

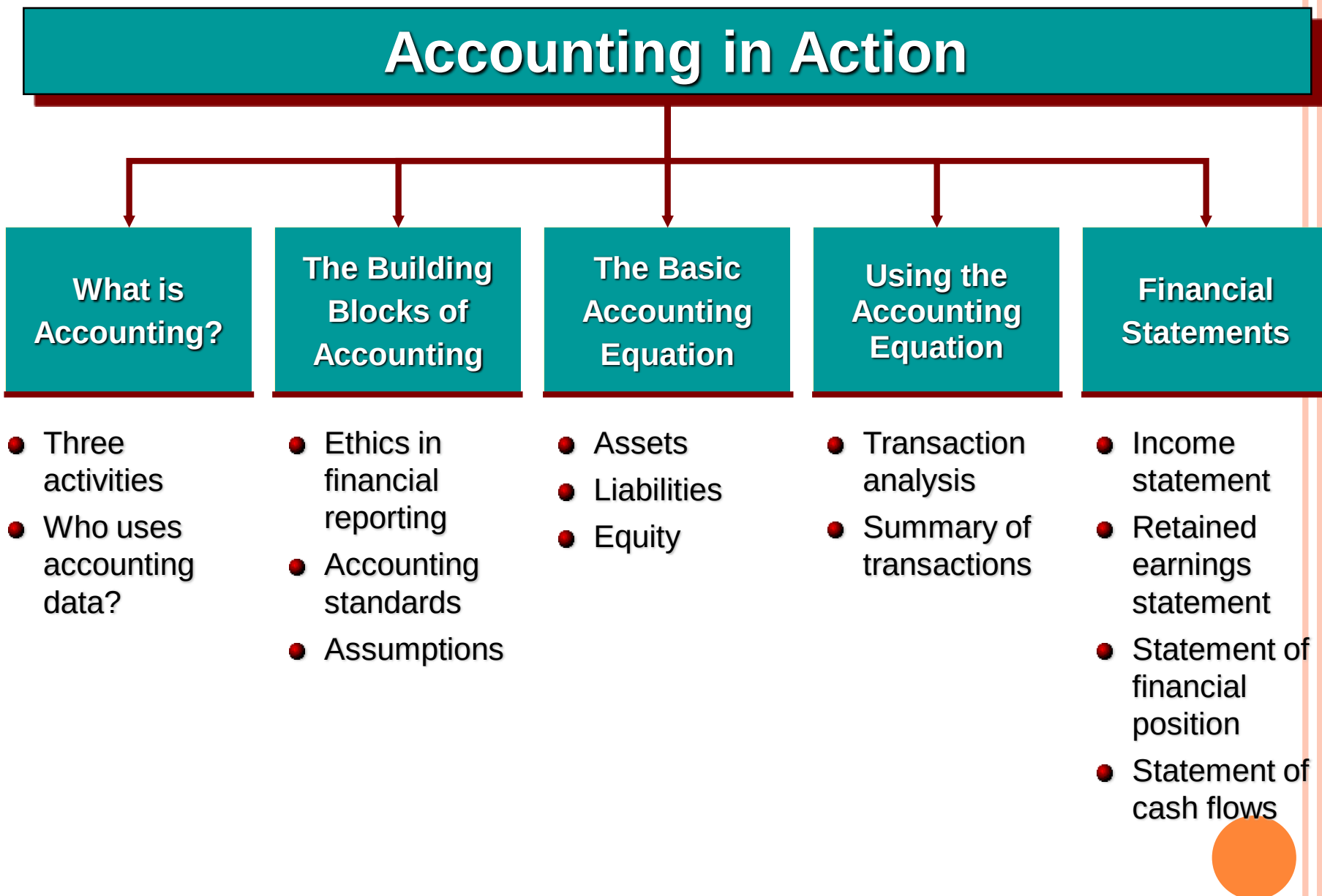
FINANCIAL ACCOUNTING-I



1. Explain what accounting is.
2. Identify the users and uses of accounting.
3. Understand why ethics is a fundamental business concept.
4. Explain accounting standards and the measurement principles.
5. Explain the monetary unit assumption and the economic entity assumption.
6. State the accounting equation, and define its components.
7. Analyze the effects of business transactions on the accounting equation.
8. Understand the four financial statements and how they are prepared.



Accounting in Action



What is Accounting?

- Three activities
- Who uses accounting data?

The Building Blocks of Accounting

- Ethics in financial reporting
- Accounting standards
- Assumptions

The Basic Accounting Equation

- Assets
- Liabilities
- Equity

Using the Accounting Equation

- Transaction analysis
- Summary of transactions

Financial Statements

- Income statement
- Retained earnings statement
- Statement of financial position
- Statement of cash flows

WHAT IS ACCOUNTING?

The purpose of accounting:

- (1) to **identify**, **record**, and **communicate** the economic events of an
- (2) organization to
- (3) interested users.



WHAT IS ACCOUNTING?

Three Activities

Illustration 1-1

The activities of the accounting process

Identification



Identify economic events (transactions)

Recording



Record, classify, and summarize

Communication



Prepare accounting reports



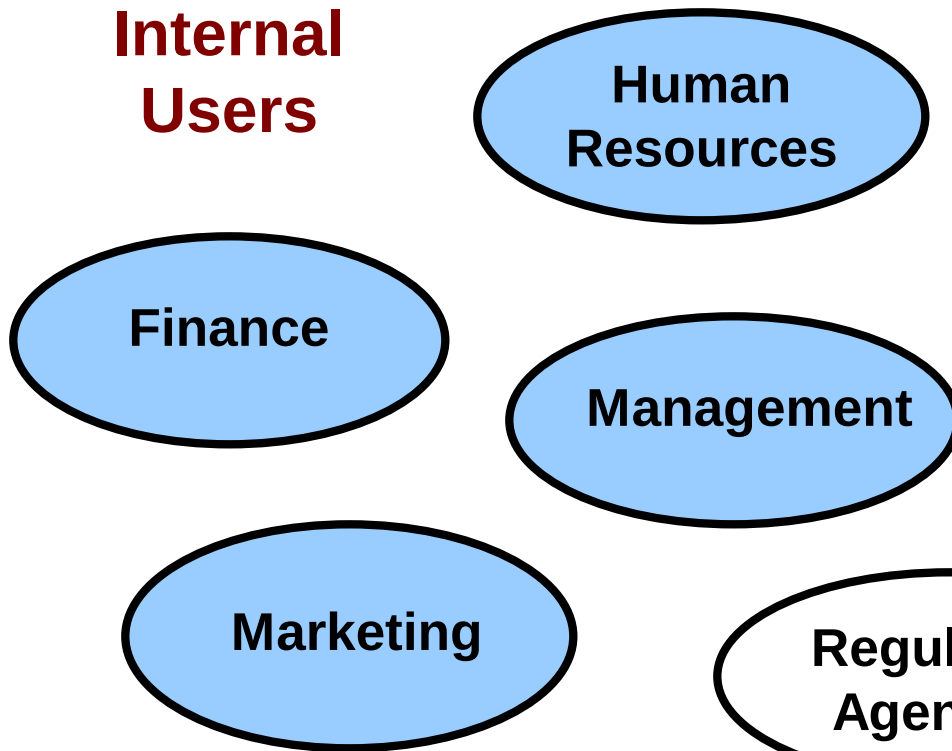
Analyze and interpret for users

The accounting process **includes** the bookkeeping function.

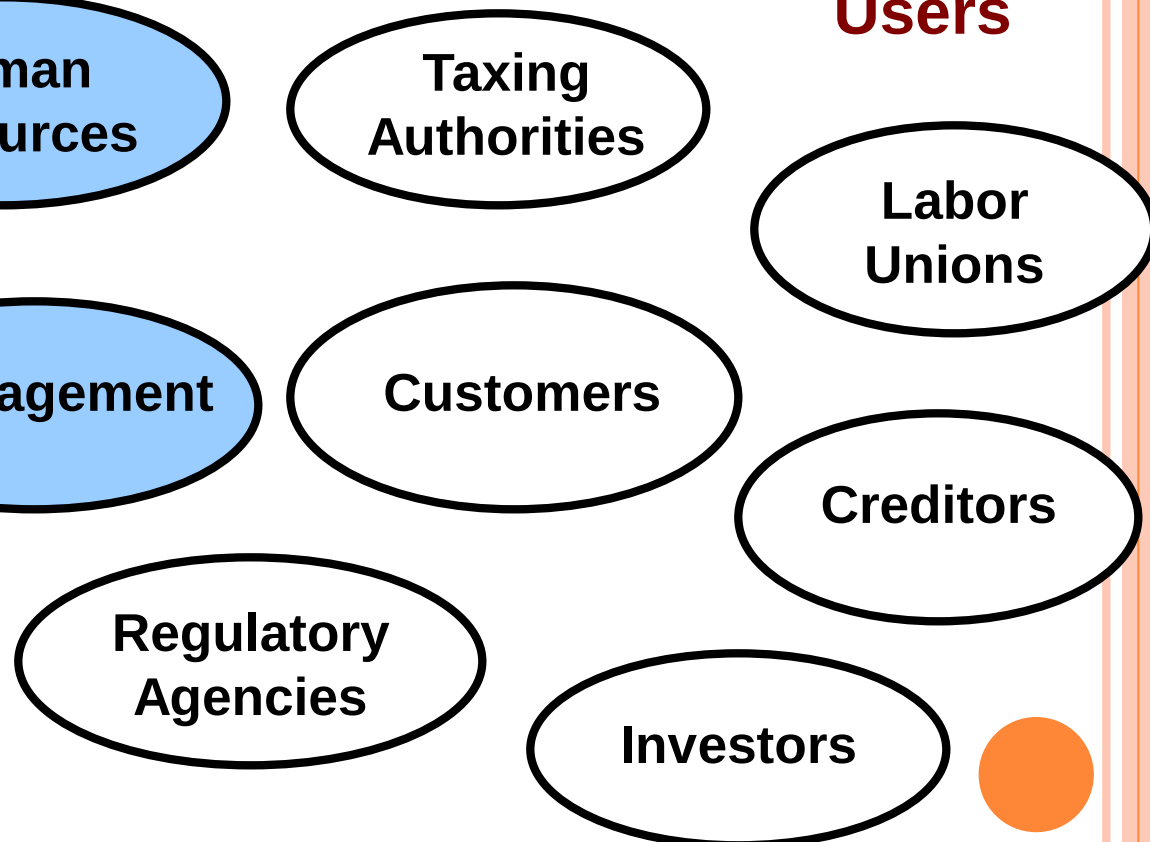
WHAT IS ACCOUNTING?

Who Uses Accounting Data

Internal Users



External Users



WHAT IS ACCOUNTING?

Common Questions Asked

User

- | | | |
|---|---|------------------------|
| 1. Can we afford to give our employees a pay raise? | ➔ | Human Resources |
| 2. Did the company earn a satisfactory income? | ➔ | Investors |
| 3. Should any product lines be eliminated? | ➔ | Management |
| 4. Is cash sufficient to pay dividends to shareholders? | ➔ | Finance |
| 5. What price for our product will maximize net income? | ➔ | Marketing |
| 6. Will the company be able to pay its debts? | ➔ | Creditors |



THE BUILDING BLOCKS OF ACCOUNTING

Ethics In Financial Reporting

Standards of conduct by which one's actions are judged as right or wrong, honest or dishonest, fair or not fair, are **Ethics**.

- Recent financial scandals include: **Enron** (USA), **Parmalat** (ITA), **Satyam Computer Services** (IND), **AIG** (USA), and others.
- Effective financial reporting depends on sound ethical behavior.



THE BUILDING BLOCKS OF ACCOUNTING

Ethics In Financial Reporting

Illustration 1-4

Steps in analyzing ethics cases and situations



1. Recognize an ethical situation and the ethical issues involved.

Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.

2. Identify and analyze the principal elements in the situation.

Identify the *stakeholders*—persons or groups who may be harmed or benefited. Ask the question: What are the responsibilities and obligations of the parties involved?

3. Identify the alternatives, and weigh the impact of each alternative on various stakeholders.

Select the most ethical alternative, considering all the consequences. Sometimes there will be one right answer. Other situations involve more than one right solution; these situations require an evaluation of each and a selection of the best alternative.

THE BUILDING BLOCKS OF ACCOUNTING

Measurement Principles

Cost Principle (Historical) – dictates that companies record assets at their cost.

Issues:

- Reported at cost when purchased and also over the time the asset is held.
- Cost easily verified, market value is often subjective.
- Fair value information may be more useful.



THE BUILDING BLOCKS OF ACCOUNTING

Measurement Principles

Fair Value Principle – indicates that assets and liabilities should be reported at fair value.

- In determining which measurement principle to use, companies weigh the factual nature of cost figures versus the relevance of fair value.
- Only in situations where assets are actively traded, such as investment securities, is the fair value principle applied.



The Building Blocks of Accounting

Assumptions

Monetary Unit Assumption – include in the accounting records only transaction data that can be expressed in terms of money.

Economic Entity Assumption – requires that activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities.

- Proprietorship.
- Partnership.
- Corporation.



**Forms of Business
Ownership**

The Building Blocks of Accounting

Proprietorship

- Generally owned by one person.
- Often small service-type businesses
- Owner receives any profits, suffers any losses, and is personally liable for all debts.

Partnership

- Owned by two or more persons.
- Often retail and service-type businesses
- Generally unlimited personal liability
- Partnership agreement

Corporation

- Ownership divided into shares
- Separate legal entity organized under state corporation law
- Limited liability



THE BASIC ACCOUNTING EQUATION

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

Applies to all economic entities regardless of size.



THE BASIC ACCOUNTING EQUATION

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

Assets

- Resources a business owns.
- Provide future services or benefits.
- Cash, Inventory, Equipment, etc.



THE BASIC ACCOUNTING EQUATION

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

Liabilities

- Claims against assets (debts and obligations).
- Creditors - party to whom money is owed.
- Accounts payable, Notes payable, etc.



THE BASIC ACCOUNTING EQUATION

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

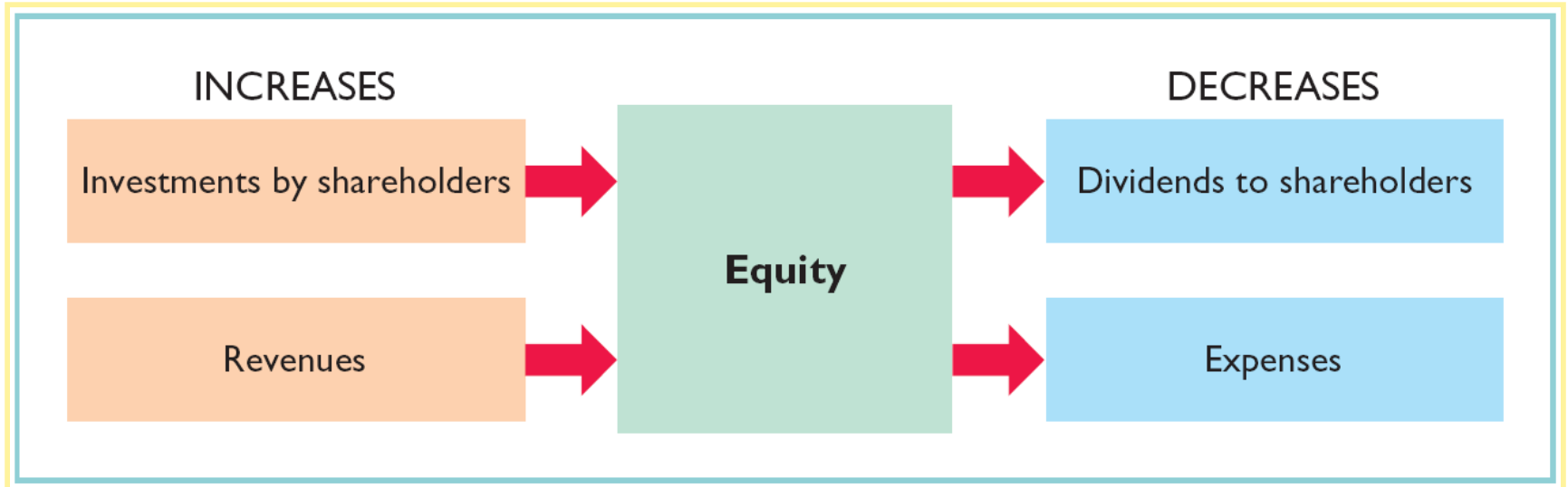
Equity

- Ownership claim on total assets.
- Referred to as residual equity.
- Share capital and retained earnings.



The Basic Accounting Equation

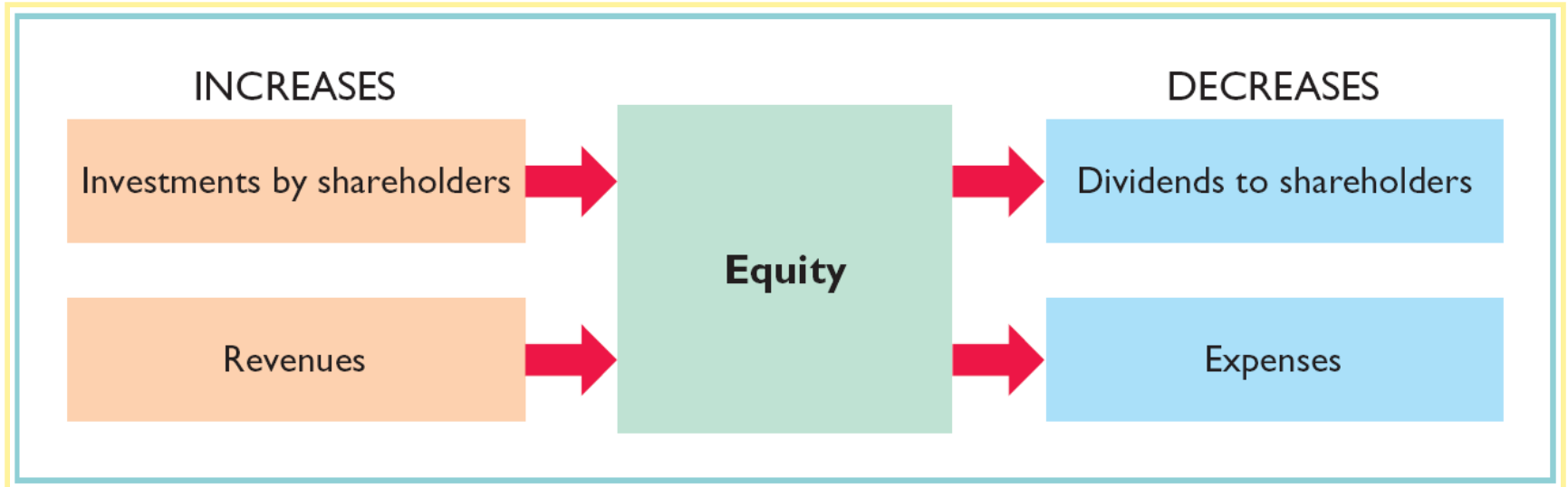
Illustration 1-7



Revenues result from business activities entered into for the purpose of earning income.

Generally results from selling merchandise, performing services, renting property, and lending money.

The Basic Accounting Equation



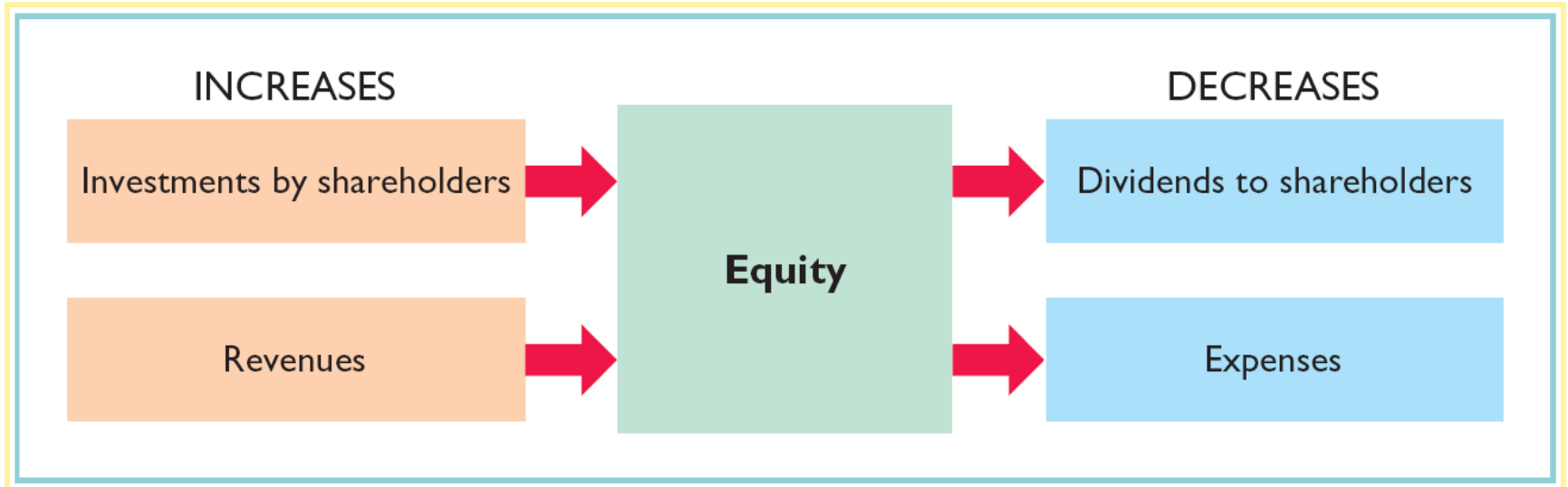
Expenses are the cost of assets consumed or services used in the process of earning revenue.

Common expenses are salaries expense, rent expense, utilities expense, tax expense, etc.



The Basic Accounting Equation

Illustration 1-7



Dividends are the distribution of cash or other assets to shareholders.

- Reduce retained earnings
- Not an expense



USING THE ACCOUNTING EQUATION

Transactions are a business's economic events *recorded* by accountants.

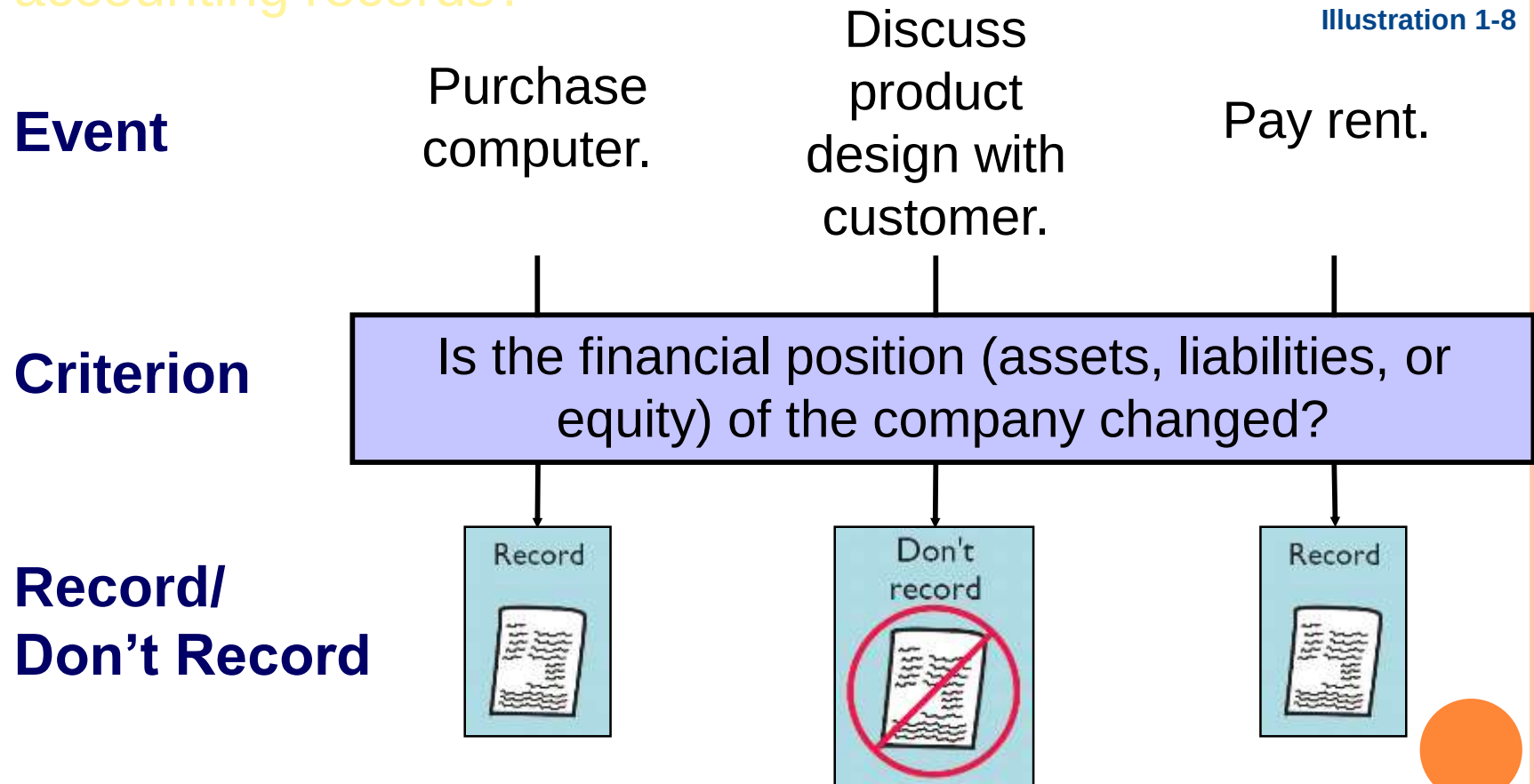
- May be external or internal.
- Not all activities represent transactions.
- Each transaction has a **dual effect** on the accounting equation.



Using The Accounting Equation

Illustration: Are the following events recorded in the accounting records?

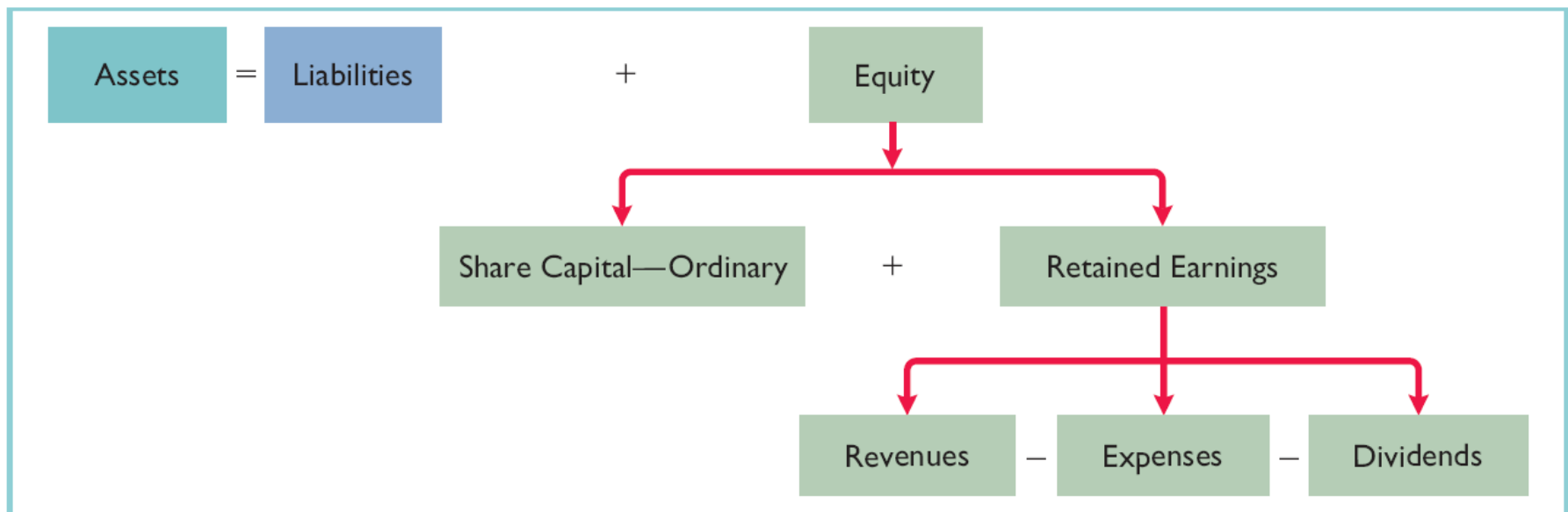
Illustration 1-8



Using The Accounting Equation

Transaction Analysis

Illustration 1-9
Expanded accounting
equation



FINANCIAL STATEMENTS

Companies prepare four financial statements from the summarized accounting data:

