ACCT 2101 Bhandarkar Test # 1

Tuesday

January 7th

Went over syllabus. No new notes.

Thursday

January 9th

Chapter 1: Introducing Accounting in Business

- Businesses can take on different entity forms.
  - Businesses can be a sole proprietorship with one owner, a partnership with two owners, or a corporation with multiple shareholders.
  - These different businesses can either be service, merchandising, or manufacturing.
    - Service businesses offer services and merchandising and manufacturing businesses both offer products.

- Corporations are the main business entity form that will be focused on in this class.
  - Owners of a corporation are called shareholders or stockholders.
  - When a corporation issues only one class of stock, we call it common stock, or capital stock.

- Accounting is the language of business.
  - Accounting is a system that identifies, records, and communicates information that is relevant, reliable, and comparable to help users make better decisions.

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- *Identifying* business activities: requires selecting transactions and events relevant to an organization
- *Recording* business activities: requires keeping a chronological log of transactions and events measured in dollars and classified and summarized in a useful format
- *Communicating* business activities: requires preparing accounting reports such as financial statements; it also requires analyzing and interpreting such reports

- Users of accounting information can be either internal or external.
  - External Users work for a firm and consult with other corporations to stabilize them.
    - Example: Lenders, Shareholders, Governments, Consumer groups, external auditors and customers
  - Internal Users work within a corporation to help stabilize it.
    - Example: officers, managers, internal auditors, sales executives, budget officers, controllers
- There are two types of accounting: financial and managerial.
  - Financial Accounting provides information to external users via financial statements. This is the type of accounting that will be focused on in this class.
  - Managerial Accounting provides information to internal users via internal reports.

- Ethics: beliefs that distinguish right from wrong or accepted standards of good and bad behavior

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- The goal of accounting is to provide useful information so decisions can be made. Therefore, in order for it to be useful, information must be trusted.
- Misleading information can lead to a wrongful closing of division that harms workers, customers and suppliers

- Financial accounting practice is governed by concepts and rules known as generally accepted accounting principles (GAAP).
  - The GAAP exists to provide relevant, reliable, and comparable information. It allows to companies to be able to compare reports.
    - *Relevant*: information affects decisions of its users
    - *Reliable*: information is trusted by users
    - *Comparable*: information is helpful in contrasting organization

- In the United States, the Securities and Exchange Commission (SEC), a government agency, has the legal authority to establish reporting requirements and set GAAP for companies that issue stock to the public.
  - The SEC accepts the pronouncements for the FASB.
  - The Financial Accounting Standards Board (FASB) is the private group that sets both broad and specific principles.
    - This board is responsible for creating GAAP.
  - The International Accounting Standards Board (IASB) issues international standards that identify preferred accounting practices in other companies.
    - More than 100 countries now require or permit companies to prepare financial reports following IFRS.

Make sure you know these government agencies and what they do: it may be on the test.

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  - The United States is moving towards global standards so the United States can also be comparable to international countries.
  - However, the United States has not yet adopted the IFRS, so in this class we will focus on GAAP instead.

- The Sarbanes-Oxley Act (SOX) of 2002 was an act passed by Congress in response to a number of publicized accounting scandals.
  - This act aims at curbing financial abuses by companies that issue their stock to the public.
  - This act requires that public companies apply both accounting oversight and stringent internal controls to ensure more transparency, accountability, and truthfulness in reporting transactions.

- There are both principles and assumptions in accounting.
  - There are four principles.
    1. The <u>measurement principle</u> (cost principle) says that accounting information should be based on actual cost.
       - Cost is measured on a cash or equal to cash basis. If cash is given for a service, its cost is measured as the amount of cash paid. If something besides cash is exchanged, cost is measured as the cost value of what is given up or received.
    2. The <u>revenue recognition principle</u> provides guidance on when a company must recognize revenue.
       - Revenue is recognized when earned. The earning process is complete when services are performed or a seller transfers ownership of products to the buyer

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- Proceeds from selling products and services need not be in cash. A common non-cash proceed received by a seller is a customers promise to pay at a future date (credit sales)
- Revenue is measured by the cash received plus the cash value of any other item received

3. The <u>matching principle</u> (expense recognition) prescribes that a company must record its expenses incurred to generate the revenue.
4. The <u>full disclosure principle</u> requires a company to include all information in financial statements that would impact users' decisions.

- There are four assumptions.
  1. The going-concern assumption says that accounting information reflects a presumption that the business will continue operating.
  2. The monetary unit assumption says that transactions are expressed using "money" as their common denominator.
  3. The time period assumption says that the life of a business can be divided into distinct time periods, such as months and years.
  4. The business entity assumption says that a business is accounted to separately from it owner or other business entities.

- Assets are things that a company owns or a resource that they control.
  - These include cash, land, buildings, equipment, supplies, vehicles, accounts receivable, and notes receivable.
    - Accounts receivable occurs when a company sells products or services to a client on credit. The money will be received in the future, so the company has a right to receive payment in the future.

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  - Notes receivable is also a right to receive payment in the future, but it is accompanied by a written promise from the client that owes money. This can also include interest sometimes.

- Liabilities are creditors' claims on assets, or what a company owes others.
  - Some examples of liabilities include taxes payable, wages payable, accounts payable, and notes payable. Anything ending in payable can be a liability.
    - Account payable is an obligation to make payment in the future.
    - Notes payable is also an obligation to make payment in the future, but is accompanied by a written promise from the company. This can be accompanied with interest.

- Equity is the owner's claim on assets.
  - Equity is made up of contributed capital, or common stock, and retained earnings.
    - Common stock is investments made in a business.
    - Retained earnings is income that is not distributed to shareholders. It can be broken down into revenue, expenses, and dividends.
      - Revenues are assets earned from a company's earnings activity. Examples might include fees, service revenue, sales, or rent revenue. Revenue increases retained earnings.
      - Expenses are assets used up in the process of earning revenues. Examples might include wages expense, rent expense, or utilities expense. Expenses decrease retained earnings.
      - Net income or net loss is calculated by subtracting expenses from revenues.

        Net income =Revenues-Expenses

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- Dividends are the distribution of corporations' assets to shareholders. Dividends decrease retained earnings.

- Equation for retained earnings:

  Beginning balance of retained earnings

  + Net income or – Net loss

  - Dividends

  = Ending balance of retained earnings

- Accounting equation:
  - This accounting equation must remain in balance after each transaction.
    - A transaction is an event that causes some change in the equation.

assets = liabilities + equity

equity: common stock + retained earnings

retained earnings: revenues – expenses – dividends

assets = liabilities + common stock + revenues – expenses – dividends

- Equation for equity:

  Beginning balance of equity

  + Additional investments (stock issuance)

  + Net income or – Net loss

  - Dividends

  = Ending balance of equity

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