

1 Chapter 1: Accounting in Action

in the aggregate accumulate transactions of the same type over a certain period and report the data as one amount in the company's financial statements

accounting the entire process of identifying, recording, and communicating economic events (bookkeeping is part of recording only)

Who uses accounting data?

Internal users

Managerial accounting provides internal reports to help users make decisions about their companies

- Management
- Employees

External users (investors and creditors, etc.)

Financial accounting provides economic and financial information for investors, creditors, and other external users

- Lenders
- Investors
- Competitors
- Government agencies
- IRS: SEC:
- The press

Measurement principles (used by IFRS)

- **[IMPT]** Follow trade-offs between **relevance** (makes a difference in decision making) and **faithful representation** (factual and accurate)
- **[IMPT]** Enhancing qualitative characteristics (**Comparability, Verifiability, Timeliness, Understandability**)
- **Historical cost** principle: record assets at their initial cost when it was purchased
- **Fair value** principle: assets and liabilities should be reported at fair value (price received to sell an asset or settle a liability)
 - Only used when assets are actively traded, otherwise rarely used
 - Also used when market value info is available for certain assets

Accounting assumptions

- **Monetary unit** assumption: include only data that can be expressed in money terms
- **Economic entity** assumption: activities of the entity are separate and distinct from the activities of its owner and all other economic entities
 - Proprietorship
 - * owned by **one** person
 - * the owner receives any profits and suffers any losses
 - * the owner has **unlimited liability** (liable for all debts of business)
 - * **no legal distinction** between the business as an economic unit and the owner
 - * Accounting records of the business activities are kept **separate** from owner's personal records
 - Partnership
 - * owned by **two or more** persons associated as

partners

- * each owner has **unlimited personal liability**
- * for accounting purposes, partnership transactions are kept **separate** from personal activities
- Corporation
 - * **separate legal identity** under corporation law
 - * ownership is divided into **transferable shares**: shareholders may transfer part or all of their ownership shares to other investors at any time
 - * holders of shares enjoy **limited liability**
 - * **Unlimited life**; ownership can be transferred without dissolving the corporation

1.1 The Basic Accounting Equation

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

Assets: A resource controlled by the entity in the *present* due to *past* event that will give rise to *future* benefits

- Cash
- Accounts Receivable
- Supplies
- Equipment

Liabilities: A *present* obligation arising from *past* event that is expected to lead to a *future* outflow of resources upon settlement

- accounts payable: purchase commodities/equipment on credit from suppliers
- note payable: money borrowed
- salaries/wages payable
- sales and real estate taxes payable
- **[IMPT]** Example: claim from an employee due to workplace accident which is highly likely to be settled in the future

Equity: the ownership claim on a company (residual equity after creditors' claims are satisfied)

- **Share capital-ordinary:** paid in by shareholders in exchange for the ordinary shares they purchase
- **Retained earnings**
 - Revenues
 - Expenses
 - Dividends: increase in net assets, available to distribute to shareholders

1.2 Financial Statements

1. **Income statement (IS)** presents the revenues and expenses and resulting net income or net loss for a specific period of time.
2. **Retained earnings statement** summarizes the changes in retained earnings for a specific period of time.
3. **Statement of financial position (SFP)** (sometimes referred to as a balance sheet) reports the assets, liabilities, and equity of a company at a specific date.
 - Current and noncurrent assets/liabilities (can be turned into cash/settled within 1 year?)
 - Preferably sorted from higher liquidity to lower

- **[IMPT]** Assets recorded at **cost/book value**, not market value
- **[IMPT]** Revenue vs Loss/Gain
Revenue:

4. **Statement of cash flows (SCF)** summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time.

$$\Delta Cash = CFO + CFI + CFF$$

5. **Statement of comprehensive income (SCI)**

presents other comprehensive income items that are not included in the determination of net income

2 Accounting Cycles

- **Prepaid rent** is an **asset**!
The benefits are not going to happen now; but will happen in the future
- **Unearned revenue** is a **liability**
Has to be settled in the future