

Introduction to Accounting

What is Accounting?

Accounting is an Information System.

The purpose of accounting is to:

identify, record, classify and summarize and finally communicate the economic events of an organization to interested users.

Who Uses Accounting Data?

Internal Users

Management

TAX

Investors

Human
Resources

There are two broad groups
of users of financial
information: internal users
and external users.

Labor
Unions

Finance

Creditors

Marketing

SEC


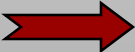




Customers

External
Users

Who Uses Accounting Data?

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. Do we need to borrow in the near future? |  | Management |
| 4. Is cash sufficient to pay dividends to the stockholders? |  | Finance |
| 5. What price for our product will maximize net income? |  | Marketing |
| 6. Will the company be able to pay its short-term debts? |  | Creditors |

Who Uses Accounting Data?

Discussion Question

Q1. “Accounting is ingrained in our society and it is vital to our economic system.” Do you agree? Explain.

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**.

- Effective financial reporting depends on sound ethical behavior.

The Building Blocks of Accounting

Various users need
financial
information



Financial Statements

- Balance Sheet
- Income Statement
- Statement of Owner's Equity
- Statement of Cash Flows
- Note Disclosure



The accounting profession has
attempted to develop a set of
standards that are generally
accepted and universally
practiced.



**Generally Accepted
Accounting Principles
(GAAP)**

The Building Blocks of Accounting

Organizations Involved in Standard Setting:



Securities and Exchange Commission (SEC)

<http://www.sec.gov/>



Financial Accounting Standards Board (FASB)

<http://www.fasb.org/>



International Accounting Standards Board (IASB)

<http://www.iasb.org/>

Forms of Business Ownership

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 of stock
- Separate legal entity organized under state corporation law
- Limited liability

The Basic Accounting Equation

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\begin{array}{c} \text{Owner's} \\ \text{Equity} \end{array}}$$

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

Assets are claimed by either creditors or owners.

Claims of creditors must be paid before ownership claims.

The Basic Accounting Equation

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Owner's Equity}}$$

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

Assets

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

The Basic Accounting Equation

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Owner's Equity}}$$

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

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Owner's Equity}}$$

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

Owner's Equity

- Ownership claim on total assets.
- Referred to as residual equity.
- Capital, Drawings, etc. (Proprietorship or Partnership).

Owner's Equity

Basic Equation:	Assets = Liabilities	+	Owner's Equity
Expanded Basic Equation:	Assets = Liabilities	+	Owner's Capital – Owner's Drawings + Revenues – Expenses

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

Common sources of revenue are: sales, fees, services, commissions, interest, dividends, royalties, and rent.

Owner's Equity

Basic Equation:	Assets = Liabilities	+	Owner's Equity
Expanded Basic Equation:	Assets = Liabilities	+	Owner's Capital – Owner's Drawings + Revenues – Expenses

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.

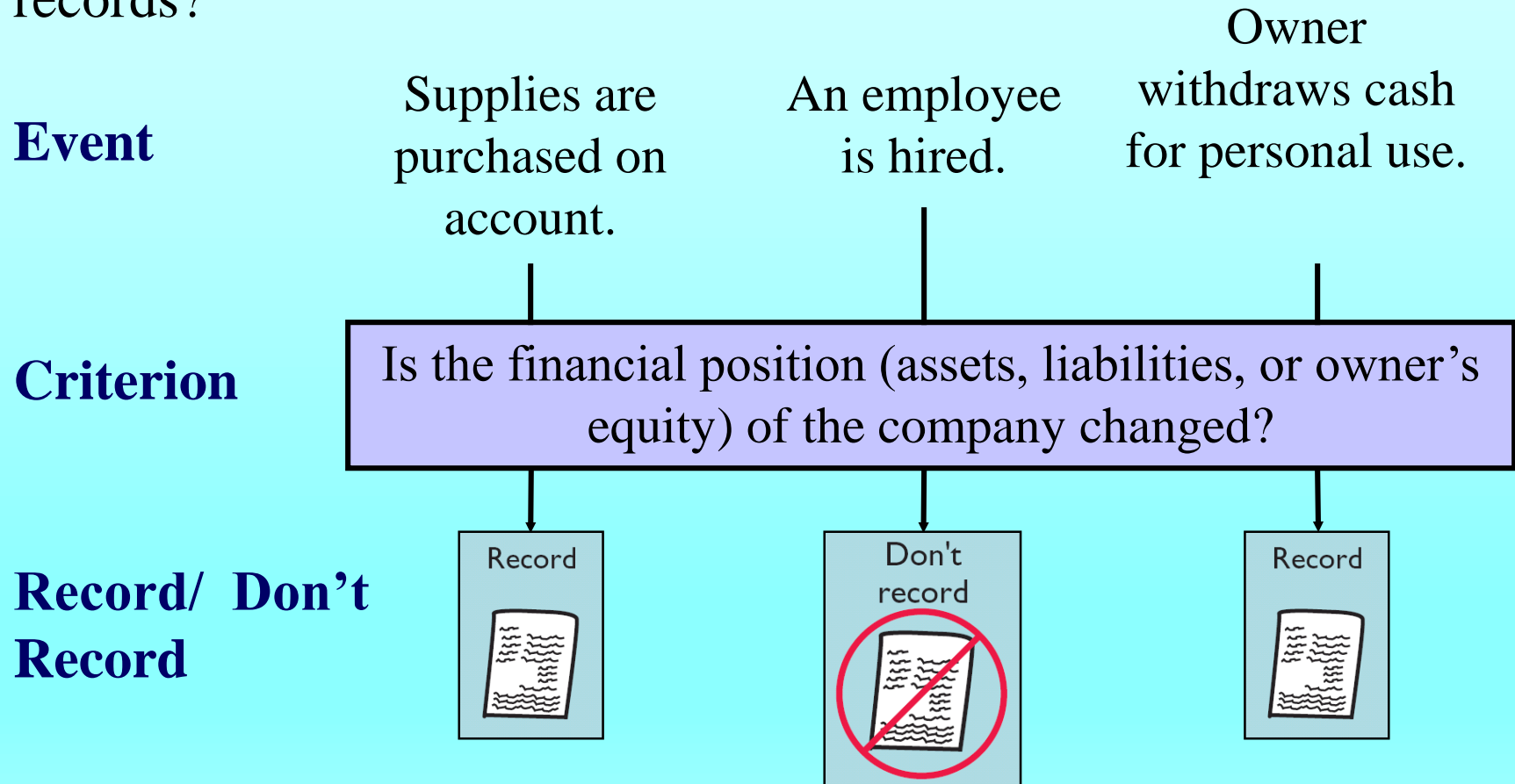
Using The Basic Accounting Equation

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.

Transactions (Question?)

Q1-15: Are the following events recorded in the accounting records?



Transactions

Discussion Question

Q1-18. In February 2010, Paula King invested an additional \$10,000 in her business, King's Pharmacy, which is organized as a proprietorship. King's accountant, Lance Jones, recorded this receipt as an increase in cash and revenues. Is this treatment appropriate? Why or why not?

Transactions (Problem)

P1-1A: Barone's Repair Shop was started on May 1 by Nancy Barone. Prepare a tabular analysis of the following transactions for the month of May.

1. Invested \$10,000 cash to start the repair shop.

Assets				=	Liabilities	+	Owners' Equity							
Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000							+10,000						

Transactions (Problem)

2. Purchased equipment for \$5,000 cash.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.															
4.															
5.															
6.															
7.															
8.															
9.															
10.															

Transactions (Problem)

3. Paid \$400 cash for May office rent.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.															
5.															
6.															
7.															
8.															
9.															
10.															

Transactions (Problem)

4. Incurred \$250 of advertising costs, on account.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.							+250								-250
5.															
6.															
7.															
8.															
9.															
10.															

Transactions (Problem)

5. Received \$5,100 from customers for repair service.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.							+250								-250
5.	+5,100												+5,100		
6.															
7.															
8.															
9.															
10.															

Transactions (Problem)

6. Withdrew \$1,000 cash for personal use.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.							+250								-250
5.	+5,100												+5,100		
6.	-1,000										-1,000				
7.															
8.															
9.															
10.															

Transactions (Problem)

7. Paid part-time employee salaries of \$2,000.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.							+250								-250
5.	+5,100												+5,100		
6.	-1,000										-1,000				
7.	-2,000														-2,000
8.															
9.															
10.															

Transactions (Problem)

8. Paid utility bills \$140.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.							+250								-250
5.	+5,100												+5,100		
6.	-1,000										-1,000				
7.	-2,000														-2,000
8.	-140														-140
9.															
10.															

Transactions (Problem)

9. Provided \$750 of repair services on account.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.							+250								-250
5.	+5,100												+5,100		
6.	-1,000										-1,000				
7.	-2,000														-2,000
8.	-140														-140
9.			+750										+750		
10.															



Transactions (Problem)

10. Collected \$120 cash for services previously billed.

	Assets			=	Liabilities	+	Owners' Equity								
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Barone, Capital	-	Barone, Drawing	+	Revenues	-	Expenses
1.	+10,000								+10,000						
2.	-5,000				+5,000										
3.	-400														-400
4.							+250								-250
5.	+5,100												+5,100		
6.	-1,000										-1,000				
7.	-2,000														-2,000
8.	-140														-140
9.			+750										+750		
10.	+120		-120												

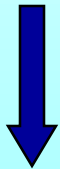
Transactions (Problem)

10. Collected \$120 cash for services previously billed.

	Assets			=	Liabilities	+	Owners' Equity		
	Cash	+ Accounts Receivable	+ Equipment	=	Accounts Payable	+ Barone, Capital	- Barone, Drawing	+ Revenues	- Expenses
1.	+10,000					+10,000			
2.	-5,000		+5,000						
3.	-400								-400
4.					+250				-250
5.	+5,100							+5,100	
6.	-1,000						-1,000		
7.	-2,000								-2,000
8.	-140								-140
9.		+750						+750	
10.	+120	-120							
	<u>+6,680</u>	<u>+630</u>	<u>+5,000</u>	=	<u>+250</u>	<u>+10,000</u>	<u>-1,000</u>	<u>+5,850</u>	<u>-2,790</u>
									
DMH 1-29	\$12,310				\$12,310				

Financial Statements

Companies prepare four financial statements from the summarized accounting data:



Income
Statement



Owner's
Equity
Statement



Balance
Sheet



Statement of
Cash Flows

Financial Statements

Income Statement

Barone's Repair Shop Income Statement

For the Month Ended May 31, 2010

Revenues:

Service revenue	<u>\$ 5,850</u>
-----------------	-----------------

Expenses:

Salary expense	2,000
----------------	-------

Rent expense	400
--------------	-----

Utility expense	140
-----------------	-----

Advertising expense	250
---------------------	-----

Total expenses	<u>2,790</u>
----------------	--------------

Net income	<u><u>\$ 3,060</u></u>
------------	------------------------

- Reports the revenues and expenses for a specific period of time.
- Net income – revenues exceed expenses.
- Net loss – expenses exceed revenues.

Financial Statements

Income Statement

Barone's Repair Shop	
Income Statement	
For the Month Ended May 31, 2010	
Revenues:	
Service revenue	<u>\$ 5,850</u>
Expenses:	
Salary expense	2,000
Rent expense	400
Utility expense	140
Advertising expense	250
Total expenses	<u>2,790</u>
Net income	<u>\$ 3,060</u>

Owner's Equity Statement

Barone's Repair Shop	
Owner's Equity Statement	
For the Month Ended May 31, 2010	
Barone's, Capital May 1	\$ -
Add: Investment	10,000
Net income	<u>3,060</u>
	13,060
Less: Drawings	<u>1,000</u>
Barone's, Capital May 31	<u>\$12,060</u>

Net income is needed to determine the ending balance in owner's equity.

Financial Statements

- Statement indicates the reasons why owner's equity has increased or decreased during the period.

Owner's Equity Statement

Barone's Repair Shop	
Owner's Equity Statement	
For the Month Ended May 31, 2010	
Barone's, Capital May 1	\$ -
Add: Investment	10,000
Net income	3,060
	<hr/> 13,060
Less: Drawings	1,000
Barone's, Capital May 31	<hr/> \$12,060 <hr/>

Financial Statements

Balance Sheet

Barone's Repair Shop Balance Sheet May 31, 2010

Assets

Cash	\$ 6,680
Accounts receivable	630
Equipment	5,000
Total assets	<u>\$12,310</u>

Liabilities

Accounts payable	\$ 250
------------------	--------

Owner's Equity

Barone's, capital	12,060
Total liab. & equity	<u>\$12,310</u>

Owner's Equity Statement

Barone's Repair Shop Owner's Equity Statement

For the Month Ended May 31, 2010

Barone's, Capital May 1	\$ -
Add: Investment	10,000
Net income	3,060
	<u>13,060</u>
Less: Drawings	1,000.00
Barone's, Capital May 31	<u>\$12,060</u>

The ending balance in owner's equity is needed in preparing the balance sheet

Financial Statements

Balance Sheet

Barone's Repair Shop
Balance Sheet
May 31, 2010

Assets

Cash	\$ 6,680
Accounts receivable	630
Equipment	5,000
Total assets	<u>\$12,310</u>

Liabilities

Accounts payable	\$ 250
------------------	--------

Owner's Equity

Barone's, capital	12,060
Total liab. & equity	<u>\$12,310</u>

- Reports the assets, liabilities, and owner's equity at a specific date.
- Assets listed at the top, followed by liabilities and owner's equity.
- Total assets must equal total liabilities and owner's equity.

Financial Statements

Balance Sheet

Barone's Repair Shop
Balance Sheet
May 31, 2010

Assets

Cash	\$ 6,680
Accounts receivable	630
Equipment	5,000
Total assets	<u>\$12,310</u>

Liabilities

Accounts payable	\$ 250
------------------	--------

Owner's Equity

Barone's, capital	12,060
Total liab. & equity	<u>\$12,310</u>

Statement of Cash Flows

Barone's Repair Shop

Statement of Cash Flows

For the Month Ended May 31, 2010

Cash flow from operating activities

Cash receipts from revenues	\$ 5,220
Cash paid for expenses	(2,540)
Cash provided by operations	<u>2,680</u>

Cash flow from investing activities

Purchase of equipment	<u>(5,000)</u>
-----------------------	----------------

Cash flow from financing activities

Investment by owners	10,000
Drawing by owner	(1,000)
Cash provided by financing	<u>9,000</u>

Net increase in cash 6,680

Cash balance, May 1 -

Cash balance, May 31 **\$ 6,680**

Financial Statements

- Information for a specific period of time.
- Answers the following:
 1. Where did cash come from?
 2. What was cash used for?
 3. What was the change in the cash balance?

Statement of Cash Flows

Barone's Repair Shop	
Statement of Cash Flows	
For the Month Ended May 31, 2010	
<hr/>	
Cash flow from operating activities	
Cash receipts from revenues	\$ 5,220
Cash paid for expenses	(2,540)
Cash provided by operations	<hr/> 2,680
Cash flow from investing activities	
Purchase of equipment	<hr/> (5,000)
Cash flow from financing activities	
Investment by owners	10,000
Drawing by owner	(1,000)
Cash provided by financing	<hr/> 9,000
Net increase in cash	<hr/> 6,680
Cash balance, May 1	<hr/> -
Cash balance, May 31	<hr/> \$ 6,680

Financial Statements

Review Question

Which of the following financial statements is prepared as of a specific date?

- a. Balance sheet.
- b. Income statement.
- c. Owner's equity statement.
- d. Statement of cash flows.

Financial Statements

Discussion Question

Q1-19. “A company’s net income appears directly on the income statement and the owner’s equity statement, and it is included indirectly in the company’s balance sheet.”
Do you agree? Explain.