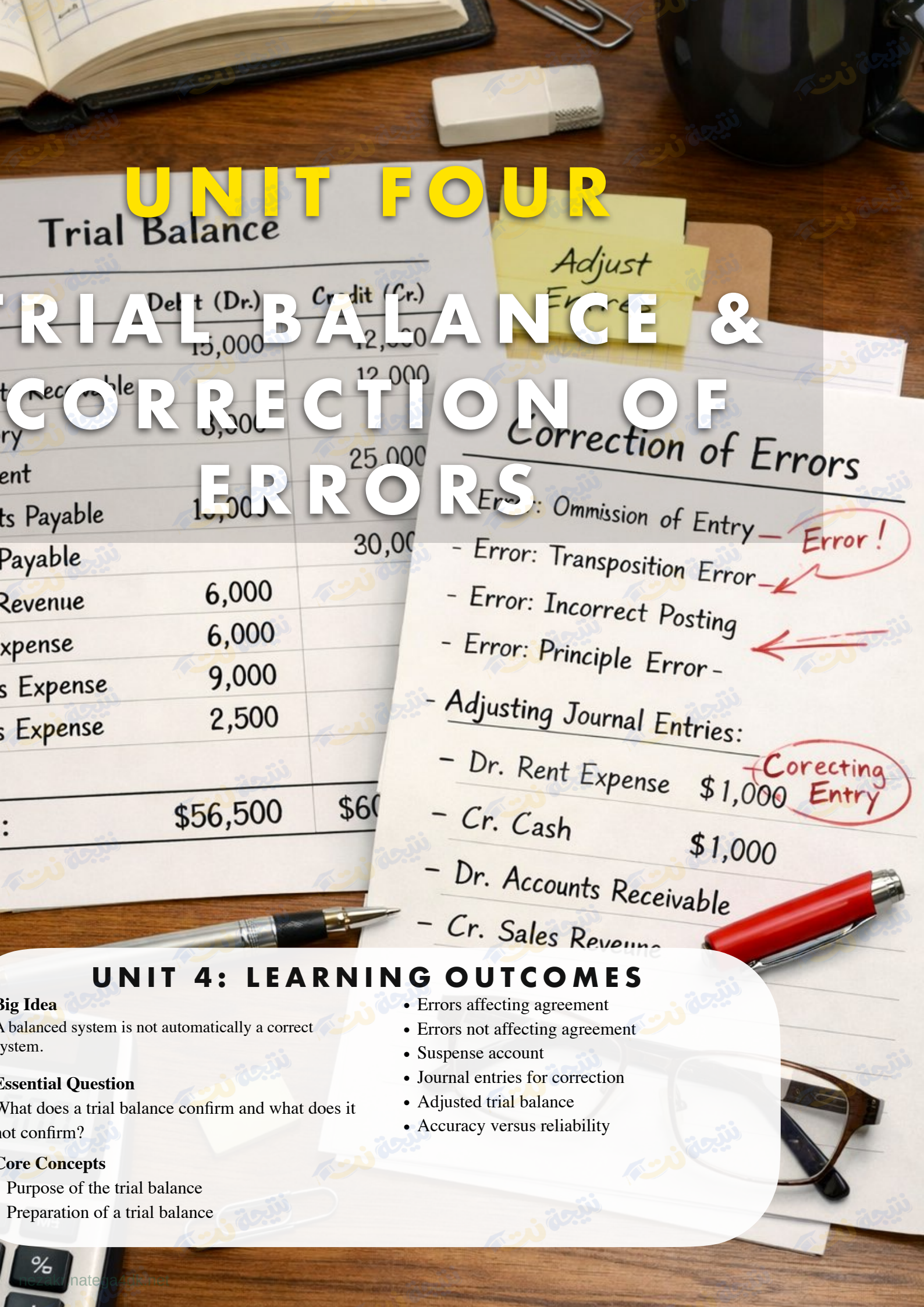
Total: 137,500 = 137,500
Opinion regarding the level of control:

Control over these records is relatively difficult due to the large number of similar transactions (credit purchases, credit sales, purchases returns, and sales returns). Therefore, it is better to use subsidiary journals, where each type of transaction is recorded separately in its own journal (purchases journal, sales journal, returns journals, etc.), improving accuracy and control.
Subsidiary Journals
Credit Purchases Journal
1 March – Mansour Stores – Purchase on account – 50,000
5 March – Meligy Stores – Purchase on account – 20,000
Total creditors: 70,000
Journal entry:
Dr Purchases 70,000
Cr Creditors (total) 70,000
Recording credit purchases
Credit Sales Journal
15 March – Gabriel Stores – Sale on account – 25,000
20 March – Gamal Stores – Sale on account – 30,000
Total debtors: 55,000
Journal entry:
Dr Debtors (total) 55,000
Cr Sales 55,000
Recording credit sales
Purchases Returns Journal
7 March – Mansour Stores – 5,000

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10 March – Meligy Stores – 2,000
Total creditors: 7,000
Journal entry:
Dr Creditors (total) 7,000
Cr Purchases Returns 7,000
Return of purchased goods
Sales Returns Journal
18 March – Gabriel Stores – 3,000
25 March – Gamal Stores – 2,500
Total debtors: 5,500
Journal entry:
Dr Sales Returns 5,500
Cr Debtors (total) 5,500
Return of sold goods
Effect on control level:
Control is significantly improved because:
Each type of transaction has a dedicated journal, improving accuracy and organization.
Subsidiary journals allow detailed review and verification of each category.
A dual control system is created: subsidiary journals and general journal postings.
Posting totals to the general journal adds an additional layer of review, strengthening internal control.

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UNIT FOUR

TRIAL BALANCE & CORRECTION OF ERRORS

UNIT 4: LEARNING OUTCOMES

Big Idea

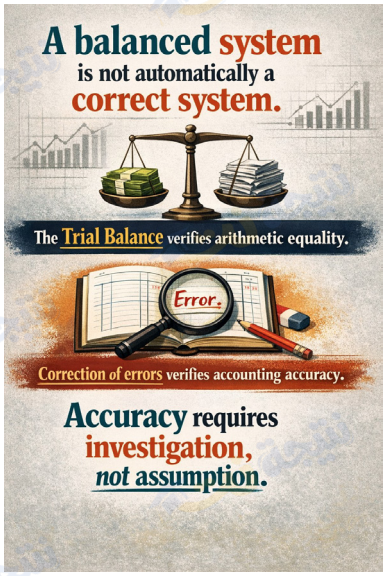
A balanced system is not automatically a correct system.

Essential Question

What does a trial balance confirm and what does it not confirm?

Core Concepts

- Purpose of the trial balance
- Preparation of a trial balance
- Errors affecting agreement
- Errors not affecting agreement
- Suspense account
- Journal entries for correction
- Adjusted trial balance
- Accuracy versus reliability



UNIT BIG IDEA

A balanced system is not necessarily a correct system.
The trial balance ensures that debit balances equal credit balances.
Error correction enhances accounting accuracy.
Accuracy requires procedures to ensure that no errors exist at all stages of the accounting cycle.

ESSENTIAL QUESTION

What does the trial balance confirm, and what does it not confirm?
Why do errors still exist even when totals are equal?
What is the purpose of the suspense account?
How are errors corrected using journal entries?
Does the equality of both sides of the trial balance guarantee accounting accuracy?

UNIT OPENER CASE
CASE STUDY: THE BALANCED MISTAKE

Youssef prepared a trial balance for his company. The total debit balances equaled the total credit balances. He felt confident. A week later, the auditor reviewed the accounts and discovered the following:

* The purchase of equipment was recorded as inventory.
* A payment to one of the suppliers was posted to the wrong account.
* One sales transaction was omitted.

The trial balance was balanced, but the accounts were incorrect.
The system was balanced, but the information was not accurate.
This is the focus of Unit Four.

Connecting to the Text
Formative Discussion

1. Why can a trial balance agree even when errors exist?

2. Is arithmetic balance sufficient for decisionmaking?

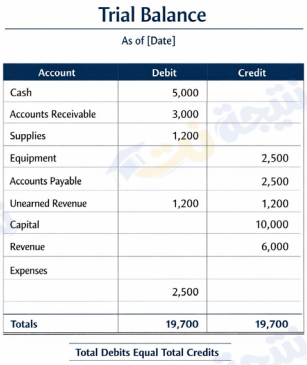
3. What risks arise if errors remain undetected?

T HINK!

If Youssef's trial balance agreed, how could his accounts still be wrong?

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SECTION 1: PREP ARIN G THE TRIAL BA L A N C E



Trial Balance

As of [Date]

Account	Debit	Credit
Cash	5,000	
Accounts Receivable	3,000	
Supplies	1,200	
Equipment		2,500
Accounts Payable		2,500
Unearned Revenue	1,200	1,200
Capital		10,000
Revenue		6,000
Expenses		
	2,500	
Totals	19,700	19,700

Total Debits Equal Total Credits

Previously, you posted transactions to ledger accounts and calculated
balances.
The next logical step is verification.
The trial balance is prepared at the end of a period to test whether total debits
equal total credits.
It does not prepare financial statements.
It checks arithmetic accuracy before statements are prepared.
The trial balance is therefore a control tool.

PURPOSE OF THE TRIAL B AL AN CE

The trial balance serves three main purposes:
To verify the arithmetic accuracy of ledger posting.
To ensure total debits equal total credits.
To provide a structured list of account balances for financial statement
preparation.
If total debits do not equal total credits, an error has occurred.
However, equality does not guarantee correctness.
This distinction will become central later in this unit.

Exercise
Formative Check

1. What is the primary purpose of a trial balance?

2. Does the trial balance prove that all transactions are correct?

FORMAT OF THE TRIAL BALANCE

The trial balance lists all ledger accounts and their balances in two columns:
Debit column
Credit column
Each account appears only once.
The balance of each ledger account is transferred to the trial balance.

THINK!
Why is the trial balance prepared before financial statement T R I A L BALANC E FORMAT s?

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TRIAL BALANCE FORMAT

Trial Balance
As at (Date)

Account Name	Debit (EGP)	Credit (EGP)
Total		

Worked Example

Below are the closing balances extracted from the ledger of Or
Cash – 40,000 (Debit)
Equipment – 70,000 (Debit)
Inventory – 25,000 (Debit)
Accounts Receivable – 15,000 (Debit)
Accounts Payable – 20,000 (Credit)
Capital – 90,000 (Credit)
Sales – 50,000 (Credit)
Rent Expense – 10,000 (Debit)

PREPARATION OF THE TRIAL BALANCE

Trial Balance of Omar Trading
As at 30 June

Account Name	Debit (EGP)	Credit (EGP)
Cash	40,000	
Equipment	70,000	
Inventory	25,000	
Accounts Receivable	15,000	
Rent Expense	10,000	
Accounts Payable		20,000
Capital		90,000
Sales		50,000
Total	160,000	160,000

The totals agree.
The ledger is arithmetically balanced.
But remember Youssef's case.
Agreement confirms internal consistency.
It does not guarantee accuracy.

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SECTION 2: ERRORS THAT AFFECT THE TRIAL BALANCE

When preparing a trial balance, the total debits may not equal total credits.
If this occurs, an error exists.
This type of error affects the agreement of the trial balance.
These errors are usually mechanical. They arise from incorrect posting, calculation mistakes, or omissions
that disturb duality.
They are detectable because the totals do not balance.

COMMON TYPES OF ERRORS THAT AFFECT THE TRIAL BALANCE

1. One-Sided Posting
A transaction was recorded in only one account.
Example:
Cash credited 5,000, but no corresponding debit was recorded.
Effect:
Credits exceed debits by 5,000.
The principle of duality has been violated.

2. Unequal Posting
Both debit and credit were recorded, but different amounts were used.
Example:
Equipment debited 12,000
Cash credited 21,000
Difference: 9,000
Effect:
The trial balance will not agree.

3. Error in Addition of Ledger Accounts
The total of one side of a ledger account was calculated incorrectly.
Effect:
The balance transferred to the trial balance is wrong.

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4. Error in Transferring Balances

The correct ledger balance was placed in the wrong column in the trial balance.

Example:

Rent Expense (Debit) was placed in the credit column.

Effect:

The totals will differ by double the amount of the mistake.

Recap Questions

1. Why does one-sided posting violate accounting principles?
2. How does unequal posting affect totals?
3. Why does placing a debit balance in the credit column double the error?

INVESTIGATING A DIFFERENCE

Suppose the trial balance totals are:

Total Debit: 200,000

Total Credit: 185,000

Difference: 15,000

This difference gives clues.

Accountants carry out systematic checks through:

Accountants carry out systematic checks through:

1. Re-adding the debit and credit balances of the trial balance.
2. Verifying the accuracy of transferring balances from the general ledger to the trial balance.
3. Recalculating general ledger accounts.
4. Ensuring the correctness and accuracy of journal entries.
5. Dividing the difference by 2 to detect reversed entries.

   Dividing by 2 helps identify errors where an amount has been placed on the wrong side.

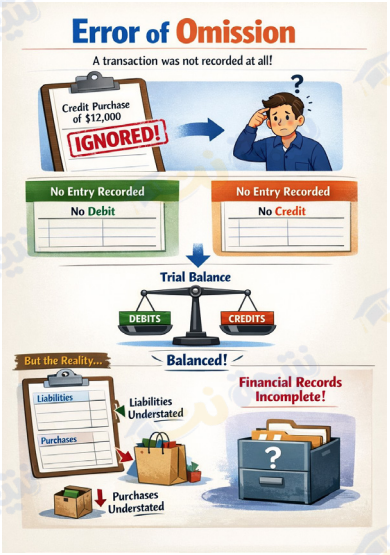
   7,500 = 15,000 ÷ 2

   Search for a balance of 7,500 that may have been incorrectly recorded. This method does not guarantee finding the error, but it narrows the search range.
6. Ensuring the accuracy and correctness of recording source documents in the journal.

Recap Questions

1. Why is dividing the difference by 2 sometimes useful?
2. What does a difference equal to a single transaction suggest?
3. What systematic steps should be followed during investigation?

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SECTION 3: ERRORS THAT DO NOT AFFECT THE TRIAL BALANCE

A trial balance may agree.
Total debits may equal total credits.
And yet the accounts may still contain serious errors.
These errors do not disturb arithmetic equality because duality has not been
violated.
Both sides were recorded.
But they were recorded incorrectly.
These errors are more dangerous because they are hidden.

1. ERROR OF OMISSION

A transaction was not recorded at all.
Example:
Credit purchase of 12,000 was completely ignored.
Effect:
Neither debit nor credit was recorded.
Duality remains balanced because nothing was entered.
The trial balance still agrees.
But liabilities and purchases are understated.

Exercise
Formative Check

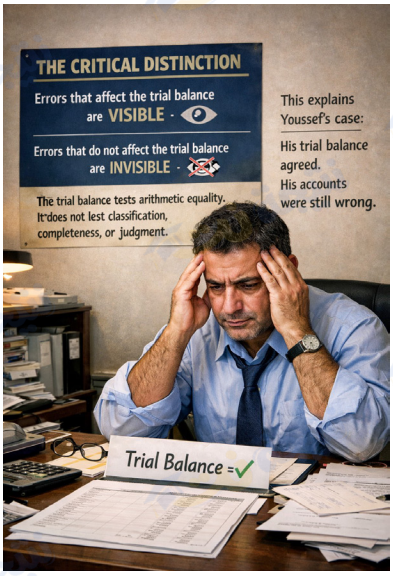
1. Why does omission not affect the trial balance?»

2 . ERROR OF COMMISSION

The correct amount was recorded in the correct type of account, but in the
wrong personal account.
Example:
Sale to Karim 8,000 recorded in Salma's account.
Sales total is correct.
Accounts Receivable total is correct.
The trial balance agrees. But individual customer balances are wrong.

THINK!
Why is omission dangerous for financial reporting?

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3. Error in accounting classification (technical error)

The transaction was recorded in an incorrect account category.
Example:
The purchase of equipment for 50,000 was recorded under purchases (inventory).
Both the debit and credit sides were recorded correctly, but the classification was incorrect; as a result, assets appear understated and expenses overstated. Therefore, the trial balance remains balanced. However, the financial statements do not accurately reflect the performance and financial position.
This is considered a mix-up between revenue expenditure (operating expense) and capital expenditure.

4. Compensating errors

Two independent errors that cancel each other out.
Example:
Sales were understated by 5,000, and expenses were also understated by 5,000.
Totals remain equal, and therefore the trial balance still balances despite the presence of an error. However, this accuracy is accidental. The danger of compensating errors lies in the fact that they are difficult to detect, as they create a false sense that the account balances and journal entries are correct.
Logical facts:
Errors that affect the balance of the trial balance are visible, while errors that do not affect its balance are hidden; since the trial balance only tests arithmetic equality. It does not guarantee the correctness of accounting classification, the completeness of data, or the validity of judgmental estimates.
This explains Youssef's case; his trial balance balanced, even though his accounts were still incorrect
The trial balance was balanced, but the accounts were incorrect.
The system was balanced, but the information was not accurate.
This is the focus of Unit Four.

Logical facts:

Errors that affect the balance of the trial balance are visible, while errors that do not affect its balance are hidden; since the trial balance only tests arithmetic equality. It does not guarantee the correctness of accounting classification, the completeness of data, or the validity of judgmental estimates.
This explains Youssef's case; his trial balance balanced, even though his accounts were still incorrect.

Exercise
Formative Check

1. Why is this called an error of principle?

2. How does this affect profit calculation?

3. Why are compensating errors difficult to detect?

T HINK!
Why is omission dangerous for financial reporting?

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SECTION 4: SUSPENSE ACCOUNTS

When the trial balance is out of balance, it becomes necessary to identify the difference and address its causes. However, accountants may not be able to identify the error immediately, while time pressure requires the preparation of financial statements. To maintain temporary balance, a suspense account is opened.

The suspense account is a temporary account used to record the difference between the debit and credit sides of the trial balance until errors are identified and corrected. Therefore, it is not a final solution to the problem, but rather a temporary (organizational) procedure.

When is the suspense account used?

The suspense account is opened in the following cases:

* When total debits do not equal total credits
* When the difference cannot be identified immediately
* When financial statements must be prepared without delay

It allows the trial balance to balance temporarily. Once errors are discovered, correcting journal entries are made to close the suspense account and reduce its balance to zero.

Recap Questions

1. Why are purchases of fixed assets excluded from the purchases journal?
2. Why is the total posted to the purchases account while suppliers are posted individually?
3. How does grouping transactions contribute to strengthening control?
4. What would happen if credit purchases were recorded in the cash book instead?

OPENING A SUSPENSE ACCOUNT

Suppose a trial balance shows:

Total Debit: 250,000

Total Credit: 240,000

Difference: 10,000

Debits exceed credits.

To balance the trial balance:

A credit of 10,000 is entered in the Suspense Account.

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TRIAL BALANCE WITH SUSPENSE ACCOUNT

Account	Debit (EGP)	Credit (EGP)
Various Accounts	250,000	
Various Accounts		240,000
Suspense Account		10,000
Total	250,000	250,000

The trial balance now agrees.

But the Suspense Account signals that an unresolved issue exists.

Recap Questions
1. Why is the Suspense Account placed on the smaller side?
2. What does the balance in Suspense represent?
3. Does the Suspense Account correct the error?

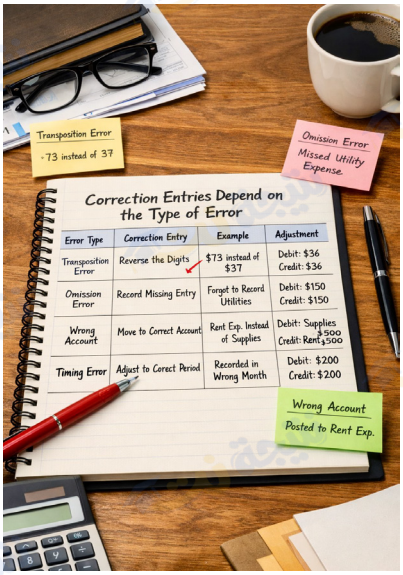
CLEARING THE SUSPENSE ACCOUNT

When errors are discovered, correcting entries are made. Each correcting entry will either:
* Debit the suspense account, or
* Credit the suspense account.

In the end, the suspense account balance becomes zero. When its balance reaches zero, all detectable errors have been corrected.

Date	Details	Debit (EGP)	Credit (EGP)
	Suspense Account	4,000	
	Cash		4,000

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SECTION 5: CORRECTION OF ERRORS USING JOURNAL ENTRIES

When errors are discovered, they must be corrected properly.

CORRECTION IS NOT DONE BY REWRITING ACCOUNTS.

It is done through journal entries.
Every correction must:

- **RESTORE DUALITY**
- **ADJUST THE AFFECTED ACCOUNTS**
- **CLEAR THE SUSPENSE ACCOUNT IF ONE WAS OPENED**

Correction entries depend on the type of error.

Exercise
Formative Check

1. Recount the use of journals in the correction of errors.

Recap Questions
1. What error could cause the trial balance to be out of balance?
2. How is a correcting entry made?

T HINK!
Why shouldn't we rewrite accounts to correct errors?

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Example 1: One-Sided Posting

Remember that the suspense account has a balance of 10,000 in the previously prepared trial balance. It was found that an expense of 4,000 was correctly recorded as a debit, but it was not recorded as a credit in cash. It is noted that the suspense account balance appeared as a credit of 4,000 instead of cash. Therefore, the correcting entry is made as follows:

Date	Details	Debit (EGP)	Credit (EGP)
	Suspense Account	4,000	
	Cash		4,000

It is noted that this entry reduces the balance of the suspense account. This means that there is still a credit balance of 6,000 in the suspense account whose cause has not yet been identified and therefore has not been corrected.

It was discovered that the rent expense account was correctly charged with 6,000, but it was not credited to the cash account. The suspense account still shows a credit balance of 6,000. Therefore, the following correcting entry is made:

Correcting entry:

Date	Details	Debit (EGP)	Credit (EGP)
	Suspense Account	6,000	
	Cash		6,000

Why?

Because the debit side has already been recorded correctly, the missing credit entry must now be recorded.

The suspense account temporarily resolves the imbalance. After correction, the suspense account balance becomes zero.

Recap Questions

1. Why is Suspense used in this correction?
2. Why is Rent not included in the correcting entry?

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Example 2: Wrong Side Posting

A balance of 8,000 for Insurance Expense was entered in the credit column instead of debit.
Effect:
Difference in trial balance = 16,000
Correction Entry:

Date	Details	Debit (EGP)	Credit (EGP)
	Insurance Expense	16,000	
	Suspense Account		16,000

Why 16,000?
Because the account must first cancel the incorrect credit (8,000) and then record the correct debit (8,000).
Total adjustment = 16,000.

STEP 2: ERRORS THAT DO NOT AFFECT THE TRIAL BALANCE

These do not involve Suspense.
They require direct correction between accounts.

Example 3: Error of Principle

Equipment purchased 50,000 was recorded as Purchases.
Incorrect Entry (already recorded):

Date	Details	Debit (EGP)	Credit (EGP)
	Equipment	50,000	
	Purchases		50,000

Correction Entry:

Date	Description	Debit (EGP)	Credit (EGP)
	Purchases	50,000	
	Cash		50,000

Explanation:
We remove the incorrect expense.
We restore the correct asset.
The incorrect entry (already recorded) is as follows:

Recap Questions
1. Why is Suspense not used here?
2. How does this error affect profit?

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Example 4: Posting error (personal accounts)

A credit sale of goods to Karim for 7,000 was incorrectly recorded in Salma's account. This means that the account appearing in the debit side is Salma instead of Karim. Therefore, the correction is made as follows:

Correcting entry:

Date	Description	Debit (EGP)	Credit (EGP)
	Karim (correcting entry)	7,000	
	Salma (reversal entry)		7,000

Explanation:
We reverse the incorrect personal account entry and record the correct one.

The total debtors (customers) balance remains unchanged.

Recap Questions
1. Why does this error not affect the trial balance?

Example 5: Omission error

A credit purchase of 12,000 was not recorded. This means the transaction was completely omitted, and therefore no accounts were recorded in the books. The correcting entry is as follows:
Correcting entry:

Date	Description	Debit (EGP)	Credit (EGP)
	Purchases	12,000	
	Creditors (Suppliers)		12,000

Explanation:
We record the transaction that was not previously recorded.

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Trial Balance after correction

After recording all correcting entries:

- The suspense account balance must be zero.
- All ledger accounts reflect correct balances.
- An adjusted trial balance is prepared.



Adjusted Trial Balance Format

Account Name	Debit Balances	Credit Balances
Cash		
Purchases		
Equipment		
Creditors		
Sales		
Capital		
Total		

Key information

Correction is an analytical process to restore balance before preparing the adjusted trial balance. Therefore, the accountant must understand: what the error is, why it occurred, and how to restore balance correctly.

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SECTION 6: INTEGRATED APPLICATION – TRIAL BALANCE & CORRECTION

Case Study: Zayed Trading

The following trial balance was extracted from the books of Zayed Trading as at 31 December.

Trial Balance (As Extracted)

Account	Debit (EGP)	Credit (EGP)
Cash	35,000	
Equipment	80,000	
Inventory	40,000	
Accounts Receivable	25,000	
Rent Expense	12,000	
Purchases	60,000	
Accounts Payable		47,000
Capital		120,000
Sales		90,000
Total	252,000	257,000

Difference = 12,000 (Debit exceeds Credit)

A Suspense Account was opened for the difference.

Additional Information – Errors Discovered

After investigation, the following errors were found:

1. A credit sale of 5,000 was posted only to the Sales Account.
2. Equipment purchased 20,000 was recorded as Purchases.
3. Rent of 4,000 was correctly debited but credited to Accounts Payable instead of Cash.
4. A credit purchase of 3,000 was completely omitted.

Required

1. Prepare the Suspense Account.
2. Pass the correcting journal entries.
3. Close the Suspense Account.
4. Prepare the Adjusted Trial Balance.

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TASK 1: SUSPENSE ACCOUNT

Debit	Amount	Credit	Amount
		Balance b/d	5,000

TASK 2: CORRECTING JOURNAL ENTRIES

Use proper journal format.

Date	Details	Debit (EGP)	Credit (EGP)

You must identify:

- Which errors affect agreement
- Which require Suspense
- Which do not

TASK 3: ADJUSTED TRIAL BALANCE

After corrections are posted, prepare the corrected trial balance.

Account	Debit (EGP)	Credit (EGP)
Total		

ANALYTICAL REFLECTION

1. Which errors affected the trial balance?
2. Which errors did not affect the trial balance?
3. Why was the Suspense Account necessary?
4. Does correction restore reliability or only balance?

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SECTION 7: Justify and Reasoning with Evidence (JRE)

In this unit, you learned:

- A trial balance may agree yet still contain errors
- Some errors disturb equality
- Some errors remain hidden
- Suspense accounts temporarily isolate imbalance
- Correction requires structured journal entries

The system is technical.
But an important question now arises:

Does correcting accounting errors restore financial integrity, or does it only restore numerical balance?"

UNDERSTANDING THE QUESTION

When an error is corrected:

- The accounts balance
- The Suspense Account is cleared
- The trial balance agrees

But integrity is more than arithmetic.
Financial integrity includes:

- Accurate classification
- Honest valuation
- Complete recording
- Ethical judgment

You are not being asked whether correction is necessary.
You are being asked whether correction alone is sufficient to guarantee integrity.
Does restoring balance automatically restore trust?
This distinction is critical.

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EXPECTATIONS FOR A STRONG RESPONSE

A high-quality JRE response should:

- Define financial integrity clearly
- Explain how correction procedures function
- Distinguish between balance and truth
- Evaluate ethical dimensions
- Present counterarguments
- Reach a justified and coherent conclusion

Your argument must move beyond describing procedures.
It must analyze their implications.

WRITING FRAMEWORK FOR THE JRE

Section	What You Should Do	Guiding Focus
Introduction	Define financial integrity and present your position.	Does balance equal integrity?
Argument ١	Explain how correcting errors restores structural accuracy.	Role of journal corrections
Argument ٢	Discuss limitations of mechanical correction.	Ethical judgment and intent
Counterargument	Address the view that procedures are sufficient.	Is process enough?
Conclusion	Reach a balanced and reasoned judgment.	What truly restores integrity?

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Justify and Reasoning with Evidence (JRE)

MARKING RUBRIC

Total Marks: 20

Criterion	Excellent (4)	Good (3)	Developing (2)	Limited (1)
Conceptual Understanding	Precise understanding of trial balance limitations, error types, suspense accounts, and correction procedures	Clear understanding with minor gaps	Basic understanding of correction procedures	Limited or incorrect understanding of Unit 4 concepts
Analytical Depth	Insightful evaluation of integrity versus numerical balance; demonstrates mature reasoning	Clear evaluation with some depth	Some evaluation but largely descriptive	Minimal analysis; mostly summary
Use of Unit ٤ Evidence	Integrates examples of errors, suspense accounts, and correction entries effectively	Refers to relevant Unit ٤ examples	Limited application of Unit 4 concepts	Little or no reference to Unit 4 material
Structure and Coherence	Logical progression with strong counterargument and clear transitions	Mostly clear structure with minor weaknesses	Weak flow or limited counterargument	Disorganized or unclear structure
Judgment and Conclusion	Balanced, justified, and independent conclusion demonstrating professional insight	Clear conclusion with some justification	Weak or underdeveloped conclusion	Unsupported, vague, or missing conclusion

Mark Interpretation

18–20 marks: Exceptional reasoning. Demonstrates intellectual maturity and strong accounting insight.

14–17 marks: Strong analytical performance with minor weaknesses.

10–13 marks: Adequate understanding but limited analytical depth.

6–9 marks: Basic comprehension with significant weaknesses.

0–5 marks: Limited understanding and insufficient reasoning.

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A practical case on "Trial Balance and Error Correction"

Case data:Al-Amal Trading Company prepared a trial balance on 31/12/2025, and it was balanced as follows:

Account	Debit	Credit
Cash	80,000	
Debtors	100,000	
Inventory	150,000	
Machinery	200,000	
Purchases	400,000	
Expenses	70,000	
Sales		700,000
Creditors		120,000
Capital		180,000
Total	1,000,000	1,000,000

However, during the audit, the following errors were discovered:

1. Depreciation was calculated at 5% instead of 10%.
2. No provision for bad debts was made at 5% of debtors.
3. Closing inventory was overstated by 20,000 EGP.
4. A purchase invoice of 15,000 EGP was not recorded.

Required (JRE):

Discuss the statement:

"A balanced trial balance does not mean that the financial statements are free from errors."

Explain how the above errors affected:

- Profit
- Assets
- Fair presentation of the financial position

Answer:

The trial balance is used to ensure that total debit balances equal total credit balances, but a balanced trial balance does not always mean that the financial statements are completely correct. In Al-Amal Trading Company, the trial balance was balanced, yet errors were found that affected profit and financial position.

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First: Depreciation was calculated at 5% instead of 10%. Therefore, recorded depreciation was:

5% × 200,000 = 10,000 EGP

while the correct depreciation should be:

10% × 200,000 = 20,000 EGP

This means profit was overstated by 10,000 EGP.

Second: No provision for bad debts was made at 5% of debtors, so the required provision is:

5% × 100,000 = 5,000 EGP

This led to an overstatement of both profit and assets by 5,000 EGP.

Third: Inventory was overstated by 20,000 EGP, which led to a reduction in cost of goods sold and an increase in profit by approximately the same amount.

This shows that inventory valuation directly affects profit.

Fourth: A purchase invoice of 15,000 EGP was not recorded, which reduced both purchases and liabilities, even though the trial balance remained balanced because the transaction was completely omitted.

Conclusion:

Accounting standards and adjusting entries improve the accuracy of financial statements, and the accrual basis ensures that revenues and expenses are recorded in the correct period. However, financial statements rely on estimates and accounting policies such as depreciation, bad debts, and inventory valuation.

In conclusion, a balanced trial balance is not sufficient to prove that financial statements are correct, because some errors do not affect the accounting equality but do affect profit, assets, and the true financial position of the entity.

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UNIT FIVE

FINANCIAL STATEMENTS – SOLE TRADER

UNIT 5: LEARNING OUTCOMES

Big Idea

Financial statements transform accounting records into decision-ready information.

Essential Question

Why must adjustments be made before preparing final accounts?

Core Concepts

- Trading Account
- Gross Profit
- Profit and Loss Account
- Net Profit
- Statement of Financial Position
- Accruals
- Prepayments
- Depreciation
- Bad debts
- Adjusted trial balance

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UNIT BIG IDEA



Financial statements transform accounting records into decision-ready information.

They do not merely list balances.

They explain performance and position.

A sole trader must answer two fundamental questions:

Did the business make a profit?

What does the business own and owe at year end?

Unit 5 answers both.

ESSENTIAL QUESTION

Why must adjustments be made before preparing final accounts?

What is the difference between gross profit and net profit?

How does depreciation affect reported performance?

Why must bad debts be recognized?

Does profit equal cash?

UNIT OPENER CASE

CASE STUDY: THE ILLUSION OF PROFIT

Nadia owns a small trading business.

Her trial balance shows:

Sales: 500,000

Purchases: 320,000

Expenses: 100,000

She quickly calculates:

Profit = 80,000.

She feels successful.

But at year end:

- 15,000 rent was unpaid
- 10,000 insurance was prepaid
- Equipment worth 200,000 has depreciated
- One customer owing 12,000 cannot pay

Her original profit figure changes. Accounting performance requires adjustment.

This is where Unit 5 begins.

Exercise
Formative Check

1. **Why might Nadia's initial profit calculation be misleading?**
2. **Why are year-end adjustments necessary?**

THINK!
Should profit be measured before or after adjustments?

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SECTION 1 : FROM ADJUST EDTRIAL BALANCE TO TRADING ACCOUNT



By the end of Unit 4, you were able to prepare an adjusted trial balance.
That document confirms arithmetic agreement after corrections.
But it does not explain performance.
A sole trader needs to know:

Did the business generate profit from its core trading activity?

To answer this, we prepare the **Trading Account**.
The Trading Account measures gross profit. It focuses only on buying and selling
goods. It does not include administrative or operating expenses. It answers a
simple but fundamental question:

What profit was made from trading goods before operating expenses?

S TRUCTURE OF THE TRADING ACCOUNT

The Trading Account compares:

Revenue from sales

with

Cost of Goods Sold

The difference is **Gross Profit**.

COST OF GOODS SOLD (COGS)

Cost of Goods Sold represents the cost of inventory that was actually sold during
the period.
It is calculated as:
Opening Inventory
+ Purchases
– Closing Inventory
This ensures that only the cost of goods sold during the year is matched against
revenue.
Inventory that remains unsold is not treated as an expense.
This reflects the matching principle.

Exercise
Formative Check

1. **Why is closing inventory deducted in calculating cost of goods sold?**
2. **Why does the Trading Account exclude operating expenses?**

THINK!
What does gross profit measure?

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Exercise
Formative Check

1. **In Step 1, why must opening inventory be added before deducting closing inventory when calculating Cost of Goods Sold?**

WORKED EXAMPL E

The following balances are extracted from the adjusted trial balance of Lina
Trading:
Sales: 400,000
Opening Inventory: 60,000
Purchases: 250,000
Closing Inventory: 80,000

The following balances are extracted from the adjusted trial balance of Younis Trading Company:

Required:
1. Calculate the cost of goods sold
2. Prepare the Trading Account

Solution

1. Calculation of Cost of Goods Sold
Goods available for sale= Opening inventory+ Purchases
Goods available for sale = 60,000 + 250,000 = 310,000
Cost of goods sold= Goods available for sale− Closing inventory
Cost of goods sold = 310,000 − 80,000 = 230,000

2. Trading Account Preparation
Trading Account of Younis Trading Company
For the year ended 31 December
(Structure implied from the data):

Debit	EGP	Credit	EGP
Opening Inventory	60,000	Sales	400,000
Purchases	250,000	Closing Inventory	80,000
Gross Profit c/d	170,000		
Total	480,000	Total	480,000

THINK!
In Step 2, why is Gross Profit placed on the opposite side of Cost of Goods Sold in the Trading Account format?

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VERTICAL PRESENTATION
(PREFERRED MODERN FORMAT)

For the Year Ended 31 December

Sales	**400,000**
Less:	
Opening Inventory	60,000
Purchases	250,000
Goods Available for Sale	310,000
Less Closing Inventory	(80,000)
Cost of Goods Sold	230,000
Gross Profit	170,000

KEY INSIGHT

Gross profit is measured by the trading account, and it reflects how efficiently the business performs its buying and selling operations. However, it does not represent the final net profit because it does not include operating expenses, which are calculated in a later stage.

Gross profit = Sales − Cost of goods sold

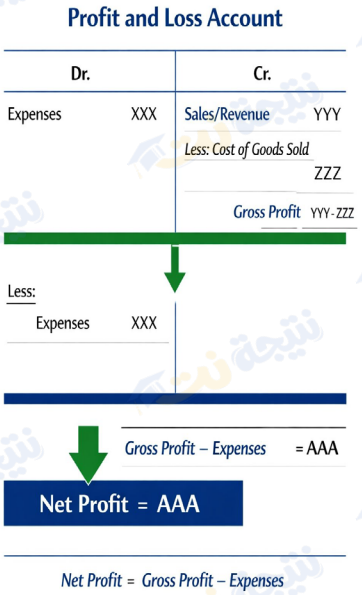
Exercise
Formative Check

1. **Does a high gross profit automatically mean the business is successful? Why or why not?**
2. **Why is closing inventory treated differently from purchases?**

THINK!
What would happen to gross profit if closing inventory increases?

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SECTION 2 : THE PROFIT AND LOSS ACCOUNT



While the trading account is concerned with recording profits arising directly from buying and selling goods, the business also incurs additional costs known as operating expenses (rent, electricity, salaries and wages, insurance costs, depreciation, and bad debts). To calculate the net profit, the profit and loss account deducts all these expenses from gross profit. The net profit formula is:

Net profit = Gross profit − Operating expenses

Profit and Loss Account

Debit | Credit

Expenses | Sales revenue

Deduct:

Cost of goods sold

Gross profit

Deduct:

Operating expenses

Net profit

Structure of the Profit and Loss Account

The profit and loss account starts with gross profit from the trading account. From this point, all operating expenses are deducted. The result is net profit. It should be noted that if operating expenses exceed gross profit, the result is a net loss.

Exercise

Formative Check

1. What distinguishes operating expenses from cost of goods sold?
2. What does Net Profit represent?

THINK!

In Step 2, why is Gross Profit placed on the opposite side of Cost of Goods Sold in the Trading Account format?

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WORKED EXAMPLE



Continuing from Lina Trading:

Gross Profit: 170,000

Operating expenses:
Rent: 30,000
Salaries: 45,000
Insurance: 10,000
Depreciation: 15,000
Total Expenses = 100,000

PREPARATION OF THE PROFIT AND LOSS ACCOUNT

Profit and Loss Account of Lina Trading

For the Year Ended 31 December

Gross Profit 170,000

Less:

Rent 30,000

Salaries 45,000

Insurance 10,000

Depreciation 15,000

Total Expenses 100,000

Net Profit 70,000

Exercise
Formative Check

1. Why is depreciation included as an expense even though it does not involve cash payment?
2. How does an increase in operating expenses affect Net Profit?

KEY INSIGHT

Net Profit reflects the overall performance of the business after all operating costs are considered.

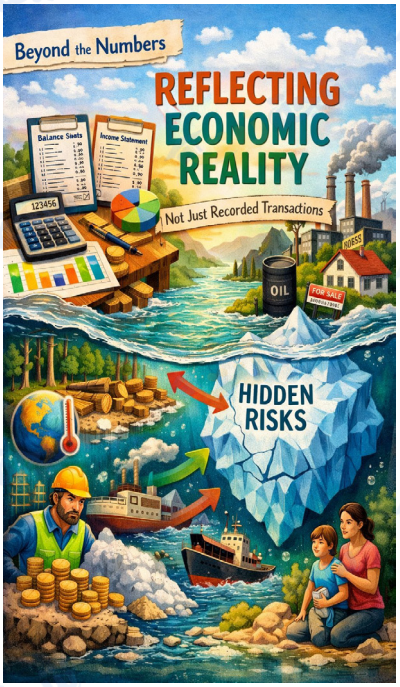
It is not equal to cash generated.

It is an accounting measure of performance.

THINK!

Why might a business have high Gross Profit but low Net Profit?

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SECTION 3: YEAR -END ADJUSTMENTS

Financial statements must reflect economic reality, not just recorded transactions.
At the end of an accounting period, some expenses and revenues may not yet be
fully recorded.
Adjustments ensure that income and expenses are recognized in the correct
period.
This reflects the accrual principle and the matching principle.

Adjustments affect:

- Profit
- Assets
- Liabilities
- Capital

They are not optional. They are essential for accuracy.

Exercise
Formative Check

1. **Why must accrued expenses be included in the current period?**
2. **How does accrual affect profit?**

1. ACCRUED EXPENSES

Concept: Accrued Expense

In accounting, the term accrued expense refers to amounts that the business has become obligated to pay as a result of receiving a service or goods during the financial period. This concept can be explained as follows:
Actual consumption: The business has already used the benefit (for example, electricity consumption has already occurred).
Accounting recognition: The expense is recorded in the current period regardless of whether it has been paid or not.
Recognition principle: It is recognized in accordance with the accrual basis of accounting.

THINK!
Why does accrual create a liability?

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Accumulation: Refers to the buildup of unpaid expenses over time.
Accrual as a liability: It represents rights earned by others over the business, so it appears as a liability in the statement of financial position.

GROSS PROFIT MARGIN
= GROSS PROFIT ÷ SALES

170,000 ÷ 400,000 = 42.5%

NET PROFIT MARGIN
= NET PROFIT ÷ SALES

70,000 ÷ 400,000 = 17.5%

THESE RATIOS HELP EVALUATE EFFICIENCY.

- A simple percentage table may be used for comparison across years.
- A graph is only necessary if analyzing trends over time.

Example:

Rent of 5,000 remains unpaid at year end.

Effect:

- Expense must increase
- Liability must increase

Adjustment Entry

Debit	Credit
Rent Expense	5,000
Accrued Rent	5,000

Presentation in Final Accounts

Profit and Loss Account:

Rent increases by 5,000.

Statement of Financial Position:

Accrued Rent appears as a current liability.

Vocabulary: "INCURRED"

In Accounting / Finance Context

- **Sustained (e.g., sustained an expense)**
- **Recorded**
- **Recognized (more technical accounting term)**
- **Accumulated**
- **Acquired (when referring to liabilities)**

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2. PREPAID EXPENSES



A **prepaid expense** is an expense that has been paid in advance.

Example:

Insurance paid 12,000 covers 12 months. Only 9 months relate to the current year.

Prepaid portion = 3,000.

Effect:

- Expense decreases
- Asset increases

Adjustment Entry

Date	Details	Debit (EGP)	Credit (EGP)
	Prepaid Insurance	3,000	
	Insurance Expense		3,000

Presentation

Profit and Loss Account:

Insurance expense reduced.

Statement of Financial Position:

Prepaid Insurance shown as a current asset.

Exercise
Formative Check

1. **Why is prepaid expense treated as an asset?**
2. **How does prepayment affect net profit?**

THINK!

Why must expenses be matched to the correct period?

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3. DEPRECIATION



Depreciation is the allocation of the cost of a non-current asset over its useful life.

It reflects wear and usage.

Example:

Equipment costing 100,000 depreciated at 10% per year.

Depreciation = 10,000.

*Something *depreciating* is something whose value is going down.

Adjustment Entry

Date	Details	Debit (EGP)	Credit (EGP)
	Depreciation Expense	10,000	
	Accumulated Depreciation		10,000

Presentation

Profit and Loss Account:

Depreciation appears as an expense.

Statement of Financial Position:

Asset shown at cost less accumulated depreciation.

Exercise Formative Check

1. **Why is depreciation considered an expense even without cash outflow?**
2. **How does depreciation affect asset value?**

THINK!

Why must assets not be overstated?

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4. BAD DEBTS



If a customer cannot pay, the amount must be written off.

Example:

Customer owes 4,000 and is declared bankrupt.

Adjustment Entry

Date	Details	Debit (EGP)	Credit (EGP)
	Bad Debt Expense	4,000	
	Accounts Receivable		4,000

Presentation

Profit and Loss Account:

Bad Debts included as expense.

Statement of Financial Position:

Accounts Receivable reduced.

KEY INSIGHT

Adjustments ensure:

- Income is not overstated
- Expenses are not understated
- Assets are realistic
- Liabilities are complete

THEY TRANSFORM *RAW PROFIT* INTO *ADJUSTED PROFIT.*

Exercise
Formative Check

1. Why must bad debts be recognized immediately?
2. What would happen if bad debts were ignored?

THINK!
How does this reflect prudence?

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SECTION 4: STATEMENT OF FINANCIAL POSITION



The Statement of Financial Position shows the financial position of the business at a specific date.

It presents:

Assets
Liabilities
Capital

It is not a performance statement.
It is a position statement.

It reflects the accounting equation:

Assets = Capital + Liabilities

STRUCTURE OF THE STATEMENT OF FINANCIAL POSITION

Assets are divided into:

Non-current assets
Current assets

Liabilities are divided into:

Non-current liabilities
Current liabilities

Capital is adjusted as follows:

Opening Capital

- Net Profit
  – Drawings

This gives **Closing Capital**.

Exercise
Formative Check

1. **Why is the Statement of Financial Position prepared at a specific date?**

2. **How does Net Profit affect Capital?**

THINK!
Why must Drawings be deducted from Capital?

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WORKED EXAMPLE

Continuing with Lina Trading:

Net Profit from Section 2: 70,000

Opening Capital: 200,000

Drawings during year: 30,000

Required: Calculate the ending period capital

The solution:

CALCULATE CLOSING CAPITAL

Opening Capital: 200,000 + Net Profit: 70,000

= 270,000

– Drawings: 30,000

Closing Capital = 240,000

ADDITIONA L BALANCES AFTER ADJUSTMENTS

Equipment (cost): 150,000

Less Accumulated Depreciation: 25,000

Net Equipment: 125,000

Inventory: 80,000

Accounts Receivable: 50,000

Cash: 40,000

Prepaid Insurance: 3,000

Creditors (Accounts Payable): 60,000

Accrued Rent: 5,000

Exercise
Formative Check

1. **Why is Net Profit added to Opening Capital, while Drawings are deducted, when calculating Closing Capital?**

THINK!

Why is Equipment shown at 125,000 instead of its original cost of 150,000 in the Statement of Financial Position?

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PREPARATION OF THE STATEMENT OF FINANCIAL POSITION

Statement of Financial Position of Lina Trading

As at 31 December

Non-Current Assets

Equipment (150,000 – 25,000) 125,000

Current Assets

Inventory 80,000
Accounts Receivable 50,000
Cash 40,000
Prepaid Insurance 3,000

Total Current Assets 173,000

Total Assets 298,000

Capital

Closing Capital 240,000

Current Liabilities

Accounts Payable 60,000
Accrued Rent 5,000

Total Current Liabilities 65,000

Total Capital and Liabilities 305,000

Exercise
Formative Check

1. **Why must the Statement of Financial Position balance?**

THINK!

What does imbalance signal?

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NOW WE PAUSE…

We notice something.

Total Assets = 298,000

Total Capital and Liabilities = 305,000

They do not balance.

This signals either:

- A missing adjustment
- An arithmetic mistake
- Incorrect capital calculation

This deliberate imbalance reinforces Unit 4 logic:

AGREEMENT MUST BE VERIFIED.

CORRECTED BALANCING (AFTER RECHECK)

Let us recompute carefully.

Assets:

125,000 + 80,000 + 50,000 + 40,000 + 3,000 = 298,000

Liabilities:

60,000 + 5,000 = 65,000

Assets – Liabilities = 233,000

Therefore, **Closing Capital** should be 233,000, not 240,000.

This suggests an inconsistency in earlier assumptions.

This exercise reinforces structural discipline.

KEY INSIGHT

The **Statement of Financial Position:**

- Does not measure profit
- Does not show cash flow
- Shows financial stability at a moment in time

Exercise
Formative Check

1. How does this connect to the accounting equation?

THINK!

Why is closing capital derived rather than assumed?

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SECTION 5: INTEGRATED APPLICATION AND INTERPRETATION

Case Study: Farid Trading

The following Adjusted Trial Balance was extracted from the books of Farid Trading as at 31 December.

Adjusted Trial Balance

Account	Debit (EGP)	Credit (EGP)
Opening Inventory	50,000	
Purchases	220,000	
Sales		400,000
Rent Expense	40,000	
Salaries Expense	60,000	
Insurance Expense	12,000	
Depreciation Expense	18,000	
Bad Debts Expense	5,000	
Equipment (Cost)	200,000	
Accumulated Depreciation		40,000
Accounts Receivable	70,000	
Accounts Payable		90,000
Cash	45,000	
Capital (Corrected)		220,000
Drawings	30,000	
Total	750,000	750,000

Required

1. Prepare the Trading Account.
2. Prepare the Profit and Loss Account.
3. Calculate Closing Capital.
4. Prepare the Statement of Financial Position.
5. Calculate:
   - Gross Profit Margin
   - Net Profit Margin
   - Current Ratio
6. Interpret performance and position briefly.



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Use the Adjusted Trial Balance to extract only the accounts relevant to each section. Not all balances appear in every statement.

STEP 1: TRADING ACCOUNT

Trading Account of Farid Trading

For the Year Ended 31 December

Debit	EGP	Credit	EGP
Opening Inventory		Sales	
Purchases		Closing Inventory	
Cost of Goods Sold			
Gross Profit c/d			
Total		**Total**	

COGS = _____ + _____ – _____ = _____

Gross Profit = _____ – _____ = _____

STEP 2: PROFIT AND LOSS ACCOUNT

Gross Profit ..... _____

Less:

_____..... _____

_____ ..... _____

_____ ..... _____

_____ ..... _____

_____ ..... _____

_____ ..... _____

Net Profit ..... _____

STEP 3: CLOSING CAPITAL

Opening Capital ..... _____

Add Net Profit ..... _____

= _____

Less Drawings ..... _____

Closing Capital = _____

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STEP 4: STATEMENT OF FINANCIAL POSITION

Statement of Financial Position

As at 31 December

Non-Current Assets

Equipment (_____ – _____) ..... _____

Current Assets

_____..... _____

Accounts Receivable ..... _____

_____..... _____

Total Current Assets ..... _____

Total Assets ..... _____

Capital

Closing Capital ..... _____

Current Liabilities

Accounts Payable ..... _____

Total Capital and Liabilities ..... _____

Pause.

Check to see if it balances. This reinforces structural verification.

STEP 5: RATIO ANALYSIS

Gross Profit Margin

_____ ÷ _____ = _____% **Gross Profit Margin = (Gross Profit ÷ Revenue) × 100**

Net Profit Margin

_____ ÷ _____ = _____% **Net Profit Margin = (Net Profit ÷ Revenue) × 100**

Current Ratio

Current Assets ÷ Current Liabilities

_____ ÷ _____ = ____ : ____

INTERPRETATION

Gross margin of _____% suggests the business's pricing and cost control are _____.

Net margin of _____% indicates operating expenses consume …… portion of gross profit.

Current ratio of _____:_____ suggests the business's short-term liquidity is _____.

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SECTION 6: Justify and Reasoning with Evidence (JRE)

Financial statements present:

Gross profit

Net profit

Assets

Liabilities

Capital

- THEY APPEAR PRECISE.
- THEY BALANCE.
- THEY FOLLOW STANDARDS.

Yet they rely on:

- Depreciation estimates
- Bad debt judgments
- Inventory valuation
- Accrual assumptions

This leads to a deeper question.



"Do financial statements present financial reality, or do they present a structured interpretation shaped by accounting judgment?"

UNDERSTANDING THE QUESTION

You are not being asked whether financial statements are useful.

You are being asked whether they represent objective reality.

Financial statements rely on:

- Estimates
- Assumptions
- Timing decisions
- Classification choices

Depreciation is not an observable fact. It is an allocation decision.

Bad debt expense reflects judgment.

Inventory valuation affects profit.

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Two businesses with identical cash flows may report different profits depending on accounting choices.

So the central issue is:

ARE FINANCIAL STATEMENTS FACTUAL REPORTS?

OR

ARE THEY STRUCTURED INTERPRETATIONS WITHIN ACCOUNTING RULES?

KEY CONCEPTS YOU MAY USE

In developing your response, you may refer to:

- **Accrual principle**
- **Matching principle**
- **Depreciation methods**
- **Inventory valuation**
- **Bad debts**
- **Prudence**
- **Adjusted profit**
- **Capital determination**
- **Ratio analysis**

You may argue that:

➡ *Accounting standards create sufficient objectivity*

or

➡ *Judgment inevitably shapes reported performance*

Both positions are defensible if supported with disciplined reasoning.

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EXPECTATIONS FOR A STRONG RESPONSE

A high-quality JRE response should:

- Define financial reality clearly
- Explain how adjustments shape reported profit
- Distinguish between cash reality and accounting reality
- Address the role of professional judgment
- Present a counterargument
- Reach a balanced conclusion

Your essay must analyze, not describe.

It must evaluate, not summarize.

WRITING FRAMEWORK FOR THE JRE

Section	What You Should Do	Guiding Focus
Introduction	Define financial reality and state your position.	Is accounting objective?
Argument 1	Explain how standards and structure promote reliability.	Role of adjustments and principles
Argument 2	Explain how judgment shapes outcomes.	Depreciation, bad debts, inventory
Counterargument	Address the view that standards ensure objectivity.	Are rules enough?
Conclusion	Present a balanced and reasoned judgment.	Reality vs interpretation

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JUSTIFY AND REASONING WITH EVIDENCE (JRE)
MARKING RUBRIC

Total Marks: 20

Criterion	Excellent (4)	Good (3)	Developing (2)	Limited (1)
Conceptual Understanding	Strong grasp of adjustments and reporting structure	Clear understanding	Basic comprehension	Limited understanding
Analytical Depth	Insightful evaluation of reality vs interpretation	Clear evaluation	Mostly descriptive	Minimal analysis
Use of Unit ٥ Evidence	Integrates adjustments, statements, and ratios effectively	Relevant references	Limited application	Weak reference to unit concepts
Structure and Coherence	Logical progression with strong counterargument	Mostly structured	Weak flow	Disorganized
Judgment and Conclusion	Balanced, justified, and intellectually mature	Clear but limited	Weak or underdeveloped	Unsupported conclusion

Mark Interpretation

18–20: Exceptional analytical maturity and professional-level insight

14–17: Strong reasoning with minor weaknesses

10–13: Adequate understanding but limited depth

6–9: Basic comprehension with analytical gaps

0–5: Limited reasoning and insufficient structure

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SAMPLE RESPONSE

“Do financial statements present financial reality, or do they present a structured interpretation shaped by accounting judgment?”

Financial statements help people understand the financial condition of a business. They show the profit of the business and what the business owns and owes. Many people believe that financial statements show the true financial reality of a company. However, others believe that financial statements are not a perfect picture of reality because they depend on accounting judgment and decisions.

On one hand, financial statements are based on real transactions. Businesses record sales, purchases, expenses, and payments. Accountants follow clear rules and accounting principles when preparing the Trading Account, Profit and Loss Account, and Statement of Financial Position. Because these rules are used by many businesses, financial statements can give useful and reliable information. Investors, managers, and banks use them to understand how well a business is performing. In this way, financial statements help represent the financial reality of the business.

On the other hand, financial statements also depend on professional judgment. Accountants must sometimes make estimates and choose between different accounting methods. For example, a business may choose different methods to calculate depreciation. It must also estimate bad debts or the value of inventory. These decisions can change the final profit reported in the accounts. Because of this, financial statements are not a perfect reflection of reality. They are a structured interpretation of financial information based on accounting rules and judgments.

In conclusion, financial statements try to show the financial reality of a business, but they do so through accounting rules and professional judgment. They are therefore not a perfect mirror of reality, but a structured and organized way of presenting financial information so that people can understand and compare business performance.

Why this is a strong response:

- Clear understanding of the question: The essay addresses both sides — financial statements as reality and as interpretation.
- Balanced reasoning: It explains arguments for each perspective instead of giving only one opinion.
- Use of accounting examples: Concepts like depreciation, inventory valuation, and bad debts show real accounting judgment.
- Logical structure: Introduction → two viewpoints → conclusion.
- Reasoned conclusion: It recognizes that financial statements aim to show reality but are shaped by accounting rules and professional judgment.

This demonstrates the key JRE skills: analysis, evaluation, and justified conclusion.



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Case data

Al Noor Trading Company prepared its financial statements for the year ended 31/12/2025 as follows:

Item	Amount (EGP)
Sales	500,000
Cost of goods sold	300,000
Gross profit	200,000
Operating expenses	80,000
Net profit before adjustments	120,000

Additional information:

(1) Depreciation

Recorded depreciation = 10,000 EGP

Auditor's correct depreciation = 20,000 EGP

Difference: 10,000 EGP decrease in profit

(2) Bad debts provision

Recorded provision = 5,000 EGP

Required provision = 12,000 EGP

Difference: 7,000 EGP decrease in profit

(3) Inventory valuation

Recorded inventory = 50,000 EGP

Correct inventory = 45,000 EGP

Difference: 5,000 EGP decrease in profit

Required:

1. Net profit before adjustments
2. Net profit after adjustments
3. Conclusion

Solution:

1. Net profit before adjustments:

120,000 EGP

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2. Total adjustments:

Adjustment	Effect on profit
Depreciation increase	10,000
Increase in bad debts provision	7,000
Inventory decrease	5,000
Total decrease	22,000 EGP

3. Net profit after adjustments:

120,000 − 22,000 = 98,000 EGP

Conclusion:

We observe that:

The company's actual operations did not change.

Sales remained the same.

Cash flows were unchanged.

However, profit decreased from 120,000 to 98,000 due to:

Changes in depreciation estimates

Changes in bad debt estimates

Inventory valuation differences

This shows that financial statements do not always reflect reality in a purely exact way, but also depend on accounting policies, estimates, and professional judgment.

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