



UNIVERSITÀ
DEGLI STUDI
DI BERGAMO

Dipartimento
di Scienze Aziendali

Corso di Laurea Magistrale in
ACCOUNTING, GOVERNANCE AND
SUSTAINABILITY

From the ledger to the trial balance

International and Advanced Accounting

RELATORI

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SEDE

Bergamo

WHERE WE ARE

Wednesday 23 September – from the ledger to the trial balance, and what financial statements are for



Done in the first three lessons: the sandwich company, use / source, journal entries, chart of accounts, T-accounts (slides 1-62).

Today

- ✓ Organising the chart of accounts: types and liquidity
- ✓ Normal balances and the trial balance
- ✓ What a financial statement is, and who reads it
- ✓ Objective and underlying assumptions
- ✓ Preview: from the trial balance to the statements

Homework (file on Moodle)

- ✓ Set 1, due Monday 28: exercises 1-4 (Tables 1-2, T-accounts, trial balance)
- ✓ Set 2, due Wednesday 30: exercises 5-7 (The Library, the retail shop, Bergamo Bikes)
- ✓ Debriefing: first 20 minutes of each lesson

ORGANISING THE CHART OF ACCOUNTS

Seven account types, in the order of the financial statements

Type	What it contains	Statement	Normal balance
Assets	things the business owns or controls	Balance sheet	debit
Liabilities	things the business owes	Balance sheet	credit
Equity	owners' stake: capital + retained profits	Balance sheet	credit
Revenue	income from selling the products or services	Income statement	credit
Cost of goods sold	direct cost of what was sold	Income statement	debit
Expenses	operating costs with no lasting value	Income statement	debit
Other revenue and expenses	unusual items, not part of running the business	Income statement	either

Cost or expense?

A cost is what it takes to make or buy what you sell; an expense is what it takes to run the business.

You can tell them apart only if you know what the business sells.

Our example: a website selling advertising space; the only direct cost is website hosting.

In doubt, classify as expense.

Together: classify the accounts of our chart of accounts (next slide), then check.

CLASSIFY TOGETHER

Let's take a look at our Chart of Accounts in its original order. Try to Identify the accounting Type for each Account.

Account	Accounting Type
Checking Account	
Owners' Equity	
Office Equipment	
Office Supplies	
Computer Hardware	
Bank Charges	
Office Furniture	
Repairs and Maintenance	
Advertising Sales	
Phone Service	
Accounts Payable	
Electric Service	
Credit Card Interest and Fees	
Fuel	
Subscriptions	
Meals	
Website Hosting	

ORDER OF LIQUIDITY

The second sorting key, for assets and liabilities

Liquidity

How quickly an item converts to cash without losing value.

Assets are listed from cash downwards; liabilities from the ones due first.

Current = expected to turn over within one year (or the operating cycle); fixed / long-term = beyond.

Why «current» matters

Current liabilities are normally paid with current assets: if current liabilities exceed current assets, cash management needs attention.

A warning sign, not a verdict: a supermarket lives with negative working capital every day.

Assets

Current: cash, receivables, inventory, prepayments

Fixed: property, plant, equipment; intangibles; investments

Liabilities and equity

Current: payables, accrued expenses, short-term loans

Long-term: bank loans, bonds; then equity

CHECK: ACCOUNTS SORTED BY TYPE AND LIQUIDITY

Accounts Sorted by Accounting Type and Order of Liquidity

Account	Accounting Type
Checking Account	Current Asset
Office Equipment	Fixed Asset
Computer Hardware	Fixed Asset
Office Furniture	Fixed Asset
Accounts Payable	Current Liability
Owners' Equity	Equity
Sales	Revenue
Website Hosting	Cost of Goods Sold
Repairs & Maintenance	Expense
Fuel	Expense
Office Supplies	Expense
Subscriptions	Expense
Meals	Expense
Phone Service	Expense
Electric Service	Expense
Bank Charges	Expense
Credit Card Fees & Interest	Expense

QUICK CHECK

Answer the following true/false questions:

1. **The balance side of a revenue account is the debit side.**
2. **The balance side of an expense account is the debit side.**
3. **If withdrawals exceed net income, the owner's equity is increased.**



NORMAL BALANCES

Debit/Credit Classifications for the Accounts used in the November transactions

Account	Debit	Credit	Increases as	Classification / Expected Balance	More Description
Checking Account	190.00		Acquisition/Use	Debit	Something the business owns
Office Equipment	225.00		Acquisition/Use	Debit	Something the business owns
Computer Hardware	500.00		Acquisition/Use	Debit	Something the business owns
Owners' Equity		1500.00	Source	Credit	Owners Investment into Company
Rent	500.00		Acquisition/Use	Debit	Consumable (Acquisition/Use)
Office Supplies	75.00		Acquisition/Use	Debit	Consumable (Acquisition/Use)
Bank Charges	10.00		Acquisition/Use	Debit	Consumable (Acquisition/Use)

THE TRIAL BALANCE

The list of account balances at a date

What it is

Once all entries are posted, each account has a balance. The trial balance lists the accounts with their debit or credit balance.

Same grid as the journal, but one line per account instead of one per transaction.

Total debits = total credits: if not, there is an error somewhere.

What it proves, and what it does not

It proves the arithmetic: every entry was posted with equal debits and credits.

It does not detect: an omitted transaction, a transaction posted to the wrong account, a wrong amount posted on both sides, compensating errors.

That is why the auditor does not stop at the trial balance.

Three versions of the same thing: a monthly trial balance (movements of the month), a cumulative trial balance (balances since the start) and a comparative one (columns by period). Examples on the next two slides, from our website business.

TRIAL BALANCE – EXAMPLE (1/2)

Cumulative Trial Balance at Dec. 31, 2010

Account	Debits	Credits
Checking Account		
Office Equipment		
Computer Hardware		
Office Furniture		
Accounts Payable		
Owners' Equity		
Sales		
Website Hosting		
Rent		
Repairs & Maintenance		
Fuel		
Subscriptions		
Meals		
Phone Service		
Electric Service		
Office Supplies		
Bank Charges		
Credit Card Fees & Int		
Totals		

Comparative Trial Balance at Dec. 31, 2010

Account	November	December	Total
Checking Account	190.00		
Office Equipment	225.00		
Computer Hardware	500.00		
Office Furniture	0.00		
Accounts Payable	0.00		
Owners' Equity	-1500.00		
Sales	0.00		
Website Hosting	0.00		
Rent	500.00		
Repairs & Maintenance	0.00		
Fuel	0.00		
Subscriptions	0.00		
Meals	0.00		
Phone Service	0.00		
Electric Service	0.00		
Office Supplies	75.00		
Bank Charges	10.00		
Credit Card Fees & Int	0.00		
Totals	\$0.00	\$0.00	0.00

TRIAL BALANCE – EXAMPLE (2/2)

Trial Balance for November Transactions only

Account	Debit	Credit
Checking Account	190.00	
Office Equipment	225.00	
Computer Hardware	500.00	
Owners' Equity		1500.00
Rent	500.00	
Office Supplies	75.00	
Bank Charges	10.00	
Totals	\$1,500.00	\$1,500.00

Trial Balance for December Transactions only

Account	Debit	Credit
Checking Account	360.00	
Office Equipment	0.00	
Computer Hardware	400.00	
Office Furniture	945.00	
Accounts Payable		680.00
Owners' Equity		1100.00
Sales		500.00
Website Hosting	120.00	
Repairs & Maintenance	25.00	
Fuel	25.00	
Subscriptions	65.00	
Meals	45.00	
Phone Service	150.00	
Electric Service	100.00	
Office Supplies		
Bank Charges	15.00	
Credit Card Fees & Int	30.00	
Totals	\$2,280.00	\$2,280.00

WHAT IS A FINANCIAL STATEMENT?

A reporting process and a document

Process

Collecting, classifying and summarising thousands of transactions into a few pages, at regular intervals (year, quarter, month).

Form: the documents, their structure and content.

Substance: the measurement of the values that enter those documents.

Document

Reports the financial performance (income statement), the financial position (balance sheet) and the cash flows of a business for a period.

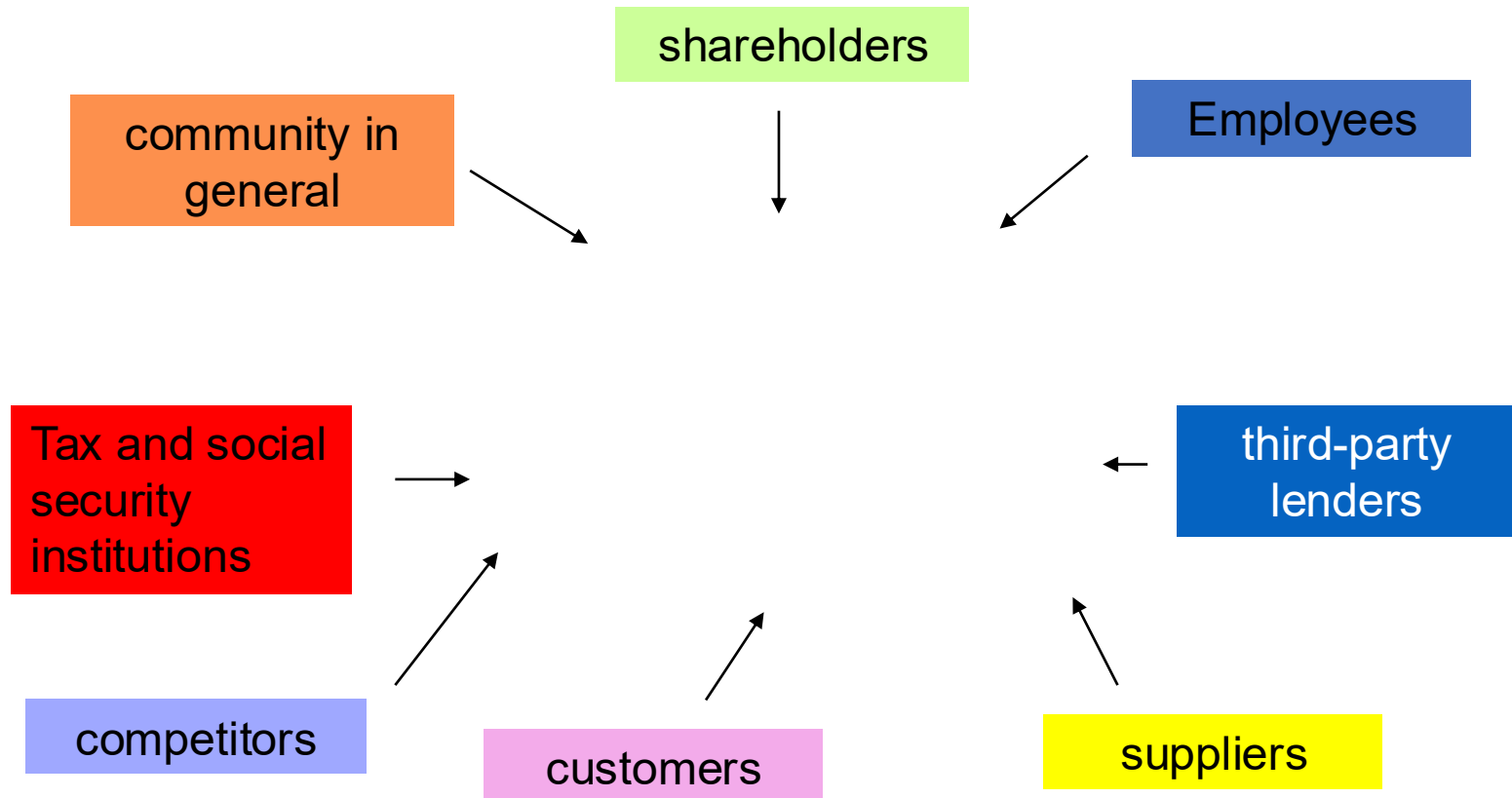
Two questions decide everything else: what does it report, and who is it for?

Who reads it? Write down three users and, for each, the one question they want answered.

(2 minutes, then we compare with the next slides)

THE STAKEHOLDERS

A person, group or organization that has interest or concern in an organization.



USERS AND THEIR QUESTIONS

Different readers, different decisions

User	The question	What they look at
Investors and owners	Is my capital earning enough? Is the business safe? Should I invest more, hold or sell?	profitability, dividends, risk, prospects, comparison with competitors
Lenders	Will interest and principal be repaid on time? Is the security adequate? Are covenants respected?	cash generation, leverage, debt/equity ratios
Suppliers	Will I be paid? Will this customer still be here next year?	liquidity, payment record, continuity
Customers	Will the business deliver, and honour warranties?	continuity, capacity
Employees	Is my job secure? Can the company pay wages, pensions, bonuses?	stability, profitability, cash
Government and tax authorities	What is the taxable income? Is the law complied with?	accounting result, compliance
Public and community	Employment, environment, health and safety: not yet well served by financial statements	→ sustainability reporting

Analysts, journalists, rating agencies and regulators sit in between: they process the information for the others.

OBJECTIVE AND UNDERLYING ASSUMPTIONS

Why we report, and on which premises

Objective of financial reporting

To communicate economic measurements of, and information about, the resources and performance of the reporting entity, useful to those having reasonable rights to such information: users must be able to take decisions and to hold management accountable.

Going concern

The entity will continue in operation for the foreseeable future (at least twelve months).

Consequence: assets are measured for their use, not for a forced sale. If the assumption fails, everything is remeasured at liquidation values.

Accrual basis

Effects of transactions are recognised when they occur, in the period to which they relate, not when cash moves.

Consequence: receivables, payables, prepayments, accruals, depreciation. Cash is not profit.

Bergamo Bikes (homework, exercise 7) is built entirely on the second assumption.

THE COMPONENTS OF THE FINANCIAL STATEMENTS

IFRS and Italian Civil Code

IFRS (IAS 1 / IFRS 18)	Italian Civil Code (art. 2423)
Statement of financial position (balance sheet)	Stato patrimoniale
Statement of profit or loss and other comprehensive income	Conto economico
Statement of changes in equity	— (information in the notes)
Statement of cash flows	Rendiconto finanziario (since 2016; not for small and micro entities)
Notes	Nota integrativa
Outside the statements: management commentary (not required by IFRS)	Outside the statements: relazione sulla gestione (required, art. 2428)

Common mistake: the directors' report accompanies the financial statements but is not part of them. Different rules, different responsibilities, different audit opinion.

PREVIEW: FROM THE TRIAL BALANCE TO THE STATEMENTS

Our website business at 31 December – what Monday's lesson will build

Income statement (Nov–Dec)	Amount
Sales	500
Rent	(500)
Phone Service	(150)
Website Hosting	(120)
Electric Service	(100)
Office Supplies	(75)
Subscriptions	(65)
Meals	(45)
Credit Card Fees & Interest	(30)
Repairs & Maint. 25 · Fuel 25 · Bank Charges 25	(75)
Net loss	(660)

Balance sheet at 31 December	Amount
Checking Account	550
Office Equipment	225
Computer Hardware	900
Office Furniture	945
Total assets	2,620
Accounts Payable	680
Owners' Equity (1,500 + 1,100)	2,600
Net loss	(660)
Total liabilities + equity	2,620

Rule: balance sheet accounts carry forward; income statement accounts are reset to zero every year and their net result moves to equity.

BEFORE YOU GO

Homework and three questions

Homework set 1 – due Monday 28

- ✓ Exercise 1 – Table 1: use / source and journal
- ✓ Exercise 2 – Table 2: on account, multi-line
- ✓ Exercise 3 – T-accounts for December
- ✓ Exercise 4 – trial balance, December and cumulative

File «Homework – double-entry exercises» on Moodle; solutions at the end, try first.

Could you answer in three lines?

1. Why does the trial balance balance even when a transaction is missing?
2. A supplier and a lender read the same balance sheet: which line does each look at first?
3. What changes in the balance sheet if the going concern assumption fails?

Monday 28 September: debriefing of set 1, then the balance sheet and the income statement (definitions, formats, from the trial balance to the statements, year-end adjustments).