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IQRA NATIONAL UNIVERSITY

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**Subject: Principle of Accounting**

**Semester: Summer**

**Exam: Final**

Q1. The business transactions of ABC Ltd. during September are given below: (15 marks)

Sept. 1 Mark opened a bank account in the name of the business by depositing $50,000 cash, which he had saved over a number of years.

Sept. 10 Purchased a small office building located on a large lot for a total price of $182,400, of which $106,000 was applicable to the land and $76,400 to the building. A cash payment of $36,500 was made and a note payable was issued for the balance of the purchase price.

Sept. 15 Purchased a microcomputer system from XYZ Stores for $5000 cash.

Sept. 19 Purchased office furnishings including equipment from Michael Operations at a cost of $5,760. A cash down payment of $960 was made, the balance to be paid in three equal instalments due September 28, October 28 and November 28. The purchase was on open account and did not require signing of a promissory note.

Sept. 26 A $140 monitor in the microcomputer system purchased on September 15 stopped working. The monitor was returned in XYZ Stores which promised to refund the $140 within five days.

Sept. 28 Paid Michael Operations $1600 cash as the first instalment due on the account payable for office furnishings

**Answer:**

 **ABC COMPANY**

 **GENERAL/JOURNAL**

 **FOR THE MONTH SEPTEMBER**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Title/Description** | **Debit** | **Credit** |
| **Sep1** | **Cash** | **$50,000** |  |
|  | **Capital** |  | **$50,000** |
|  | **Mark deposited $50,000****Cash on his account** |  |  |
| **Sep10** | **Land****Building** | **$106,000****$76,400** |  |
|  | **Cash****Note Payable** |  | **$36,500****$145,900** |
| **Sep15** | **Micro computer system** | **$5,000** |  |
|  | **Cash** |  | **$5,000** |
|  | **Purchased equipment on cash** |  |  |
| **Sep19** | **Office Equipment** | **$5,760** |  |
|  | **Cash****Note payable** |  | **$960****$4,800** |
| **Sep26** | **Account Receivable** | **$140** |  |
|  | **Office Equipment** |  | **$140** |
| **Sep28** | **Office equipment** | **$1,600** |  |
|  | **Account Receivable** |  | **$1,600** |

Q2.

|  |  |
| --- | --- |
| Edward Pine capital, December 31, 2005 $27,200 |  |
| Edward Pine, Drawing 18,000 | Depreciation expense:Painting equipment 1200 |
| Painting fees earned 163,300 | Insurance expense 12,000 |
| Paint & Supplies expense 27,500 | Painting equipment 7,200 |
| Accumulated depreciation:Painting equipment 3,000 |  |
| Salaries expense 66,800 |  |
| Rent expense 9,600 |  |
| Advertising expense 3,200 |  |

From the above account balances, prepare first an income statement and then a statement of owner’s equity for Pine Painting Contractors for the year ended December 31, 2005. (15 marks)

Answer:

 **Painting Contractors**

 **Income statement**

 **For the year ended Dec 2005**

**Revenue**

 Painting fees $ 168,300

 Total revenue $ 168,300

**EXPENSE**

 Insurance expense $ 12,000

 Depreciation expense: 1200

 Painting equipment

 Paint & Supplies expense 27,500

 Salaries expense 66,800

 Rent expense 9600

 Advertising expense 3200

 **TOTAL expense $ 120,300**

**Net income $ 4300**

Q3. Prepare the year-end closing entries for Pine Painting Contractors, using the data given above in Q2. (13 marks

**Answer:**

 **Closing entry**

Revenue A/C $ 163,300

 Income summary A/c $163,000

Income summery A/c 120,300

 Insurance expense $ 12,000

 Depreciation expense: 1200

 Painting equipment

 Paint & Supplies expense 27,500

 Salaries expense 66,800

 Rent expense 9600

 Advertising expense 3200

Income summery A/c $4300

 Retained earing A/C $4300

Accumulated depreciation A/c $300

 Painting equipment, A/C $300

Q4. Briefly explain the matching principle and the realization principle in relation to the recording of revenue and expenses. (7 marks)

**Answer:**

**Matching principal:** Matching principle is the accounting principle that requires that the expenses incurred during a period be recorded in the same period in which the related revenues are earned. This principle recognizes that businesses must incur expenses to earn revenues.

An important concept of accrual accounting, the matching principle states that the related revenues and expenses must be matched in the same period. This is done in order to link the costs of an asset or revenue to its benefits.

**EXAMPLE OF MATCHING PRINCIPLE**

The expense must relate to the period in which they were incurred rather than on the period in which they were paid. For example, if a business pays a 10% commission to sales representatives at the end of each month. If the company has $50,000 in sales in the month of December, the company will pay the commission of $5,000 next January.

The matching statement requires that the commission expense is reported in the December income statement. If the company uses the cash basis of accounting, the commission would be reported in January (in the month they were paid) rather than December (the month they were incurred).

Apart from commissions, some other examples of matching principles are:

* Depreciation
* Wages
* Employee bonuses

**Realization Principle**: The realization principle is the concept that [revenue](Syncios.lnk) can only be recognized once the underlying goods or services associated with the revenue have been delivered or rendered, respectively. Thus, revenue can only be recognized after it has been earned. The best way to understand the realization principle is through the following examples:

* *Advance payment for goods*. A customer pays $1,000 in advance for a custom-designed product. The seller does not realize the $1,000 of revenue until its work on the product is complete. Consequently, the $1,000 is initially recorded as a liability (in the unearned revenue account), which is then shifted to revenue only after the product has shipped.
* *Advance payment for services*. A customer pays $6,000 in advance for a full year of software support. The software provider does not realize the $6,000 of revenue until it has performed work on the product. This can be defined as the passage of time, so the software provider could initially record the entire $6,000 as a liability (in the unearned revenue account) and then shift $500 of it per month to revenue.
* *Delayed payments*. A seller ships goods to a customer on credit, and bills the customer $2,000 for the goods. The seller has realized the entire $2,000 as soon as the shipment has been completed, since there are no additional earning activities to complete. The delayed payment is a financing issue that is unrelated to the realization of revenues.
* *Multiple deliveries*. A seller enters into a sale contract under which it sells an airplane to an airline, plus one year of engine maintenance and initial pilot training, for $25 million. In this case, the seller must allocate the price among the three components of the sale, and realizes revenue as each one is completed. Thus, it probably realizes all of the revenue associated with the airplane upon delivery, while realization of the training and maintenance components will be delayed until earned.