

## Second lecture: Basic concepts in financial accounting

### 1-Flows and their types

#### 1-1- Definition of economic flows

Economic flows are the movement of the values of goods, services and funds between the enterprise and economic agents, or within the enterprise itself.

Economic flows are divided into:

- **Real flows (material flows):** they can take the form of commodities such as goods, raw materials and products, and can also take the form of services such as transport, insurance, studies, etc.
- **Financial flows (cash flows):** These are movements of funds from liquid cash and checks, as well as the movement of debts and rights in the case of term payment operations.

#### 1-2- Analysis of economic flows into sources and uses

In order to monitor its operations and determine the result of its activity, the entity must record in accounting the economic flows based on supporting documents such as invoices, receipt slips, delivery slips, bank checks, trade bills, etc...

For the correct accounting recording of the flows, it is required to decompose each flow into **a source** and **a use**, along with determining its value and date, as follows:

- **The source of the flow** is the point of the departure of the flow and the source will be « **creditor** »;
- **The use of the flow** is the point of arrival of the flow and the use will be « **debtor** ».

**Example 1:** On January 02, 2015, the entity obtained a loan of 1 000 000 DA from the credit institutions, and placed in the bank.

Date	The use	The source	The amount	supporting document
02/01/2015	bank	loan institutions	1 000 000	check number ...

**Example 2:** On January 08, 2015 the entity purchased a truck For 400,000 DA, by a bank check from the vehicle sales company

Date	The use	The source	The amount	supporting document
08/01/2015	a truck	bank	400 000	Purchase invoice number...

**Example 3:** On January 25, 2015 The entity purchased industrial equipment for 300,000 DA, on account.

Date	The use	The source	The amount	supporting document
15/01/2015	industrial equipment	Fixed asset suppliers	300 000	Purchase invoice number...

**Example 4 :** On January 25, 2015, an amount of 350,000 DA was withdrawn from the bank and placed in the cash box

Date	The use	The source	The amount	supporting document
25/01/2015	cash box	bank	350 000	check number ...

**Example 5:** on January 31, 2015, the entity paid DA 300,000 in cash to fixed assets suppliers.

Date	The use	The source	The amount	supporting document
31/01/2015	Fixed asset suppliers	cash box	300 000	Cash receipt or Box receipt

## 2-The Account and double entry ( الحساب والقييد المزدوج )

Each entity performs several **various** operations related to its operating activity such as the purchase and sale of goods, the purchase and sale of services, the payment of debts, the payment of expenses, the collection of receivables, etc... resulting in several flows that translate each operation it performs and so that the entity can know the result of its **exploitative** operations, **it must record all these flows** in precise accounts and according to the principle of double entry. In the following, we try to know: What is an account? And what is the principle of double entry?

### 2-1- The Account

After analyzing the economic flows in sources and uses, each source and each use must be recorded in the appropriate account, specified in the nomenclature of accounts of the financial accounting system. We try to give its definition, its form, how to register flows in it and how to determine its balance (how to extract account balance)

the entity must record all these flows

#### 2-1-1- Account definition

The account is the smallest approved unit for arranging and recording accounting operations.

It is a table consisting of two sides:

- The left side, called **the debit**, and **the usage** is recorded in it (the arrival point of the flow)
- The right side, called **the credit**, and **the source** is recorded in it (the departure point of the flow).

**2-1-2- Account form**

The account takes one of the following two forms:

**a) Complete form or regular form:**

Account number/Account name							
debit side				credit side			
date	Journal page	designation	The amount	date	Journal page	designation	The amount
			total				total

**b) The abbreviated (or simplified) form of the account (or the letter T):**

it is most commonly used to facilitate the extraction of balances.

debit	Account number/Account name	credit

**2-1-3- Recording flows in the account**

Recording is done on the left side (**debit**) of the account when the account is « **a use** » (flow end point).

Recording is done on the right side (**credit**) of the account when the account is « **a source** » (flow start point).

**2-1-4-Extracting the account balance**

“Account Balance” is the remaining value in the account after it has changed during the relevant period.

The account balance is the difference between the sum of the debited amounts and the sum of the credited amounts

**The balance** is written on the side that has **the smallest sum** to achieve balance, but it is **attributed** to the side that has **the largest sum**,

so we say:

- **Debit balance** and write it on the **credit side** if the debit total is greater than the credit total;

**Credit balance** and write it on the **debit side** if the credit total is greater than the debit total

**Zero balance** if the debit total is equal to the credit total.

**Example:** the following operations took place via the cashbox account, we ask you to extract its balance, knowing that its initial balance was 50,000 DA.

- 1- Withdraw an amount of 150,000 from the bank and put it in the cashbox
- 2- Acquisition of returnable packaging in cash at 40,000
- 3- Acquisition of a computer 100,000 in cash
- 4- Sell goods for cash at 180,000
- 5- Pay the debts of suppliers 60,000 in cash,
- 6- Purchase of merchandise 100,000 in cash,
- 7- Sell merchandise 200,000 by bank check.

**Solution:**

The account in question is the cashbox account ( C / 53: cashbox account )

The initial balance is **50,000** DA: operation (0)

debit	C/53 cashbox		credit
(2)	40 000	50 000	(0)
(3)	100 000	150 000	(1)
(5)	60 000	180 000	(4)
(6)	100 000	(80 000)	Account balance creditor
<b>(Total)</b>	<b>380 000</b>	<b>380 000</b>	<b>( Total)</b>

The sum of the debit side is **380,000** and the sum of the credit side is **300,000**

The largest sum of operations is **380 000** placed in **both sides**.

The balance is the difference between the largest sum and the smallest sum i.e.  $380\ 000 - 300\ 000 = 80,000$  is **placed** on the **credit side** to bring about balance, but is **attributed** to the **debit side**. Therefore, the balance of the fund account is: a debit balance of 80 000 DA.

**Operation (7)** is not recorded in the cashbox account because it does not affect this account.

## 2-2- The double entry principle

The principle of double entry stipulates that the accounting writings are edited according to the principle called “double entry”: where each entry touches at least two

accounts, one debit and the other credit, while respecting the chronological order in recording operations. The amount debited must be equal to the amount credited.

**Example:**

On 01/25/2015, an amount of 350,000 DZD was withdrawn from the bank and placed in the fund. It is required to analyze the flow into source and use and then register it according to the double-entry principle.

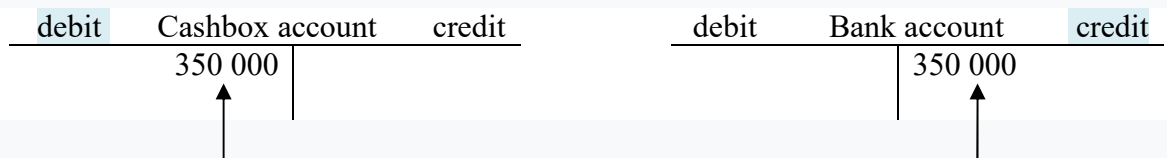
**The solution :**

Analysis of flow to source and to use:

Date	The use	The source	The amount	supporting document
01/25/2015	cash box	bank	350 000	check number ...

According to the principle of double entry: the accounting recording affects two accounts: the cashbox and the bank.

The use (cashbox) is recorded as a debtor and the source (the bank) is recorded as a credit as follows:



**2-3-Nomenclature of account of the Algerian financial accounting system**

It is a group of accounts grouped into categories called classes, numbered from 1 to 7 and divided into two categories:

- The financial position categorie, which consists of five classes and is called Balance sheet accounts (numbered from 1 to 5),
- Management accounts categorie, consisting of two classes numbered 6 and 7

Categories	Class
Balance sheet accounts	Class 1 – Capital Accounts
	Class 2 – Fixed Asset Accounts
	<b>Class 3-</b> Inventory and product in progress accounts

	<b>Class 4 - Third party accounts</b>
	<b>Class 5 - Financial accounts</b>
Management accounts	<b>Class 6 - Expense accounts</b>
	<b>Class 7 - product account</b>

Each class is divided into main accounts consisting of two numbers, where the first number on the left indicates the class, then a number from 0 to 9 is added to it on the right to distinguish the accounts that belong to the class.

**Example:**

**Class 2: Fixed asset accounts**

Main Account 20: Intangible Fixed Assets

Main Account 21: Tangible Fixed Assets

.....

Main Account 29: Value losses on fixed assets.

Each main account is also divided into sub-accounts with three numbers, where the first two numbers on the left indicate the main account, then a number from 0 to 9 is added to it on the right to distinguish the accounts that belong to the main account.

**Example:**

Main Account 21: Tangible Fixed Assets is subdivided into

Subaccount 211: Lands

Subaccount 212: Land arrangement and configuration operations

Subaccount 213: Constructions

.....

Subaccount 218: Other tangible fixed assets.

The sub-account, in turn, can be divided into partial-accounts with four numbers, where the first three numbers on the left indicate the sub-account, then a number from 0 to 9 is added to it on the right to distinguish the accounts that belong to the sub-account.

**Example:**

Subaccount 218: Other tangible fixed assets is subdivided into partial account

Partial account 2181: Automated Media

Partial account 2182: Transmission Equipment

.....

Partial account 2186: Returnable packaging

### 3-Accounting documents (المستندات المحاسبية)

Every operation carried out by the institution is recorded in its appropriate account based on supporting documents called legal accounting documents, such as:

- Purchase invoice received from suppliers
- Sales invoice sent to customers
- Note entry to stores
- Receipt of the goods
- A memorandum of output from the stores
- Cash payment note
- trade bills
- bill of exchange
- trading effects

### 4- Stages of the accounting cycle (مراحل الدورة المحاسبية)

For the entity to be able to determine the result of its activity, whether profit or loss, and to present its financial position over a fixed period called the accounting cycle, it must analyze and record all the transactions it has carried out in appropriate accounting books and on the basis of supporting documents, then classify and process them according to the adopted accounting methods and principles, then present them in financial statements that faithfully show the financial position of the entity and its efficiency and all change in his financial situation in the considered accounting cycle.

#### **The stages of the accounting cycle are:**

- Carry over the balances of the beginning of the period from the closing budget of the previous session
  - Recording accounting operations in the daily book
  - Post each account from the journal to the ledger and account monitored
  - Preparing trial balance before inventory
  - Physical inventory
- Registration of settlement entries
  - Preparing the trial balance after the inventory
  - Determine the net result
- Preparing the financial statements (Statement of financial position, Statement of comprehensive income, Statement of cash flows, statement of changes in equity and the appendix)