LEARNING OBJECTIVES

1. Define *accounting*, identify business goals and activities, and describe the role of accounting in making informed decisions.

2. Identify the many users of accounting information in society.

3. Explain the importance of business transactions, money measure, and separate entity to accounting measurement.

4. Describe the corporate form of business organization.
5. Define *financial position*, state the accounting equation, and show how they are affected by simple transactions.

6. Identify the four financial statements.

7. State the relationship of generally accepted accounting principles (GAAP) to financial statements and the independent CPA’s report, and identify the organizations that influence GAAP.

8. Define *ethics* and describe the ethical responsibilities of accountants.
Accounting as an Information System

OBJECTIVE 1

Define *accounting*, identify business goals and activities, and describe the role of accounting in making informed decisions.
Accounting provides a vital service by supplying the information decision makers need to make reasoned choices among alternative uses of scarce resources in the conduct of business and economic activities.
Accounting is a link between business activities and decision makers.

- Accounting measures business activities by recording data about them for future use.
- The data are stored until needed and then processed to become useful information.
Business Goals

1. Profitability.
   A business must take in enough money to pay all the costs of doing business, with enough left over as profit for the owners to want to stay in business.

2. Liquidity.
   A business must have enough cash available to pay debts when they are due.
Business Goals and Activities

BUSINESS GOALS

- PROFITABILITY
  - The Daily Record
    - Company Has Record

- LIQUIDITY
  - Money

BUSINESS ACTIVITIES

- FINANCING
  - Bank

- OPERATING
  - Boxes

- INVESTING
  - Title Deed
Business Activities

1. Financing Activities.
   - Obtaining capital from owners and creditors.
   - Repaying creditors and a return to owners.

2. Investing Activities.
   - Spending the capital it receives in ways that are productive and will help the business achieve its objectives.
   - Buying and selling assets to be used in the business.
3. Operating Activities.

- Selling of goods and services to customers.
- Employing managers and workers, buying and producing goods and services, and paying taxes.
Financial and Management Accounting

- Accounting’s role of assisting decision makers by measuring, processing, and communicating information is usually divided into two categories:
- The two may be distinguished by the principal users of their information.
Management Accounting

- Is oriented toward the needs of internal decision makers.
- Provides managers and employees with information regarding how they have done in the past and what they can expect in the future.
Financial Accounting

- Is oriented toward the needs of external decision makers.
- Provides information in the form of financial statements so that external decision makers can evaluate how well the business has achieved its goals.
- Financial statements report directly on the goals of profitability and liquidity.
  - Financial statements are used extensively both inside and outside a business to evaluate the business’s success.
Processing Accounting Information

- Accounting versus bookkeeping

✔ Bookkeeping is the mechanical and repetitive process of recording financial transactions and keeping financial records.

✔ Bookkeeping is a small part of accounting.

✔ Accounting includes the design of an information system that meets user’s needs.

✔ Accounting goals are the analysis, interpretation, and use of information.
Computers are used extensively in accounting as a tool for the accountant.

A business’s many information needs are organized into a Management Information System (MIS).

✔ An MIS consists of various interconnected subsystems.

✔ The Accounting Information System (AIS) is the most important subsystem.
OBJECTIVE 2
Identify the many users of accounting information in society.
The Users of Accounting Information

- MANAGEMENT
  - Finance
  - Investment Operations and Production
  - Marketing
  - Human Resources
  - Information Systems
  - Accounting

- THOSE WITH DIRECT FINANCIAL INTEREST
  - Investors
  - Creditors

- THOSE WITH INDIRECT FINANCIAL INTEREST
  - Tax Authorities
  - Regulators
  - Labor Unions
  - Customers
  - Economic Planners
Management

- Requires financial information to carry out its basic functions.
  1. Financing the business.
  2. Investing the resources of the business.
  3. Producing goods and services.
  4. Marketing goods and services.
  5. Managing employees.
  6. Providing information to decision makers.
Outside Users with a Direct Financial Interest

- Investors
- Creditors
People, Organizations, and Agencies with an Indirect Financial Interest

- Tax Authorities.
- Regulatory Agencies.
- Labor Unions.
- Customers.
- Economic Planners.
OBJECTIVE 3
Explain the importance of business transactions, money measure, and separate entity to accounting measurement.
What Is Measured?

- Business transactions as the object of measurement.
- *Business transactions* are economic events that affect the financial position of a business entity.
  - Transactions are the raw material of accounting reports.
  - Transactions must relate directly to a business entity.
Money Measure.

- Money is the only factor common to all business transactions.
- The monetary unit a business uses depends on the country in which the business resides.
- Exchange rates translate one currency to another.

The Concept of Separate Entity.

- A business is a separate entity, distinct from its creditors and customers and from its owner or owners.
The Corporation as a Separate Entity

OBJECTIVE 4
Describe the corporate form of business organization.
Types of Business Organization

- Sole Proprietorship.
- Partnership.
- Corporation.
The Corporate Form of Business

- Formation of a Corporation.
- Organization of a Corporation.
  - Stockholders.
  - Board of Directors.
  - Management.
Number and Receipts of U.S. Proprietorships, Partnerships, and Corporations, 1994

**NUMBER OF BUSINESSES**

- **Proprietorships**: 15,848
- **Partnerships**: 1,468
- **Corporations**: 3,965

**RECEIPTS OF BUSINESSES**

- **Proprietorships**: $757
- **Partnerships**: 656
- **Corporations**: 12,269
Financial Position and the Accounting Equation

OBJECTIVE 5
Define financial position, state the accounting equation, and show how they are affected by simple transactions.
**Assets**

- Assets are economic resources owned by a business that are expected to benefit future operations.
  - ✔ Monetary items.
  - ✔ Nonmonetary physical things.
Liabilities

Liabilities are the present obligations of a business to pay cash, transfer assets, or provide services to other entities in the future.
Owners’ Equity

- Owners’ equity represents the claims by the owners of a business to the assets of the business.
- Owners’ equity is the residual equity that remains after deducting liabilities from assets.
- \( OE = \text{Assets} - \text{Liabilities} \).
- \( \text{Assets} = \text{Liabilities} + \text{SE} \).
- \( \text{SE} = \text{Contributed Capital} + \text{Retained Earnings} \).
Three Types of Transactions That Affect Retained Earnings

INCREASES

REVENUES -> RETAINED EARNINGS

DECREASES

EXPENSES

DIVIDENDS
Some Illustrative Transactions
## T1. Owners’ Investments

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td><strong>$50,000</strong></td>
<td><strong>$50,000</strong></td>
</tr>
<tr>
<td><strong>Beg. Bal.</strong></td>
<td><strong>$ 0</strong></td>
<td><strong>$ 0</strong></td>
</tr>
<tr>
<td><strong>T1.</strong></td>
<td><strong>50,000</strong></td>
<td><strong>50,000</strong></td>
</tr>
<tr>
<td><strong>End. Bal.</strong></td>
<td><strong>$50,000</strong></td>
<td><strong>$50,000</strong></td>
</tr>
</tbody>
</table>

Assets = $50,000; L+SE = $50,000
### T2. Purchase of Assets with Cash

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash</td>
</tr>
<tr>
<td>Beg. Bal.</td>
<td>$50,000</td>
</tr>
<tr>
<td>T2.</td>
<td>-35,000</td>
</tr>
<tr>
<td>End. Bal.</td>
<td>$15,000</td>
</tr>
</tbody>
</table>

\[\text{Assets} = \$50,000; \ L+SE = \$50,000\]
## T3. Purchase of Assets by Incurring a Liability

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
<th></th>
<th>LIABILITIES</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplies</td>
<td>Beg. Bal.</td>
<td>$ 0</td>
<td>A/P</td>
<td>$ 0</td>
</tr>
<tr>
<td>T3.</td>
<td>$500</td>
<td>+500</td>
<td>$500</td>
<td>+500</td>
</tr>
<tr>
<td>End. Bal.</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
</tr>
</tbody>
</table>

Assets = $50,500; L+SE= $50,500
T4. Payment of a Liability with Cash

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>A/P</td>
</tr>
<tr>
<td>Beg. Bal.</td>
<td>$15,000</td>
</tr>
<tr>
<td>T4.</td>
<td>-200</td>
</tr>
<tr>
<td>End. Bal.</td>
<td>$14,800</td>
</tr>
</tbody>
</table>

Assets = $50,300; L+SE = $50,300
### T5. Revenues Earned

Commission That Was Paid in Cash

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Beg. Bal</strong></td>
<td>$14,800</td>
<td>$0</td>
</tr>
<tr>
<td><strong>T5.</strong></td>
<td>+ 1,500</td>
<td>+1,500</td>
</tr>
<tr>
<td><strong>End. Bal.</strong></td>
<td>$16,300</td>
<td>$1,500</td>
</tr>
</tbody>
</table>

\[
\text{Assets} = \$51,800; \text{L+SE} = \$51,800
\]
### T6. Revenues Earned

Commission with Deferred Receipt

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A/R</td>
<td>R/E</td>
</tr>
<tr>
<td>Beg. Bal</td>
<td>$0</td>
<td>$1,500</td>
</tr>
<tr>
<td>T6.</td>
<td>+2,000</td>
<td>+2,000</td>
</tr>
<tr>
<td>End. Bal.</td>
<td>$2,000</td>
<td>$3,500</td>
</tr>
</tbody>
</table>

Assets = $53,800; L+SE = $53,800
## T7. Collection of Accounts Receivable

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td>$16,300</td>
</tr>
<tr>
<td><strong>A/R</strong></td>
<td>$2,000</td>
</tr>
<tr>
<td><strong>Beg. Bal.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>T7.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>End. Bal.</strong></td>
<td>$17,300</td>
</tr>
<tr>
<td><strong>- 1,000</strong></td>
<td></td>
</tr>
<tr>
<td><strong>- 1,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

|                | $1,000          |

Assets = $53,800; L+SE = $53,800
### T8. Paid Equipment Rental Expense

### T9. Paid Wages Expense with Cash

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>R/E</td>
</tr>
<tr>
<td>Beg. Bal</td>
<td>$17,300 $3,500</td>
</tr>
<tr>
<td>T8.</td>
<td>- 1,000 -1,000</td>
</tr>
<tr>
<td>T9.</td>
<td>- 400   - 400</td>
</tr>
<tr>
<td>End. Bal.</td>
<td>$15,900 $2,100</td>
</tr>
</tbody>
</table>

Assets = $52,400; L+SE = $52,400
### T10. Paid Utility Expense Incurring a Current Liability

**SE**

<table>
<thead>
<tr>
<th></th>
<th>A/P</th>
<th>R/E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beg. Bal.</td>
<td>$300</td>
<td>$2,100</td>
</tr>
<tr>
<td>T10.</td>
<td>+300</td>
<td>- 300</td>
</tr>
<tr>
<td>End. Bal.</td>
<td>$600</td>
<td>$1,800</td>
</tr>
</tbody>
</table>

**Assets = $52,400; L+SE = $52,400**
### T11. Paid Dividends with Cash

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>R/E</td>
</tr>
<tr>
<td>Beg. Bal</td>
<td>$15,900</td>
</tr>
<tr>
<td>T11.</td>
<td>- 600</td>
</tr>
<tr>
<td>End. Bal.</td>
<td>$15,300</td>
</tr>
</tbody>
</table>

**Assets = $51,800; L+SE = $51,800**
OBJECTIVE 6
Identify the four financial statements.
The Importance of Financial Statements

◆ Financial statements are the primary means of communicating important accounting information to users.

◆ Financial statements represent models of the business enterprise because they show the business in financial terms.

◆ Financial statements are not perfect pictures of the real thing.
The Income Statement

- Summarizes revenues earned expenses incurred over a period of time.
- Is considered by many to be the most important financial report because it shows whether or not a business achieved its profitability goal of earning an acceptable income.
### Income Statement

**For the Month Ended December 31, 20xx**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
</tr>
<tr>
<td>Commissions Earned</td>
<td>$3,500</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
</tr>
<tr>
<td>Equipment Rental</td>
<td>$1,000</td>
</tr>
<tr>
<td>Wages</td>
<td>400</td>
</tr>
<tr>
<td>Utilities</td>
<td>300</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$1,700</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$1,800</td>
</tr>
</tbody>
</table>

Trace to Statement of Retained Earnings
The Statement of Retained Earnings

- Shows the changes in retained earnings over a period of time.
Shannon Realty, Inc.
Statement of Retained Earnings
For the Month Ended December 31, 20xx

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained Earnings, 12/1/xx</td>
<td>$ 0</td>
</tr>
<tr>
<td>Net Income for the Month</td>
<td>1,800</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$ 1,800</td>
</tr>
<tr>
<td>Less Dividends</td>
<td>600</td>
</tr>
<tr>
<td>Retained Earnings, 12/31/xx</td>
<td>$ 1,200</td>
</tr>
</tbody>
</table>

Trace to Owners’ Equity Section of Balance Sheet
The Balance Sheet

- Shows financial position at a point in time.
- Is often called the statement of financial position.
- Presents a view of the business as the holder of resources, or assets, that are equal to the claims against those assets.
Shannon Realty, Inc.
Balance Sheet
As of December 31, 20xx

ASSETS

Cash $15,300
A/R 1,000
Supplies 500
Land 10,000
Building 25,000
Total Assets $51,800
Shannon Realty, Inc.
Balance Sheet
As of December 31, 20xx

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A/P</td>
<td>$600</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>STOCKHOLDERS’ EQUITY</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Stock</td>
<td>$50,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>$1,200</td>
</tr>
<tr>
<td>Total SE</td>
<td>$51,200</td>
</tr>
<tr>
<td>Total Liabilities and SE</td>
<td>$51,800</td>
</tr>
</tbody>
</table>
The Statement of Cash Flows

- Focuses on a company’s liquidity goal.
- Shows cash produced by operating a business as well as important financing and investing transactions that take place during an accounting period.
- Is derived from the income statement and balance sheet.
- Is directly related to the other three statements.
Shannon Realty, Inc.
Statement of Cash Flows
For the Month Ended December 31, 20xx

Cash Flows from Operating Activities

Net Income $1,800

Noncash Expenses and Revenues

Included in Income

Increase in A/R $(1,000)
Increase in Supplies (500)
Increase in A/P 600 (900)

Net Cash Flows from Operating Activities $900
Shannon Realty, Inc.
Statement of Cash Flows
For the Month Ended December 31, 20xx

Cash Flows from Investing Activities

Purchase of Land ($10,000)
Purchase of Building (25,000)
Net Cash Flows from Investing Activities (35,000)
# Shannon Realty, Inc.

## Statement of Cash Flows

For the Month Ended December 31, 20xx

### Cash Flows from Financing Activities

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments by Stockholders</td>
<td>$50,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>(600)</td>
</tr>
</tbody>
</table>

Net Cash Flows from Financing Activities: 49,400

Net Increase (Decrease) in Cash: $15,300

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at Beginning of Month</td>
<td>0</td>
</tr>
<tr>
<td>Cash at End of Month</td>
<td>$15,300</td>
</tr>
</tbody>
</table>

Trace to Balance Sheet

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OBJECTIVE 7
State the relationship of generally accepted accounting principles (GAAP) to financial statements and the independent CPA’s report, and identify the organizations that influence GAAP.
Generally Accepted Accounting Principles (GAAP)

- Focus on understandability of financial statements.
- Encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time.
Financial Statements, GAAP, and the Independent CPA’s Report

Financial statements are prepared by management and may be biased.

Financial statements are audited by independent CPAs.

An audit ascertains that the financial statements have been prepared in accordance with GAAP.
Discussion

Q. Why are GAAP important to readers of financial statements?

A. GAAP ensure that the financial statements will be understandable to their users.
OBJECTIVE 8

Define ethics and describe the ethical responsibilities of accountants.
What Are Professional Ethics?

- A code of conduct that applies to the practice of a profession.
- Code of conduct adopted by the AICPA and each state.
  - Responsibility to the public.
  - Integrity.
  - Objectivity.
  - Independence.
  - Due care.
The Institute of Management Accountants (IMA) Code of Professional Conduct

- Competency.
- Confidentiality.
- Integrity.
- Avoidance of conflicts of interest.
- Communication of information *objectively* and *without bias*.
Q. Discuss the importance of professional ethics in the accounting profession.

A. Professional ethics forms a code of conduct that applies to the practice of a profession. As members of a profession, accountants have a responsibility, not only to their employers and clients but also to society as a whole, to uphold the highest ethical standards.