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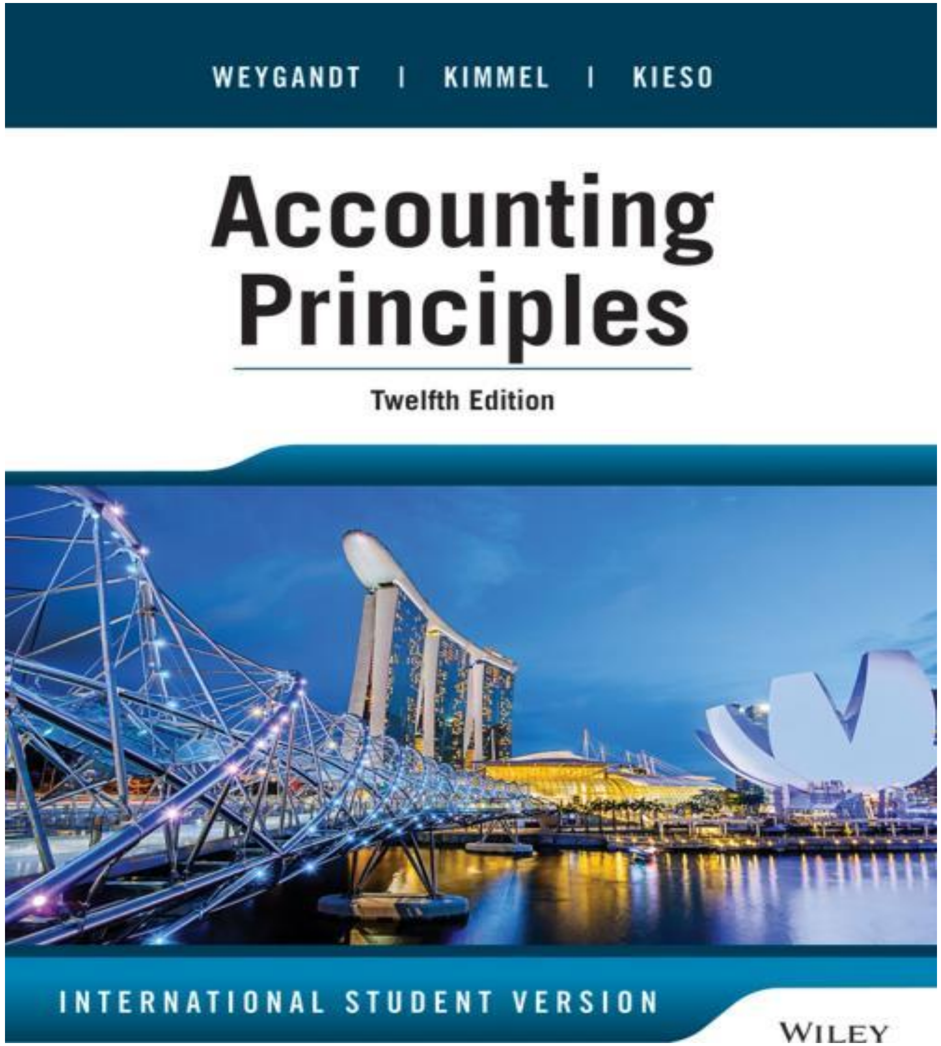


By Weygandt, Kimmel, and Kieso

Accounting

What is accounting?

Accounting is an information system that identifies records and communicates economic events to the interested users.

History of Accounting

2500 B.C.

Historical accounting records have been found in ancient civilizations like the Egyptian, Roman, and Greek Empires as well as ancient Arabia. Back then, rulers kept accounting records for taxing and spending on public works.

1000 B.C.

The Phoenicians created an alphabet with accounting so that they were not cheated through trades with ancient Egyptians.

500 B.C.

Egyptians carried on with accounting records. They even invented the first bead and wire abacus.

423 B.C.

The auditing profession was born to double check storehouses as to what came in and out the door. The reports accountants took were given orally, hence the name "auditor."

1200 – 1493

The first requirement for businesses to keep accounting records spread across many of the Italian Republics in the 13th century.

1494

Luca Pacioli, the father of accounting, writes his famous paper “Summa de Arithmetica, Geometria, Proportioni et Proportionalita.” i.e.
“Everything about Arithmetic, Geometry, and Proportion.”
The first person to publish a work on double-entry bookkeeping, and introduced the field in Italy.

1500 – 1700

Double entry records had large and small innovations added. New terms like

-invested capital

-dividend distribution

-managerial accounting, etc. came to light

1700 – 1900

During the Industrial Revolution, accounting really took a new form to be used in industrial companies.

1920 – 1940

The 20s accounting really became important to reduce the amount of fraud and scandals that were performed in businesses around the country. U.S. GAAP was developed shortly after by the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB) in the year 1939.

1940 – Present

Since this time the AICPA and FASB have been working together with the Securities Exchange Commission (SEC) to develop accounting standards for business.

CHAPTER 1

Basics of Accounting

What is accounting?

Accounting is an information system that identifies records and communicates economic events to the interested users.

Three Activities of Accounting

Identification

To identify economic events, a company selects the economic events relevant to its business. Examples of economic events are the sale of snack chips by PepsiCo, providing of telephone services by Teletalk, and payment of wages by Ford Motor Company.

Recording, classifying and Summarizing

Once a company like PepsiCo identifies economic events, it records those events in order to provide a history of its financial activities. Recording consists of keeping a systematic, chronological diary of events, measured in dollars and cents. In recording, PepsiCo also classifies and summarizes economic events.

Communication

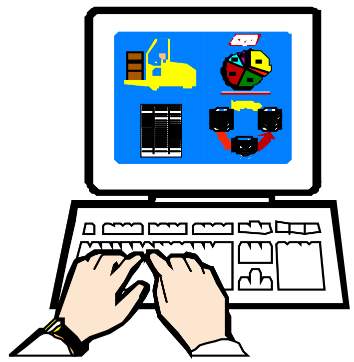
Finally, the enterprise communicates the collected information to interested users by means of accounting reports. The most common of these reports are called financial statements.

THE ACCOUNTING PROCESS

Identification

Select economic events (transactions)

Recording



Record, classify, and summarize

Communication

Prepare accounting reports

Analyse and interpret for users

Interested users of accounting information

The financial information that users need depends upon the kinds of decision they make. Their diversified decision making and different need for information classify themselves in two broad groups.

They are-

- Internal Users
- External users

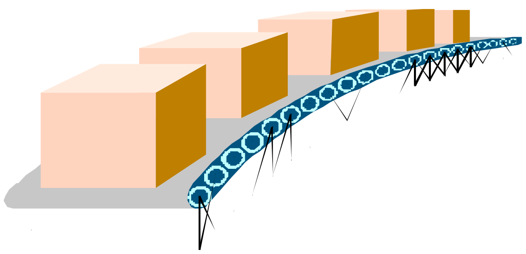
Internal Users

Internal Users of accounting information are those who plan, organize and run the business. They are-

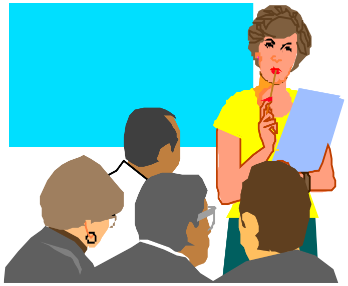
- Manager
- Marketing manager
- Production supervisor
- Finance directors and
- Company officers.

QUESTIONS ASKED BY INTERNAL USERS

Is cash sufficient to pay bills?



What is the cost of manufacturing each unit of product?



Can we afford to give employees pay raises this year?

Which product line is the most profitable?

External Users

External users are individuals and organizations outside a company who want financial information about the company.

Two common external users are-

- Investor
- creditors.

Moreover the external seekers of accounting information are-

Taxing authority
Regulatory agencies
Customer
labor unions etc.

QUESTIONS ASKED BY EXTERNAL USERS

How does the company compare in size and profitability with its competitors?

Is the company earning satisfactory income?

What do we do if they catch us?

Will the company be able to pay its debts as they come due?

Explaining the building blocks of accounting

Ethics

Principles

Assumptions

Ethics

The standards of conduct by which action are judged as right or wrong, honest or dishonest, fair and not fair are ethics.

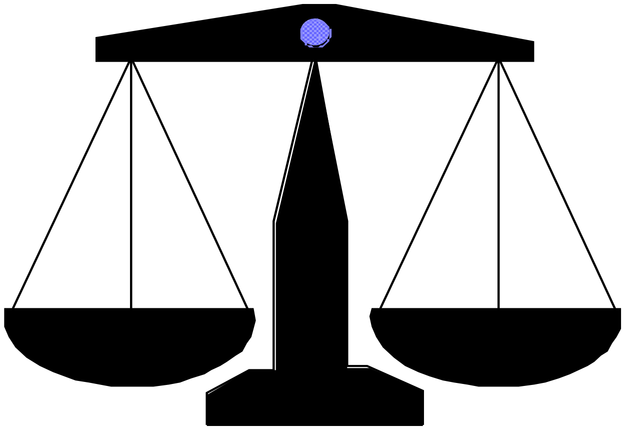
Even effective financial reporting depends on sound ethical behavior.

When analyzing various ethics cases it is useful to apply the three steps.

ETHICS

Ethics

- Standards of conduct



To Solve Ethical Dilemma

1. Recognize situation and ethical issues involved
2. Identify and analyse elements
3. Identify alternatives and weigh effects on stakeholders

Generally Accepted Accounting Principles

The accounting profession has developed a common set of standards that are generally accepted and universally practiced. This standards is called **generally accepted accounting principles (GAAP)**.

Principles

Cost/ Historical Cost Principle
Fair Value Principle

Cost/ Historical Cost Principle

The **cost principle** is one of the basic underlying guidelines in accounting. It is also known as the historical **cost principle**. The **cost principle** requires that assets be recorded at the cash amount (or its equivalent) at the time that an asset is acquired.

Fair value principle

Fair value is a rational and unbiased estimate of the potential market price of a good, service, or asset.

Fair value principles states that assets and liabilities should be reported in fair value or market value.

Why cost? or
Why fair value?

FASB used two qualities that make accounting information useful for decision making—
Reliability
Relevance

Other Principle:

Matching Principle

Revenue Recognition Principle

Full Disclosure Principle

Assumptions

Assumptions provide a foundation for the accounting process.

Two main assumptions are:

- the **monetary unit assumption**
- the **economic entity assumption**.

The monetary unit assumption

The **monetary unit assumption requires that companies include in the accounting** records only transaction data that can be expressed in money terms.

•It enables accounting to quantify (measure) economic events.

•prevents the inclusion of some irrelevant information in the accounting records.

Economic Entity Assumption

The **economic entity assumption requires that the activities** of the entity be kept separate and distinct from the activities of its owner and all other economic entities.

Economic Entity

An economic entity can be any organization or unit in society.

Example:

a company

a governmental unit

a municipality

a school district, or

a church

Other Assumptions:

Time Period Assumption
Going Concern Assumption

BUSINESS ENTERPRISES

- A business owned by one person is generally a proprietorship (owner’s equity).
- A business owned by two or more persons associated as partners is a partnership (partners’ equity).
- A business organized as a separate legal entity under corporation law and having ownership divided into transferable shares is called a corporation (shareholders’ equity).

BASIC ACCOUNTING EQUATION

The Basic Accounting Equation

Assets = **Liabilities** + **Owner's Equity**

ASSETS

- Assets are resources owned by a business.
- Assets has the capacity to provide future services or benefits
- They are things of value used in carrying out such activities as production and exchange.

These service potential or future economic benefit eventually results in cash inflows.

LIABILITIES

- Liabilities are claims against assets.
- They are existing debts and obligations.

These economic activities result in payables

OWNER'S EQUITY

- Owner's Equity is equal to total assets minus total liabilities.
- Owner's Equity represents the ownership claim on total assets.
- Subdivisions of Owner's Equity:
  1. Capital- (Increase)
  2. Drawings- (decrease)
  3. Revenues- (Increase)
  4. Expenses- (decrease)

INVESTMENTS BY OWNERS

- Investments by owner are the assets put into the business by the owner.
- These investments in the business increase owner's equity.

DRAWINGS

- Drawings are withdrawals of cash or other assets by the owner for personal use.
- Drawings decrease total owner's equity.

REVENUES

- Revenues are the gross increases in owner's equity resulting from business activities entered into for the purpose of earning income.
- Revenues may result from sale of merchandise, performance of services, rental of property, or lending of money.
- Revenues usually result in an increase in an asset.

EXPENSES

- Expenses are the decreases in owner's equity that result from operating the business.
- Expenses are the cost of assets consumed or services used in the process of earning revenue.
- Examples of expenses include utility expense, rent expense, and supplies expense.

Expanded Accounting Equation

Assets = Liabilities + Equity

Equity = Owner Capital − Owner Withdrawals + Revenues − Expenses

Ropidah, Haslinda, Aryati, Liana

What is a 'Transaction'

The term financial transaction is viewed as a business dealing, which involves the exchange of goods or services for value between two or more parties, firms or account.

Any event which has some monetary impact on the financial statement of the business is called as a transaction. It may result in it in the movement of value from one person to another.

Example, Softbyte purchases computer equipment for $7,000 cash.

Transaction Vs Event

Definition	A transaction is an agreement between a buyer and a seller to exchange goods, services or financial instruments.	The normal life occurrences or series of activities happening in every stage of our life
Change in financial position	Results in change in the financial position of the company.	May or may not result in change in financial position of the company.
Scope	Narrow	Wide
Money measurement	The financial changes caused by transactions must be measurable in terms of money.	Financial changes caused by events may or may not be measurable in terms of money.
Transfer of substances	As a consequence of transactions transfer of goods	Transfer of goods or services may or may not occur for an event.

Transaction Vs Event

Record	Every transaction must be recorded in the books of accounts; otherwise accurate results cannot be ascertained from the books of accounts.	It is not necessary that every event will be recorded in the books of accounts.
Evidence	Business transactions must be supported by evidence.	Transactions related to events are not always supported by evidence.
Relation	All transactions are events.	All events are not transactions.
parties	In the case of transaction two parties are must	It may or may not require two parties for the

What are the characteristics of Transactio?

Nature and Features of Accounting Transactions

1. Change in financial position
2. Measurable in terms of money
3. Dual aspect
4. Invisible transactions
5. Historical events
6. Evidence

Types / Classification of Accounting Transactions

On the basis of exchange of cash

- (a) Cash transactions.
  (b) Credit transactions.
  (c) Noncash transactions.

On the basis of institutional relationship

(a) External transactions

(b) Internal transactions.

Types / Classification of Accounting Transactions

On the basis of visibility

a) Visible transactions
b) Invisible transactions.

On the basis of objectivity

- Business transactions.
- Non-business or non-trading transactions.
- Personal transactions.

TRANSACTION ANALYSIS

TRANSACTION 1

On September 1, he invests $15,000 cash in the business, which he names Softbyte.

Trans. #	Assets			=	Liabilities	+	Owner's Equity	
					Accounts		M. Doucet,	
	Cash	Supplies	Equipment		Payable		Capital	
(1)	15,000			=			15,000	Investment

TRANSACTION 2

Softbyte purchases computer equipment for $7,000 cash.

Trans. #	Assets			= Liabilities +	Owner's Equity	
	Cash	Supplies	Equipment	Accounts Payable	M. Doucet, Capital	
	15,000				15,000	Investment
(2)	(7,000)		7,000			
Balance	8,000 +		7,000 =		15,000	

TRANSACTION 3

Softbyte purchases computer paper and supplies expected to last several months from Acme Supply Company for $1,600 on account.

Trans. #	Assets			=	Liabilities	+	Owner's Equity
	Cash	Supplies	Equipment		Accounts Payable		M. Doucet, Capital
Balance	8,000		7,000				15,000
(3)		1,600			1,600		
Balance	8,000 +	1,600 +	7,000	=	1,600	+	15,000

TRANSACTION 4

Softbyte receives $1,200 cash from customers for programming services it has provided.

NO	Assets =			Liability+ Owner's Equity			
	Cash	Supplies	Equip	A/P	Capital	Revnue	
4.	8,000 1,200	1,600	7,000	1,600	15,000	 1,200	
Balan ce	9,200	1,600	7,000	1,600	1,5000	1,200	

TRANSACTION 5

Softbyte receives a bill for $250 for advertising its business but pays the bill on a later date.

NO	Assets =			Liability+ Owner's Equity			
	Cash	Supplies	Equip	A/P	Capital	Revenu e	Expense
5.	9,200	1,600	.7,000	1,600 250	15,000	1,200	-250
Balan ce	9,200	1,600	7,000	1,850	1,5000	1,200	250

TRANSACTION 6

Softbyte provides programming services of $3,500 for customers and receives cash of $1,500, with the balance payable on account.

NO	Assets =				Liability+ Owner's Equity			
	Cash	AR	Supplies	Equip	A/P	Capital	Revenue	Expense
5.	9,200 1,500	2,000	1,600	7,000	1,850	**15,000**	1,200 3,500	-250
Balance	10,700	2,000	1,600	7,000	1,850	1,5000	4,700	250

TRANSACTION 7

Expenses paid in cash for September are store rent, $600, salaries of employees, $900, and utilities, $200.

NO	Assets =				Liability+ Owner's Equity			
	Cash	AR	Supplies	Equip	A/P	Capital	Revenue	Expense
5.	10,700 -600 -900 -200	2,000	1,600	7,000	1,850	**15,000**	4,700	-250 -600 -900 -200
Bala	9,000	2,000	1,600	7,000	1,850	1,5000	4,700	1,950

TRANSACTION 8

Softbyte pays its advertising bill of $250 in cash.

NO	Assets =				Liability+ Owner's Equity			
	Cash	AR	Suppli es	Equip	A/P	Capital	Reve nue	Expens e
5.	9,000 -250	2,000	1,600	7,000	1,850 -250	**15,000**	4,700	1,950
Bala nce	8,750	2,000	1,600	7,000	1,600	1,5000	4,700	1,950

TRANSACTION 9

The sum of $600 in cash is received from customers who have previously been billed for services in Transaction 6.

NO	Assets =				Liability+ Owner's Equity			
	Cash	AR	Supplies	Equip	A/P	Capital	Revenue	Expense
9.	8,750 600	2,000 -600	1,600	7,000	1,600	**15,000**	4,700	1,950
Balance	9,350	1,400	1,600	7,000	1,600	1,5000	4,700	1,950

TRANSACTION 10

Marc Doucet withdraws $1,300 in cash from the business for his personal use.

NO	Assets =				Liability+ Owner's Equity				
	Cash	AR	Supplies	Equip	A/P	Capital	Revenue	Expense	Drawings
10.	**9,350 - 1,300**	**1,400**	**1,600**	**7,000**	**1,600**	**1,5000**	**4,700**	**1,950**	**1,300**
Balance	**8,050**	**1,400**	**1,600**	**7,000**	**1,600**	**1,5000**	**4,700**	**1,950**	**1,300**

FINANCIAL STATEMENTS

After transactions are identified, recorded, and summarized, four financial statements are prepared from the summarized accounting data:

1. **An income statement** presents the revenues and expenses and resulting net income or net loss for a specific period of time.
2. **An owner's equity statement** summarizes the changes in owner's equity for a specific period of time.

FINANCIAL STATEMENTS

3. **A balance sheet** reports the assets, liabilities, and owner's equity at a specific date.
4. **A statement of cash flows** summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time.

Softbyte's Transactions

1. On September 1, he invests $15,000 cash in the business, which he names Softbyte.
2. Softbyte purchases computer equipment for $7,000 cash.
3. Softbyte purchases computer paper and supplies expected to last several months from Acme Supply Company for $1,600 on account.
4. Softbyte receives $1,200 cash from customers for programming services it has provided.
5. Softbyte receives a bill for $250 for advertising its business but pays the bill on a later

Softbyte's Transactions

6. Softbyte provides programming services of $3,500 for customers and receives cash of $1,500, with the balance payable on account.
7. Expenses paid in cash for September are store rent, $600, salaries of employees, $900, and utilities, $200.
8. Softbyte pays its advertising bill of $250 in cash.
9. The sum of $600 in cash is received from customers who have previously been billed for services in Transaction 6.
10. Marc Doucet withdraws $1,300 in cash from the business for his personal use.

No	Assets					Liability	Owner's Equity			
	Cash	A/R	Equi	Supp	=	A/p	Cap	+ Rev	- Exp	- Draw
1	+15000						+15000			
2	-7000		+7000							
3				+1600		+1600				
4	+1200							+1200		
5						+250			-250	
6	+1500	+2000						+3500		
7	-600 -900 -200								-600 -900 -200	
8	-250					-250				
9	+600	-600								
10	-1300									-1300

Financial Statements of Softbyte

SOFTBYTE Income Statement For the Month Ended September 30, 2002		
Revenues		
Service revenue		$ 4,700
Expenses		
Salaries expense	$ 900	
Rent expense	600	
Advertising expense	250	
Utilities expense	200	
Total expenses		1,950
Net income		$ 2,750

Financial Statements of Softbyte

SOFTBYTE Statement of Owner's Equity For the Month Ended September 30, 2002		
M. Doucet, Capital, September 1		$ -
Add: Investments	$ 15,000	
Net income	2,750	17,750
		$ 17,750
Less: Drawings		1,300
M. Doucet, Capital September 30		$ 16,450

Financial Statements of Softbyte

SOFTBYTE Balance Sheet September 30, 2002		
Assets		
Cash	$	8,050
Accounts receivable		1,400
Supplies		1,600
Equipment		7,000
Total assets	$	18,050
Liabilities and Owner's Equity		
Liabilities		
Accounts payable	$	1,600
Owner's Equity		
M. Doucet, Capital		16,450
Total liabilities and owner's equity	$	18,050

Financial Statements of Softbyte

SOFTBYTE Cash Flow Statement For the Month Ended September 30, 2002		
Cash flows from operating activities		
Cash receipts from customers	$ 3,300	
Cash payments to suppliers and employees	(1,950)	$ 1,350
Net cash provided by operating activities		
Cash flows from investing activities		
Purchase of equipment	$ (7,000)	
Net cash used by investing activities		(7,000)
Cash flows from financing activities		
Investments by owner	$ 15,000	
Drawings by owner	(1,300)	
Net cash provided by financing activities		13,700
Net increase in cash		$ 8,050
Cash, September 1		-
Cash, September 30		$ 8,050