

# 1

## Accounting in Action

### Learning Objectives

1

Identify the activities and users associated with accounting.

2

Explain the building blocks of accounting: ethics, principles, and assumptions.

3

State the accounting equation, and define its components.

4

Analyze the effects of business transactions on the accounting equation.

5

Describe the four financial statements and how they are prepared.

## Identify the activities and users associated with accounting.

**Accounting** consists of three basic activities—it

- ◆ identifies,
- ◆ records, and
- ◆ communicates

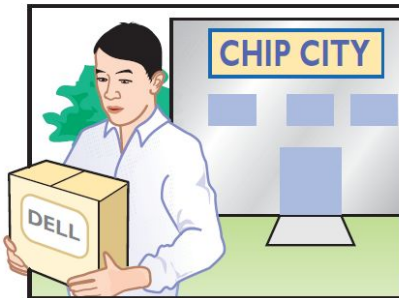
the economic events of an organization to interested users.

# Three Activities

## Illustration 1-1

The activities of the accounting process

### Identification



Select economic events (transactions)

### Recording



Record, classify, and summarize

### Communication



Prepare accounting reports



Analyze and interpret for users

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

# Who Uses Accounting Data

## INTERNAL USERS



### Marketing

What price should **Apple** charge for an iPod to maximize the company's net income?



Snack chips



Beverages

### Management

Which **PepsiCo** product line is the most profitable? Should any product lines be eliminated?



### Finance

Is cash sufficient to pay dividends to **Microsoft** stockholders?



### Human Resources

Can **General Motors** afford to give its employees pay raises this year?

### Illustration 1-2

Questions that internal users ask

## Accounting Across the Organization

### Rhino Foods



© Agnieszka Pastuszak-Maksim/iStockphoto

#### The Scoop on Accounting

Accounting can serve as a useful recruiting tool even for the human resources department. **Rhino Foods**, located in Burlington, Vermont, is a manufacturer of specialty ice cream. Its corporate website includes the following:

“Wouldn’t it be great to work where you were part of a team? Where your input and hard work made a

difference? Where you weren’t kept in the dark about what management was thinking? . . . Well—it’s not a dream! It’s the way we do business . . . Rhino Foods believes in family, honesty and open communication—we really care about and appreciate our employees—and it shows. Operating results are posted and monthly group meetings inform all employees about what’s happening in the Company. Employees also share in the Company’s profits, in addition to having an excellent comprehensive benefits package.”

Source: [www.rhinofoods.com/workforus/workforus.html](http://www.rhinofoods.com/workforus/workforus.html).

What are the benefits to the company and to the employees of making the financial statements available to all employees? (Go to **WileyPLUS** for this answer and additional questions.)



# Who Uses Accounting Data

## EXTERNAL USERS



### Investors

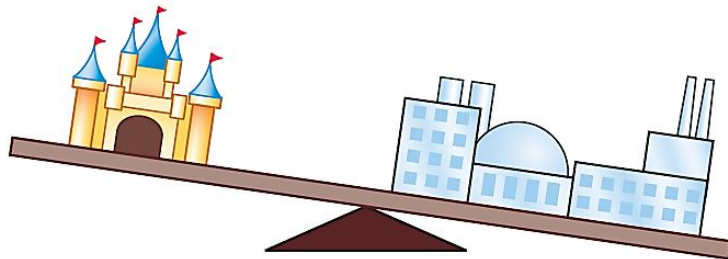
Is **General Electric** earning satisfactory income?

**Illustration 1-3**  
Questions that external users ask



### Creditors

Will **United Airlines** be able to pay its debts as they come due?



### Investors

How does **Disney** compare in size and profitability with **Time Warner**?

Indicate whether the following statements are **true or false**.

1. The three steps in the accounting process are identification, recording, and communication.
2. Bookkeeping encompasses all steps in the accounting process.
3. Accountants prepare, but do not interpret, financial reports.
4. The two most common types of external users are investors and company officers.
5. Managerial accounting activities focus on reports for internal users.

**Solution:** 1. **True** 2. **False** 3. **False** 4. **False** 5. **True**

## Ethics in Financial Reporting

- ◆ Recent financial scandals include: **Enron**, **WorldCom**, **HealthSouth**, **AIG**, and other companies.
- ◆ Regulators and lawmakers concerned that economy would suffer if investors lost confidence in corporate accounting. In response,
  - ▶ Congress passed **Sarbanes-Oxley Act (SOX)**.
- ◆ Effective financial reporting depends on sound ethical behavior.



# Ethics in Financial Reporting

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

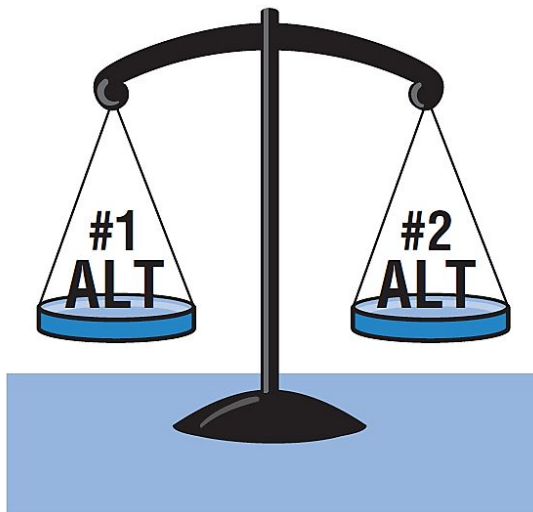
Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.

## 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.



**Illustration 1-4**  
Steps in analyzing ethics cases and situations

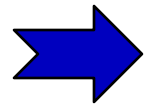
# Ethics in Financial Reporting

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## Question

Ethics are the standards of conduct by which one's actions are judged as:

- a. right or wrong.
- b. honest or dishonest.
- c. fair or not fair.
- d. all of these options.





Gemunu Amarasinghe/AP Photo

### The Numbers Behind Not-for-Profit Organizations

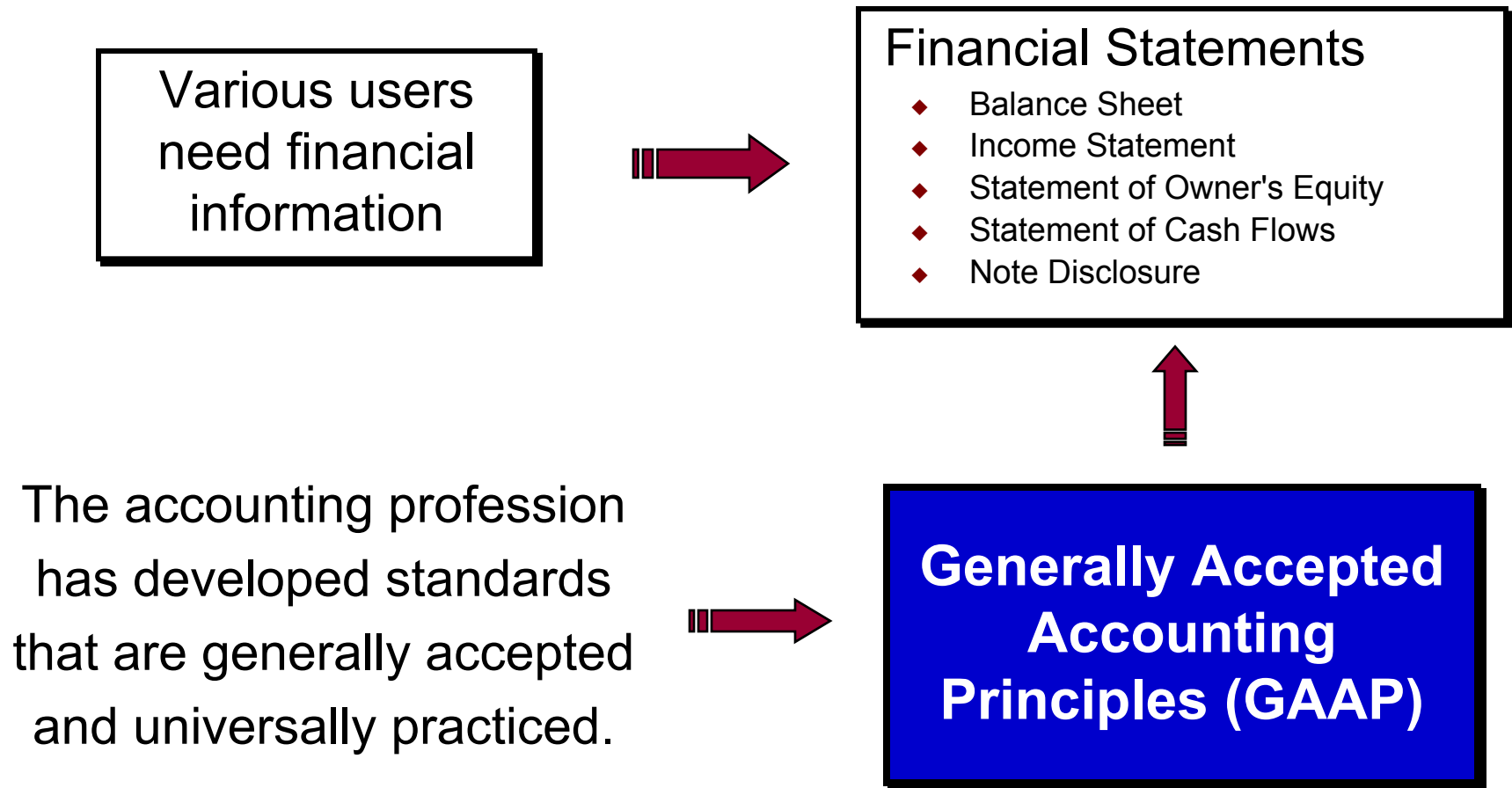
Accounting plays an important role for a wide range of business organizations worldwide. Just as the integrity of the numbers matters for business, it matters at least as much at not-for-profit organizations. Proper control and reporting help ensure that money is used the way donors intended.

Donors are less inclined to give to an organization if they think the organization is subject to waste or theft. The accounting challenges of some large international not-for-profits rival those of the world's largest businesses. For example, after the Haitian earthquake, the Haitian-born musician Wyclef Jean was criticized for the poor accounting controls in a relief fund that he founded. In response, he hired a new accountant and improved the transparency regarding money raised and spent.

What benefits does a sound accounting system provide to a not-for-profit organization? (Go to [WileyPLUS](#) for this answer and additional questions.)

# Generally Accepted Accounting Principles

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# Generally Accepted Accounting Principles

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## Generally Accepted Accounting Principles (GAAP) –

Standards that are generally accepted and universally practiced. These standards indicate how to report economic events.

### Standard-setting bodies:

- ▶ **Financial Accounting Standards Board (FASB)**
- ▶ **Securities and Exchange Commission (SEC)**
- ▶ **International Accounting Standards Board (IASB)**

### International Note



Over 100 countries use International Financial Reporting Standards (called IFRS). For example, all companies in the European Union follow international standards. The differences between U.S. and international standards are not generally significant.

# Measurement Principles

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**HISTORICAL COST PRINCIPLE** (or cost principle) dictates that companies record assets at their cost.

**FAIR VALUE PRINCIPLE** states that assets and liabilities should be reported at fair value (the price received to sell an asset or settle a liability).

Selection of which principle to follow generally relates to trade-offs between **relevance** and **faithful representation**.

## **Helpful Hint**

*Relevance and faithful representation* are two primary qualities that make accounting information useful for decision-making.

# Assumptions

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**MONETARY UNIT ASSUMPTION** requires that companies 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**



# Forms of Business Ownership

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## Proprietorship

- ◆ Owned by one person
- ◆ Owner is often manager/operator
- ◆ 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

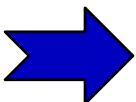
- ◆ Ownership divided into shares of stock
- ◆ Separate legal entity organized under state corporation law
- ◆ Limited liability

# Assumptions

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## Question

Combining the activities of Kellogg and General Mills would violate the

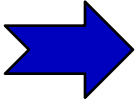
- a. cost principle.
-  b. economic entity assumption.
- c. monetary unit assumption.
- d. ethics principle.

# Assumptions

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## Question

A business organized as a separate legal entity under state law having ownership divided into shares of stock is a

- a. proprietorship.
- b. partnership.
-  c. corporation.
- d. sole proprietorship.

**Indicate whether each of the following statements presented below is **true** or **false**.**

1. Congress passed the Sarbanes-Oxley Act to reduce unethical behavior and decrease the likelihood of future corporate scandals.
2. The primary accounting standard-setting body in the United States is the Financial Accounting Standards Board (FASB).
3. The historical cost principle dictates that companies record assets at their cost. In later periods, however, the fair value of the asset must be used if fair value is higher than its cost.

**True****True****False**

Indicate whether each of the following statements presented below is **true** or **false**.

4. Relevance means that financial information matches what really happened; the information is factual.
5. A business owner's personal expenses must be separated from expenses of the business to comply with accounting's economic entity assumption.

**False****True**

State the accounting equation, and define its components.

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

## Basic Accounting Equation

- ◆ Provides the **underlying framework** for recording and summarizing economic events.
- ◆ Assets are claimed by either creditors or owners.
- ◆ If a business is liquidated, claims of creditors must be paid before ownership claims.

# Basic Accounting Equation

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

## Assets

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



# Basic Accounting Equation

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

## Liabilities

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

# Basic Accounting Equation

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

## Owner's Equity

- ◆ Ownership claim on total assets.
- ◆ Referred to as residual equity.
- ◆ Investment by owners and revenues (+)
- ◆ Drawings and expenses (-).

# Owner's Equity

Illustration 1-6  
Expanded accounting  
equation

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

## Increases in Owner's Equity

- ◆ **Investments by owner** are the assets the owner puts into the business.
- ◆ **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

Illustration 1-6  
Expanded accounting  
equation

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

## Decreases in Owner's Equity

- ◆ **Drawings** An owner may withdraw cash or other assets for personal use.
- ◆ **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.

Classify the following items as investment by owner, owner's drawings, revenue, or expenses. Then indicate whether each item increases or decreases owner's equity.

	<u>Classification</u>	<u>Effect on Equity</u>
1. Rent Expense	<input type="text"/>	<input type="text"/>
2. Service Revenue	<input type="text"/>	<input type="text"/>
3. Drawings	<input type="text"/>	<input type="text"/>
4. Salaries and Wages Expense	<input type="text"/>	<input type="text"/>

## Analyze the effects of business transactions on the accounting equation.

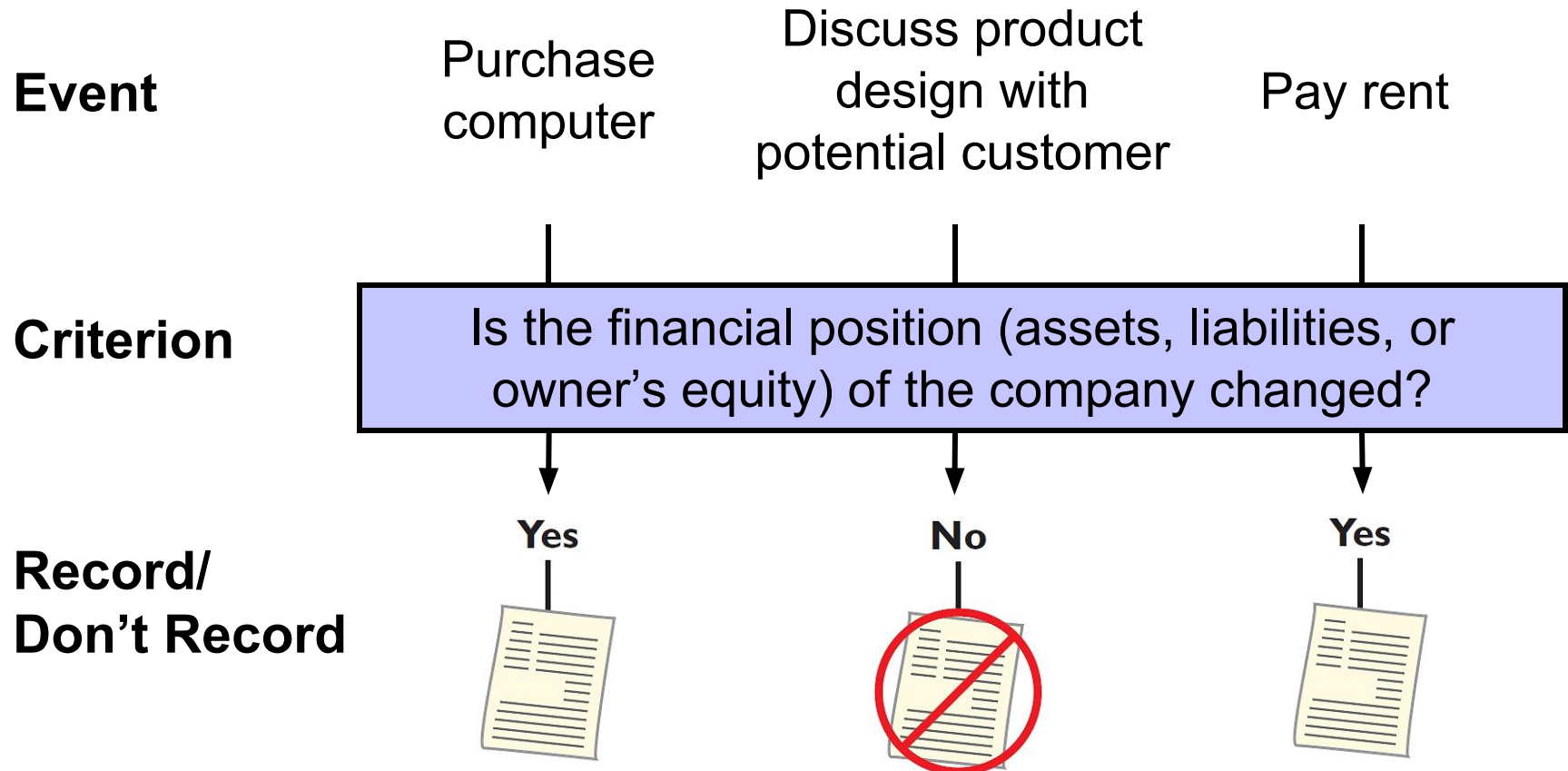
**Transactions** are a business's economic events recorded by accountants.

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

# Transaction Analysis

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

Illustration 1-7





# Transaction Analysis

**TRANSACTION 1. INVESTMENT BY OWNER** Ray Neal decides to start a smartphone app development company which he names Softbyte. On September 1, 2017, he invests **\$15,000 cash** in the business. This transaction results in an equal increase in assets and owner's equity.

	Assets				=	Liabilities + Owner's Equity											
Trans- action	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Owner's Capital	+	Owner's Drawings	+	Rev.	-	Exp.
1.	+15,000		+15,000														

## Illustration 1-8

Tabular summary of  
Softbyte transactions

## TRANSACTION 2. PURCHASE OF EQUIPMENT FOR CASH

Softbyte Inc. purchases computer equipment for **\$7,000 cash**.

Illustration 1-8

Trans- action	Assets				=	Liabilities + Owner's Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+15,000	+15,000								
2.	-7,000	+7,000								

**TRANSACTION 3. PURCHASE OF SUPPLIES ON CREDIT** Softbyte Inc. purchases for \$1,600 headsets and other accessories expected to last several months. The supplier allows Softbyte to pay this bill in October.

Illustration 1-8 **Assets = Liabilities + Owner's Equity**

Trans- action	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Owner's Capital	+	Owner's Drawings	+	Rev.	-	Exp.
1.	+15,000		+15,000														
2.	-7,000		+7,000														
3.	+1,600		+1,600														

**TRANSACTION 4. SERVICES PERFORMED FOR CASH** Softbyte Inc. receives **\$1,200 cash** from customers for app development services it has performed.

Illustration 1-8

Trans- action	Assets		= Liabilities +		Owner's Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+15,000	+15,000							
2.	-7,000	+7,000							
3.	+1,600	+1,600							
4.	+1,200		+1,200						

**TRANSACTION 5. PURCHASE OF ADVERTISING ON CREDIT** Softbyte Inc. receives a **bill for \$250** from the *Daily News* for advertising on its online website but postpones payment until a later date.

Illustration 1-8

Trans- action	Assets				=	Liabilities + Owner's Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+15,000	+15,000								
2.	-7,000	+7,000								
3.	+1,600	+1,600								
4.	+1,200		+1,200							
5.			+250			-250				

## TRANSACTION 6. SERVICES PERFORMED FOR CASH AND CREDIT.

Softbyte performs **\$3,500 of services**. The company receives **cash of \$1,500** from customers, and it bills the balance of **\$2,000 on account**.

Illustration 1-8 **Assets = Liabilities + Owner's Equity**

Trans- action	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+15,000	+15,000								
2.	-7,000	+7,000								
3.	+1,600	+1,600								
4.	+1,200		+1,200							
5.			+250			-250				
6.	+1,500	+2,000				+3,500				

**TRANSACTION 7. PAYMENT OF EXPENSES** Softbyte Inc. pays the following expenses in cash for September: office rent **\$600**, salaries and wages of employees **\$900**, and utilities **\$200**.

Illustration 1-8

Trans- action	Assets				= Liabilities + Owner's Equity					
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.	
1.	+15,000	+15,000								
2.	-7,000	+7,000								
3.	+1,600	+1,600								
4.	+1,200		+1,200							
5.			+250		-250					
6.	+1,500	+2,000			+3,500					
7.	-1,700					-600				
					-900					
					-200					



**TRANSACTION 8. PAYMENT OF ACCOUNTS PAYABLE** Softbyte Inc. pays its \$250 *Daily News* bill in cash. The company previously (in Transaction 5) recorded the bill as an increase in Accounts Payable.

Illustration 1-8 **Assets = Liabilities + Owner's Equity**

Trans- action	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+15,000	+15,000								
2.	-7,000	+7,000								
3.	+1,600	+1,600								
4.	+1,200		+1,200							
5.			+250			-250				
6.	+1,500	+2,000				+3,500				
7.	-1,700						-600			
						-900				
						-200				
8.	-250		-250							

**TRANSACTION 9. RECEIPT OF CASH ON ACCOUNT** Softbyte Inc.  
**receives \$600 in cash** from customers who had been billed for services  
(in Transaction 6).

Illustration 1-8

Trans- action	Assets = Liabilities + Owner's Equity									
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+15,000	+15,000								
2.	-7,000	+7,000								
3.	+1,600	+1,600								
4.	+1,200		+1,200							
5.			+250			-250				
6.	+1,500	+2,000				+3,500				
7.	-1,700						-600			
						-900				
						-200				
8.	-250		-250							
9.	+600	-600								

# TRANSACTION 10. WITHDRAWAL OF CASH BY OWNER Ray Neal withdraws \$1,300 in cash in cash from the business for his personal use.

Illustration 1-8 **Assets = Liabilities + Owner's Equity**

Trans- action	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+15,000	+15,000								
2.	-7,000	+7,000								
3.	+1,600	+1,600								
4.	+1,200		+1,200							
5.			+250			-250				
6.	+1,500	+2,000				+3,500				
7.	-1,700						-600			
						-900				
						-200				
8.	-250		-250							
9.	+600	-600								
10.	-1,300					-1,300				

\$1,300

# Summary of Transactions

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1. Each transaction is analyzed in terms of its effect on:
  - a. The three components of the basic accounting equation.
  - b. Specific of items within each component.
2. The two sides of the equation must always be equal.

Transactions made by Virmari & Co., a public accounting firm, for the month of August are shown below. Prepare a tabular analysis which shows the effects of these transactions on the expanded accounting equation, similar to that shown in Illustration 1-8.

1. The owner invested \$25,000 cash in the business.
2. The company purchased \$7,000 of office equipment on credit.
3. The company received \$8,000 cash in exchange for services performed.
4. The company paid \$850 for this month's rent.
5. The owner withdrew \$1,000 cash for personal use.

1. The owner invested \$25,000 cash in the business.

Trans- action	Assets		=	Liabilities		+	Owner's Equity				
	Cash	+ Equipment	=	Accounts Payable	+	Owner's Capital	+	Owner's Drawings	+	Rev.	- Exp.
1.	+25,000			+25,000							

**2. The company purchased \$7,000 of office equipment on credit.**

Trans- action	Assets		=	Liabilities		+	Owner's Equity				
	Cash	+ Equipment	=	Accounts Payable	+	Owner's Capital	+	Owner's Drawings	+	Rev.	- Exp.
1.	+25,000			+25,000							
2.		+7,000		+7,000							

3. The company received \$8,000 cash in exchange for services performed.

Trans- action	Assets		=	Liabilities		+	Owner's Equity				
	Cash	+ Equipment	=	Accounts Payable	+	Owner's Capital	+	Owner's Drawings	+	Rev.	- Exp.
1.	+25,000			+25,000							
2.		+7,000		+7,000							
3.	+8,000					+8,000					



4. The company paid \$850 for this month's rent.

Trans- action	Assets		=	Liabilities		+	Owner's Equity				
	Cash	+ Equipment	=	Accounts Payable	+	Owner's Capital	+	Owner's Drawings	+	Rev.	- Exp.
1.	+25,000			+25,000							
2.		+7,000		+7,000							
3.	+8,000			+8,000							
4.	-850			-850							

# DO IT!

# 4

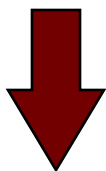
## Tabular Analysis

5. The owner withdrew \$1,000 cash for personal use.

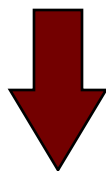
Trans- action	Assets		=	Liabilities	+	Owner's Equity			
	Cash	+ Equipment	=	Accounts Payable	+	Owner's Capital	+ Owner's Drawings	+ Rev.	- Exp.
1.	+25,000			+25,000					
2.		+7,000		+7,000					
3.	+8,000			+8,000					
4.	-850			-850					
5.	-1,000			-1,000					
	<u>\$31,150</u>	<u>\$7,000</u>		<u>\$7,000</u>	<u>\$25,000</u>	<u>+ \$1,000</u>	<u>\$8,000</u>	<u>\$850</u>	<u>-</u>
	<u>\$38,150</u>			<u>\$38,150</u>					

## Describe the four financial statements and how they are prepared.

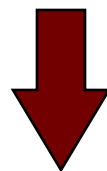
**Companies prepare four financial statements :**



**Income  
Statement**



**Owner's  
Equity  
Statement**



**Balance  
Sheet**



**Statement  
of Cash  
Flows**

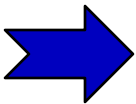
# Financial Statements

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## Question

Net income will result during a time period when:

- a. assets exceed liabilities.
- b. assets exceed revenues.
- c. expenses exceed revenues.
- d. revenues exceed expenses.



# Financial Statements

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

## SOFTBYTE Income Statement For the Month Ended September 30, 2017

Revenues		
Service revenue		\$ 4,700
Expenses		
Salaries and wages expense	\$900	
Rent expense	600	
Advertising expense	250	
Utilities expense	<u>200</u>	
Total expenses		<u>1,950</u>
Net income		<u><b>\$ 2,750</b></u>

**Illustration 1-9**  
Financial statements and  
their interrelationships

## SOFTBYTE Owner's Equity Statement For the Month Ended September 30, 2017

Owner's capital, September 1		\$ -0-
Add: Investments	\$15,000	
Net income	<u><b>2,750</b></u>	<u>17,750</u>
		17,750
Less: Drawings		<u>1,300</u>
Owner's capital, September 30		<u><b>\$16,450</b></u>

1

**SOFTBYTE**  
Owner's Equity Statement  
For the Month Ended September 30, 2017

Owner's capital, September 1		\$ -0-
Add: Investments	\$15,000	
Net income	<u>2,750</u>	17,750
		17,750
Less: Drawings		<u>1,300</u>
Owner's capital, September 30		<u><b>\$16,450</b></u>

**SOFTBYTE**  
Balance Sheet  
September 30, 2017

<u>Assets</u>		
— Cash		<b>\$ 8,050</b>
Accounts receivable		1,400
Supplies		1,600
Equipment		<u>7,000</u>
Total assets		<u><b>\$ 18,050</b></u>
<u>Liabilities and Owner's Equity</u>		
Liabilities		
Accounts payable		\$ 1,600
Owner's equity		
Owner's capital		<u><b>16,450</b></u>
Total liabilities and owner's equity		<u><b>\$ 18,050</b></u>

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

**Illustration 1-9**  
Financial statements and their interrelationships

# Financial Statements

Balance sheet and income statement are needed to prepare statement of cash flows.

**Illustration 1-9**  
Financial statements and their interrelationships

SOFTBYTE Balance Sheet September 30, 2017		
<u>Assets</u>		
Cash		\$ 8,050
Accounts receivable		1,400
Supplies		1,600
Equipment		7,000
Total assets		<u>\$ 18,050</u>
<u>Liabilities and Owner's Equity</u>		
Liabilities		
Accounts payable		\$ 1,600
Owner's equity		
Owner's capital		16,450
Total liabilities and owner's equity		<u>\$ 18,050</u>
SOFTBYTE Statement of Cash Flows For the Month Ended September 30, 2017		
Cash flows from operating activities		
Cash receipts from revenues		\$ 3,300
Cash payments for expenses		<u>(1,950)</u>
Net cash provided by operating activities		1,350
Cash flows from investing activities		
Purchase of equipment		(7,000)
Cash flows from financing activities		
Investments by owner	\$15,000	
Drawings by owner	<u>(1,300)</u>	13,700
Net increase in cash		8,050
Cash at the beginning of the period		<u>0</u>
Cash at the end of the period		<u>\$ 8,050</u>

# Income Statement

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- ◆ Reports the revenues and expenses for a specific period of time.
- ◆ Lists revenues first, followed by expenses.
- ◆ Shows net income (or net loss).
- ◆ Does not include investment and withdrawal transactions between the owner and the business in measuring net income.

## Alternative Terminology

The income statement is sometimes referred to as the *statement of operations*, *earnings statement*, or *profit and loss statement*.



# Owner's Equity Statement

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- ◆ Reports the changes in owner's equity for a specific period of time.
- ◆ The time period is the same as that covered by the income statement.

# Balance Sheet

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- ◆ Reports the assets, liabilities, and owner's equity at a specific date.
- ◆ Lists assets at the top, followed by liabilities and owner's equity.
- ◆ Total assets must equal total liabilities and owner's equity.
- ◆ Is a snapshot of the company's financial condition at a specific moment in time (usually the month-end or year-end).

# Statement of Cash Flows

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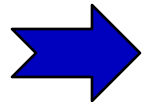
- ◆ Information on the cash receipts and payments for a specific period of time.
- ◆ Answers the following:
  - ▶ Where did cash come from?
  - ▶ What was cash used for?
  - ▶ What was the change in the cash balance?

# Financial Statements

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## 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.

## People, Planet, and Profit Insight



### Beyond Financial Statements

Should we expand our financial statements beyond the income statement, retained earnings statement, balance sheet, and state-

ment of cash flows? Some believe we should take into account ecological and social performance, in addition to financial results, in evaluating a company. The argument is that a company's responsibility lies with anyone who is influenced by its actions. In other words, a company should

be interested in benefiting many different parties, instead of only maximizing stockholders' interests.

A socially responsible business does not exploit or endanger any group of individuals. It follows fair trade practices, provides safe environments for workers, and bears responsibility for environmental damage. Granted, measurement of these factors is difficult. How to report this information is also controversial. But, many interesting and useful efforts are underway. Throughout this textbook, we provide additional insights into how companies are attempting to meet the challenge of measuring and reporting their contributions to society, as well as their financial results, to stockholders.

Why might a company's stockholders be interested in its environmental and social performance? (Go to **WileyPLUS** for this answer and additional questions)

Presented below is selected information related to Flanagan Company at December 31, 2017. Flanagan reports financial information monthly.

Equipment	\$10,000	Utilities Expense	\$ 4,000
Cash	8,000	Accounts Receivable	9,000
Service Revenue	36,000	Salaries and Wages Expense	7,000
Rent Expense	11,000	Notes Payable	16,500
Accounts Payable	2,000	Owner's Drawings	5,000

- (a) Determine the total assets of at December 31, 2017.
- (b) Determine the net income reported for December 2017.
- (c) Determine the owner's equity at December 31, 2017.

Presented below is selected information related to Flanagan Company at December 31, 2017. Flanagan reports financial information monthly.

Equipment	\$10,000	Utilities Expense	\$ 4,000
Cash	8,000	Accounts Receivable	9,000
Service Revenue	36,000	Salaries and Wages Expense	7,000
Rent Expense	11,000	Notes Payable	16,500
Accounts Payable	2,000	Owner's Drawings	5,000

**(a) Determine the total assets of at December 31, 2017.**

The total assets are \$27,000, comprised of

- Cash \$8,000,
- Accounts Receivable \$9,000, and
- Equipment \$10,000.

Presented below is selected information related to Flanagan Company at December 31, 2017. Flanagan reports financial information monthly.

Equipment	\$10,000	Utilities Expense	\$ 4,000
Cash	8,000	Accounts Receivable	9,000
Service Revenue	36,000	Salaries and Wages Expense	7,000
Rent Expense	11,000	Notes Payable	16,500
Accounts Payable	2,000	Owner's Drawings	5,000

**(b) Determine the net income reported for December 2017.**

Revenues		
Service revenue		\$36,000
Expenses		
Rent expense	\$11,000	
Salaries and wages expense	7,000	
Utilities expense	4,000	
	<hr/>	
Total expenses		22,000
		<hr/>
Net income		\$14,000
		<hr/>



Presented below is selected information related to Flanagan Company at December 31, 2017. Flanagan reports financial information monthly.

Equipment	\$10,000	Utilities Expense	\$ 4,000
Cash	8,000	Accounts Receivable	9,000
Service Revenue	36,000	Salaries and Wages Expense	7,000
Rent Expense	11,000	Notes Payable	16,500
Accounts Payable	2,000	Owner's Drawings	5,000

**(c) Determine the owner's equity at December 31, 2017.**

Total assets [as computed in (a)]		\$27,000
Less: Liabilities		
Notes payable	\$16,500	
Accounts payable	<u>2,000</u>	<u>18,500</u>
Owner's equity		<u><u>\$ 8,500</u></u>

## APPENDIX 1A: Explain the career opportunities in accounting.

### Public Accounting

Careers in auditing, taxation, and management consulting serving the general public.

### Private Accounting

Careers in industry working in cost accounting, budgeting, accounting information systems, and taxation.

### Governmental Accounting

Careers with the IRS, the FBI, the SEC, public colleges and universities, and in state and local governments.

### Forensic Accounting

Uses accounting, auditing, and investigative skills to conduct investigations into theft and fraud.

# “Show Me the Money”

## Salary estimates for jobs in public and corporate accounting

Illustration 1A-1

<u>Employer</u>	<u>Jr. Level (0–3 yrs.)</u>	<u>Sr. Level (4–6 yrs.)</u>
Public accounting (large firm)	\$51,500–\$74,250	\$71,000–\$92,250
Public accounting (small firm)	\$42,500–\$60,500	\$57,000–\$74,000
Corporate accounting (large company)	\$41,750–\$68,500	\$67,000–\$86,500
Corporate accounting (small company)	\$37,000–\$56,750	\$52,750–\$68,500

## Upper-level management salaries in corporate accounting

Illustration 1A-2

<u>Position</u>	<u>Large Company</u>	<u>Small to Medium Company</u>
Chief financial officer	\$189,750–\$411,000	\$96,750–\$190,500
Corporate controller	\$128,000–\$199,000	\$82,750–\$144,750
Tax manager	\$100,250–\$142,500	\$79,500–\$110,750



# A Look at IFRS

## LEARNING OBJECTIVE

7

**Describe the impact of international accounting standards on U.S. financial reporting.**

## Key Points

Following are the key similarities and differences between GAAP and IFRS as related to accounting fundamentals.

### Similarities

- ◆ The basic techniques for recording business transactions are the same for U.S. and international companies.
- ◆ Both international and U.S. accounting standards emphasize transparency in financial reporting. Both sets of standards are primarily driven by meeting the needs of investors and creditors.



# A Look at IFRS

## Key Points

### Similarities

- ◆ The three most common forms of business organizations, proprietorships, partnerships, and corporations, are also found in countries that use international accounting standards.

### Differences

- ◆ International standards are referred to as International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board. Accounting standards in the United States are referred to as generally accepted accounting principles (GAAP) and are developed by the Financial Accounting Standards Board.



# A Look at IFRS

## Key Points

### Differences

- ◆ IFRS tends to be simpler in its accounting and disclosure requirements; some people say it is more “principles-based.” GAAP is more detailed; some people say it is more “rules-based.”
- ◆ The internal control standards applicable to Sarbanes-Oxley (SOX) apply only to large public companies listed on U.S. exchanges. There is continuing debate as to whether non-U.S. companies should have to comply with this extra layer of regulation.



# A Look at IFRS

## Looking to the Future

Both the IASB and the FASB are hard at work developing standards that will lead to the elimination of major differences in the way certain transactions are accounted for and reported.



# A Look at IFRS

## IFRS Self-Test Questions

Which of the following is **not** a reason why a single set of high-quality international accounting standards would be beneficial?

- a) Mergers and acquisition activity.
- b) Financial markets.
- c) Multinational corporations.
- ➡ d) GAAP is widely considered to be a superior reporting system.

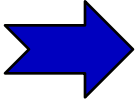




# A Look at IFRS

## IFRS Self-Test Questions

The Sarbanes-Oxley Act determines:

- a) international tax regulations.
- b) internal control standards as enforced by the **IASB**.
-  c) internal control standards of U.S. publicly traded companies.
- d) U.S. tax regulations.



# A Look at IFRS

## IFRS Self-Test Questions

**IFRS** is considered to be more:

- ➔ a) principles-based and less rules-based than **GAAP**.
- b) rules-based and less principles-based than **GAAP**.
- c) detailed than **GAAP**.
- d) None of the above.

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