

ACCOUNTING PRINCIPLES^{11e}



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Accounting in Action

Learning Objectives

After studying this chapter, you should be able to:

- [1] Explain what accounting is.
- [2] Identify the users and uses of accounting.
- [3] Understand why ethics is a fundamental business concept.
- [4] Explain generally accepted accounting 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.

Preview of Chapter 1

ACCOUNTING IN ACTION

What Is Accounting?	The Building Blocks of Accounting	The Basic Accounting Equation	Using the Accounting Equation	Financial Statements
<ul style="list-style-type: none">• Three activities• Who uses accounting data	<ul style="list-style-type: none">• Ethics in financial reporting• Generally accepted accounting principles• Measurement principles• Assumptions	<ul style="list-style-type: none">• Assets• Liabilities• Owner's equity	<ul style="list-style-type: none">• Transaction analysis• Summary of transactions	<ul style="list-style-type: none">• Income statement• Owner's equity statement• Balance sheet• Statement of cash flows

Accounting Principles
Eleventh Edition
Weygandt • Kimmel • Kieso

What is Accounting?

Purpose of accounting is to:

- 1. identify,**
- 2. record, and**
- 3. communicate**

the economic events of an organization to interested users.

What is Accounting?

Three Activities

Illustration 1-1
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



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.



What are the benefits to the company and to the employees of making the financial statements available to all employees? (See page 47.)

Who Uses Accounting Data

External Users



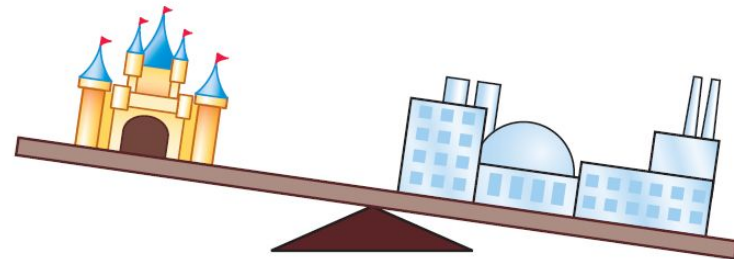
Creditors

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



Investors

Is **General Electric** earning satisfactory income?

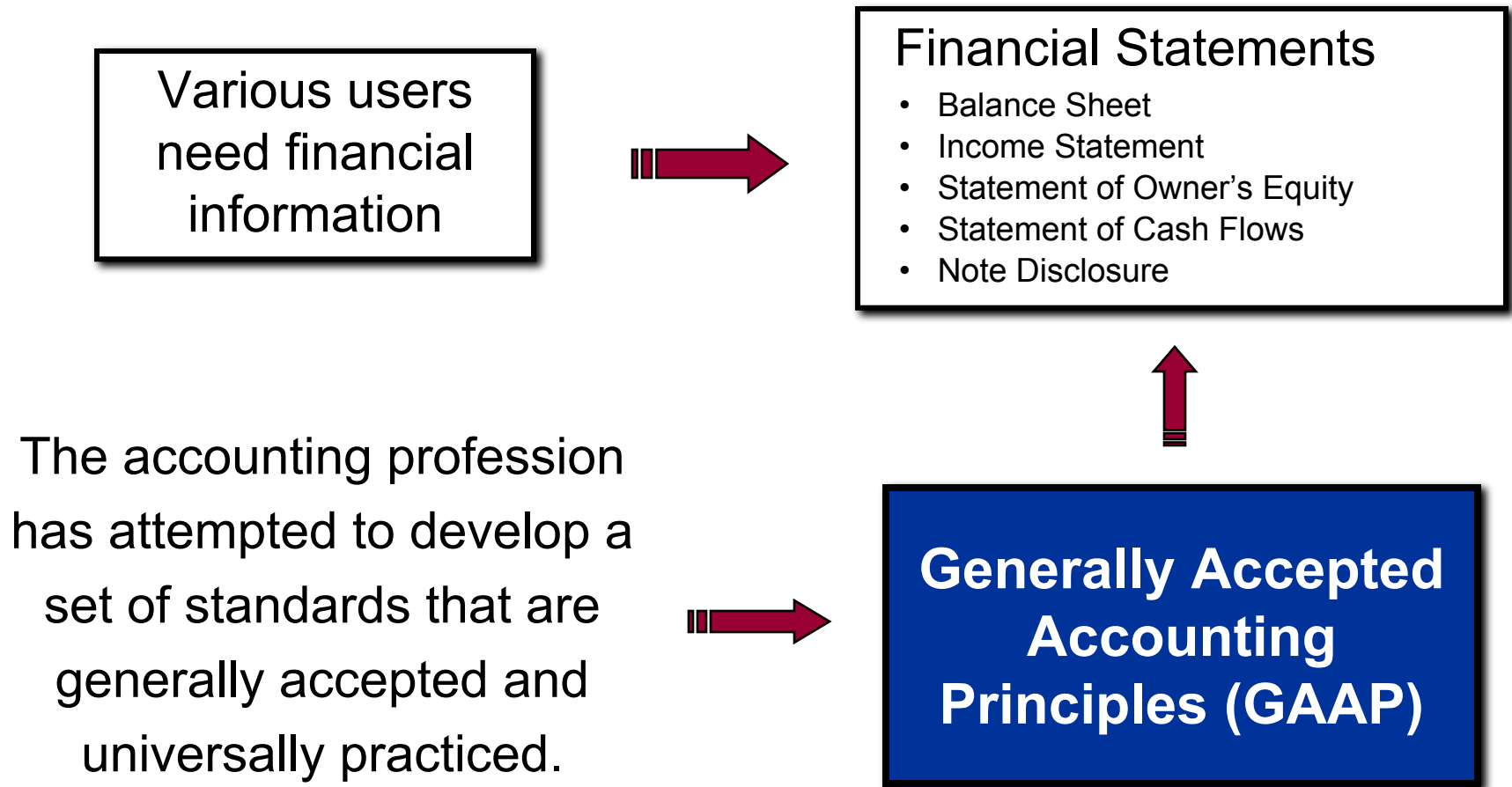


Investors

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

Illustration 1-3
Questions that external users ask

Generally Accepted Accounting Principles



Generally Accepted Accounting Principles

Generally Accepted Accounting Principles (GAAP) - A set of rules and practices, having substantial authoritative support, that the accounting profession recognizes as a general guide for financial reporting purposes.

Standard-setting bodies:

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

Generally Accepted Accounting Principles

Measurement Principles

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.

INTERNATIONAL INSIGHT



The Korean Discount

If you think that accounting standards don't matter, consider recent events in South Korea. For many years, international investors complained that the financial reports of South Korean companies were inadequate and inaccurate. Accounting practices there often resulted in huge differences between stated revenues and actual revenues. Because investors did not have faith in the accuracy of the numbers, they were unwilling to pay as much for the shares of these companies relative to shares of comparable companies in different countries. This difference in stock price was often referred to as the "Korean discount."

In response, Korean regulators decided that, beginning in 2011, companies would comply with international accounting standards. This change was motivated by a desire to "make the country's businesses more transparent" in order to build investor confidence and spur economic growth. Many other Asian countries, including China, India, Japan, and Hong Kong, have also decided either to adopt international standards or to create standards that are based on the international standards.

Source: Evan Ramstad, "End to 'Korea Discount'?" Wall Street Journal (March 16, 2007).

? What is meant by the phrase "make the country's businesses more transparent"?
Why would increasing transparency spur economic growth? (See page 48.)

Generally Accepted Accounting Principles

Assumptions

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.



Ethics Note

The importance of the economic entity assumption is illustrated by scandals involving **Adelphia**. In this case, senior company employees entered into transactions that blurred the line between the employees' financial interests and those of the company. For example, Adelphia guaranteed over \$2 billion of loans to the founding family.

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

Generally Accepted Accounting Principles

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.

Generally Accepted Accounting Principles

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.

ACCOUNTING ACROSS THE ORGANIZATION



Spinning the Career Wheel

How will the study of accounting help you? A working knowledge of accounting is desirable for virtually every field of business. Some examples of how accounting is used in business careers include:

General management: Managers of **Ford Motors**, Massachusetts General Hospital, California State University—Fullerton, a **McDonald's** franchise, and a **Trek** bike shop all need to understand accounting data in order to make wise business decisions.

Marketing: A marketing specialist at **Procter & Gamble** must be sensitive to costs and benefits, which accounting helps them quantify and understand. Making a sale is meaningless unless it is a profitable sale.

Finance: Do you want to be a banker for **Citicorp**, an investment analyst for **Goldman Sachs**, or a stock broker for **Merrill Lynch**? These fields rely heavily on accounting knowledge to analyze financial statements. In fact, it is difficult to get a good job in a finance function without two or three courses in accounting.

Real estate: Are you interested in being a real estate broker for **Prudential Real Estate**? Because a third party—the bank—is almost always involved in financing a real estate transaction, brokers must understand the numbers involved: Can the buyer afford to make the payments to the bank? Does the cash flow from an industrial property justify the purchase price? What are the tax benefits of the purchase?



How might accounting help you? (See page 48.)

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 are claimed by either creditors or owners.

Claims of creditors must be paid before ownership claims.

The Basic Accounting Equation

Assets

- ◆ Resources a business owns.
- ◆ Provide future services or benefits.
- ◆ Cash, Supplies, Equipment, etc.
- ◆ Common characteristic – the capacity to provide future services or benefits.

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

The Basic Accounting Equation

Liabilities

- ◆ Claims against assets (debts and obligations).
- ◆ Creditors - party to whom money is owed.
- ◆ Accounts payable, Notes payable, wages payable, sales tax etc.
- ◆ Creditors claims be paid before ownership claims.

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

The Basic Accounting Equation

Owner's Equity

- ◆ Ownership claim on total assets.
- ◆ Referred to as residual equity.
- ◆ Increase in equity - Investment by owners and revenues
- ◆ Decrease in equity - Drawings and expenses.

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

Owner's Equity

Illustration 1-6

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

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.

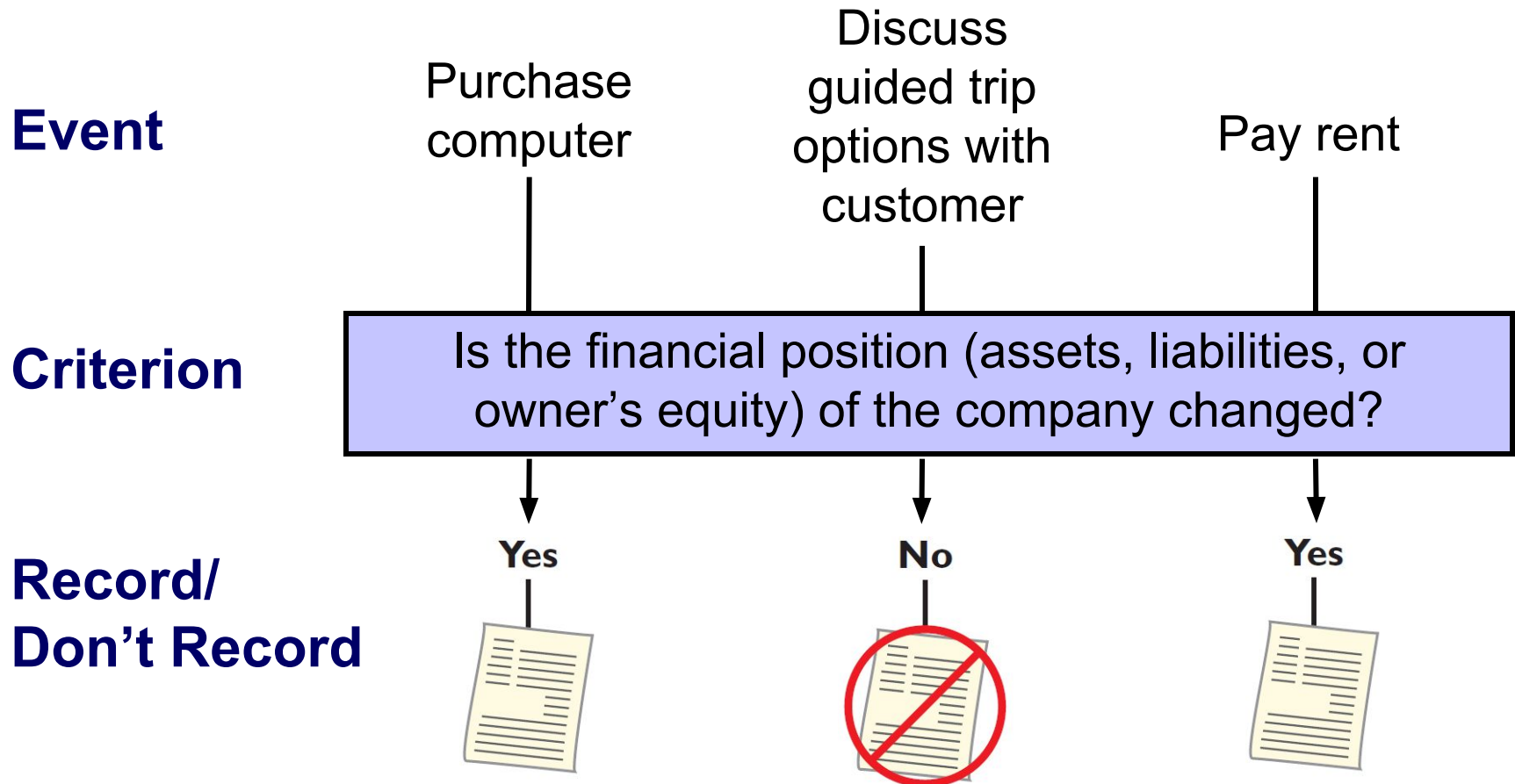
Using the Accounting Equation

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. For example, if an asset is increased, there must be a corresponding: (1) decrease in another asset, or (2) increase in a specific liability, or (3) increase in owner's equity.

Using the Accounting Equation

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



Transaction Analysis

Transaction (1): Ray Neal decides to open a computer programming service which he names Softbyte. On September 1, 2014, Ray Neal invests \$15,000 cash in the business.

	Assets				=	Liabilities	+	Owner's Equity			
	Accounts				=	Accounts	+	Owner's	Owner's	+ Rev.	- Exp.
	Cash	+ Receivable	+ Supplies	+ Equipment		Payable		Capital	- Drawings		
(1)											
(2)											
(3)											
(4)											
(5)											
(6)											
(7)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (2): Purchase of Equipment for Cash. Softbyte purchases computer equipment for \$7,000 cash.

	<u>Assets</u>				=	<u>Liabilities</u>	+	<u>Owner's Equity</u>			
	<u>Cash</u>	<u>Accounts Receivable</u>	<u>Supplies</u>	<u>Equipment</u>	=	<u>Accounts Payable</u>	+	<u>Owner's Capital</u>	-	<u>Owner's Drawings</u>	<u>Rev.</u> - <u>Exp.</u>
(1)	+\$15,000						+	\$15,000			
(2)											
(3)											
(4)											
(5)											
(6)											
(7)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (3): Softbyte purchases for \$1,600 from Acme Supply Company computer paper and other supplies expected to last several months. The purchase is made on account.

	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)											
(4)											
(5)											
(6)											
(7)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (4): Softbyte receives \$1,200 cash from customers for programming services it has provided.

	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)											
(5)											
(6)											
(7)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (5): Softbyte receives a bill for \$250 from the Daily News for advertising but postpones payment until a later date.

	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)											
(6)											
(7)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (6): Softbyte provides \$3,500 of programming services for customers. The company receives cash of \$1,500 from customers, and it bills the balance of \$2,000 on account.

	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)											
(7)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (7): Softbyte pays the following expenses in cash for September: store rent \$600, salaries of employees \$900, and utilities \$200.

	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)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (8): Softbyte pays its \$250 Daily News bill in cash.

	<u>Assets</u>				=	<u>Liabilities</u>	+	<u>Owner's Equity</u>			
	<u>Cash</u>	<u>Accounts Receivable</u>	<u>Supplies</u>	<u>Equipment</u>	=	<u>Accounts Payable</u>	+	<u>Owner's Capital</u>	-	<u>Owner's Drawings</u>	<u>Rev.</u> - <u>Exp.</u>
(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)	-600										-600
	-900										-900
	-200										-200
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (9): Softbyte receives \$600 in cash from customers who had been billed for services [in Transaction (6)].

	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)	-600										-600
	-900										-900
	-200										-200
(8)	-250					-250					
(9)											
(10)											

Transaction Analysis

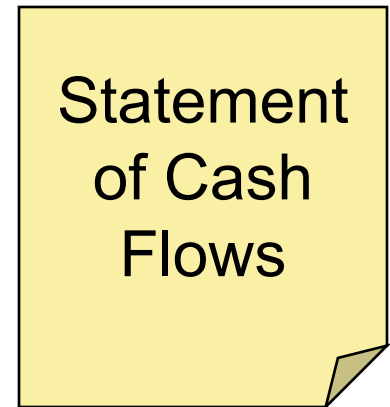
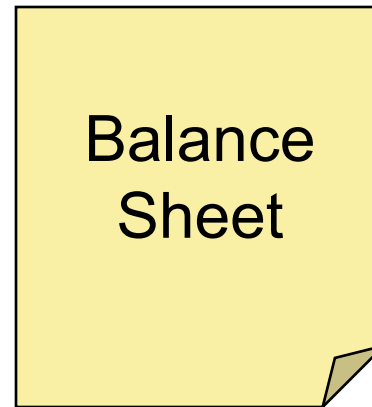
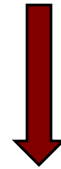
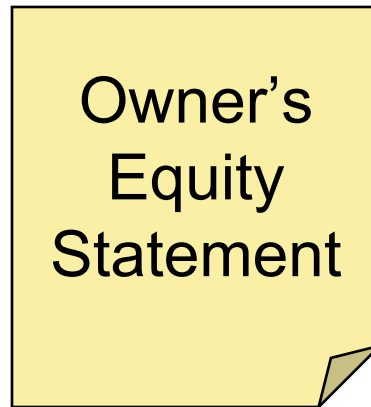
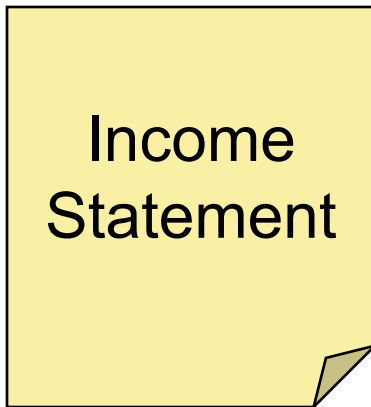
Transaction (10): Ray Neal withdraws \$1,300 in cash from the business for his personal use.

Illustration 1-8
Tabular summary of
Softbyte transactions

	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)	-600										-600
	-900										-900
	-200										-200
(8)	-250					-250					
(9)	+600	-600									
(10)											

Financial Statements

Companies prepare **four** financial statements :



Financial Statements

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, 2014

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

Illustration 1-9
Financial statements and
their interrelationships



SOFTBYTE Owner's Equity Statement For the Month Ended September 30, 2014

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

1

Financial Statements

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

 SOFTBYTE Owner's Equity Statement For the Month Ended September 30, 2014			1
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><u>\$16,450</u></u>	
 SOFTBYTE Balance Sheet September 30, 2014			
<u>Assets</u>			
Cash		\$ 8,050	
Accounts receivable		1,400	
Supplies		1,600	
Equipment		<u>7,000</u>	
Total assets		<u><u>\$ 18,050</u></u>	
<u>Liabilities and Owner's Equity</u>			
Liabilities			
Accounts payable		\$ 1,600	
Owner's equity			
Owner's capital		<u>16,450</u>	
Total liabilities and owner's equity		<u><u>\$ 18,050</u></u>	

Illustration 1-9

Financial Statements

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



 SOFTBYTE Balance Sheet September 30, 2014		
<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		<u>16,450</u>
Total liabilities and owner's equity		<u>\$ 18,050</u>
 SOFTBYTE Statement of Cash Flows For the Month Ended September 30, 2014		
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>	<u>13,700</u>
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>

Illustration 1-9

Financial Statements

Income Statement

- ◆ Reports the revenues and expenses for a specific period of time.
- ◆ Lists revenues first, followed by expenses.
- ◆ Shows net income (or net loss).

Alternative Terminology

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

Financial Statements

Owner's Equity Statement

- ◆ 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.

Financial Statements

Balance Sheet

- ◆ 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).

Financial Statements

Statement of Cash Flows

- ◆ 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?

Helpful Hint The income statement, owner's equity statement, and statement of cash flows are all for a *period* of time, whereas the balance sheet is for a *point* in time.

PEOPLE, PLANET, AND PROFIT INSIGHT



Beyond Financial Statements

Should we expand our financial statements beyond the income statement, owner's equity statement, balance sheet, and statement 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? (See page 48.)

Financial Statements

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.

APPENDIX 1A Accounting Career Opportunities

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.

Government

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

Forensic Accounting

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



A Look at IFRS

Key Points

- ◆ International standards are referred to as International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board (IASB).
- ◆ Recent events in the global capital markets have underscored the importance of financial disclosure and transparency not only in the United States but in markets around the world. As a result, many are examining which accounting and financial disclosure rules should be followed. As indicated in the graphic on the next page, much of the world has voted for the standards issued by the IASB. Over 115 countries require or permit use of IFRS.



A Look at IFRS

Key Points

- ◆ U.S standards, referred to as generally accepted accounting principles (GAAP), are developed by the Financial Accounting Standards Board (FASB). The fact that there are differences between what is in this textbook (which is based on U.S. standards) and IFRS should not be surprising because the FASB and IASB have responded to different user needs. In some countries, the primary users of financial statements are private investors; in others, the primary users are tax authorities or central government planners. It appears that the United States and the international standard-setting environment are primarily driven by meeting the needs of investors and creditors.



A Look at IFRS

Key Points

- ◆ The internal control standards applicable to Sarbanes-Oxley (SOX) apply only to large public companies listed on U.S. exchanges. There is a continuing debate as to whether non-U.S. companies should have to comply with this extra layer of regulation. Debate about international companies (non-U.S.) adopting SOX-type standards centers on whether the benefits exceed the costs. The concern is that the higher costs of SOX compliance are making the U.S. securities markets less competitive.
- ◆ The textbook mentions a number of ethics violations, such as Enron, WorldCom, and AIG. These problems have also occurred internationally, for example, at Satyam Computer Services (India), Parmalat (Italy), and Royal Ahold (the Netherlands).



A Look at IFRS

Key Points

- ◆ IFRS tends to be simpler in its accounting and disclosure requirements; some people say more “principles-based.” GAAP is more detailed; some people say it is more “rules-based.” This difference in approach has resulted in a debate about the merits of “principles-based” versus “rules-based” standards.
- ◆ U.S. regulators have recently eliminated the need for foreign companies that trade shares in U.S. markets to reconcile their accounting with GAAP.



A Look at IFRS

Key Points

- ◆ The three most common forms of business organization, proprietorships, partnerships, and corporations, are also found in countries that use IFRS. Because the choice of business organization is influenced by factors such as legal environment, tax rates and regulations, and degree of entrepreneurism, the relative use of each form will vary across countries.
- ◆ The conceptual framework that underlies IFRS is very similar to that used to develop GAAP. The basic definitions provided in this textbook for the key elements of financial statements, that is, assets, liabilities, equity, revenues (referred to as income), and expenses, are simplified versions of the official definitions provided by the FASB.



A Look at IFRS

Looking into 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. In fact, at one time the IASB stated that no new major standards would be issued for a period of time. The major reason for this policy was to provide companies the time to translate and implement IFRS into practice, as much has happened in a very short period of time. Consider, for example, that as a result of a joint project on the conceptual framework, the definitions of the most fundamental elements (assets, liabilities, equity, revenues, and expenses) may actually change. However, whether the IASB adopts internal control provisions similar to those in SOX remains to be seen.

LO 10 Describe the impact of international accounting standards on U.S. financial reporting.



A Look at IFRS

IFRS Practice

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 Practice

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 Practice

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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