

Principles of Accounting

Lecture 1

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Subject code: MGM 227



Principles of Accounting

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Chapter 1:
Accounting and the Business Environment
“Accounting is the Language of Business”

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Chapter

01

Learning Objectives

We try through this chapter to answer the following main questions:

- Why Is Accounting Important?
- What Are the Organizations and Rules That Govern Accounting?
- What Is the Accounting Equation?
- How Do You Analyze a Transaction?
- How Do You Prepare Financial Statements?
- How Do You Use Financial Statements to Evaluate Business Performance?

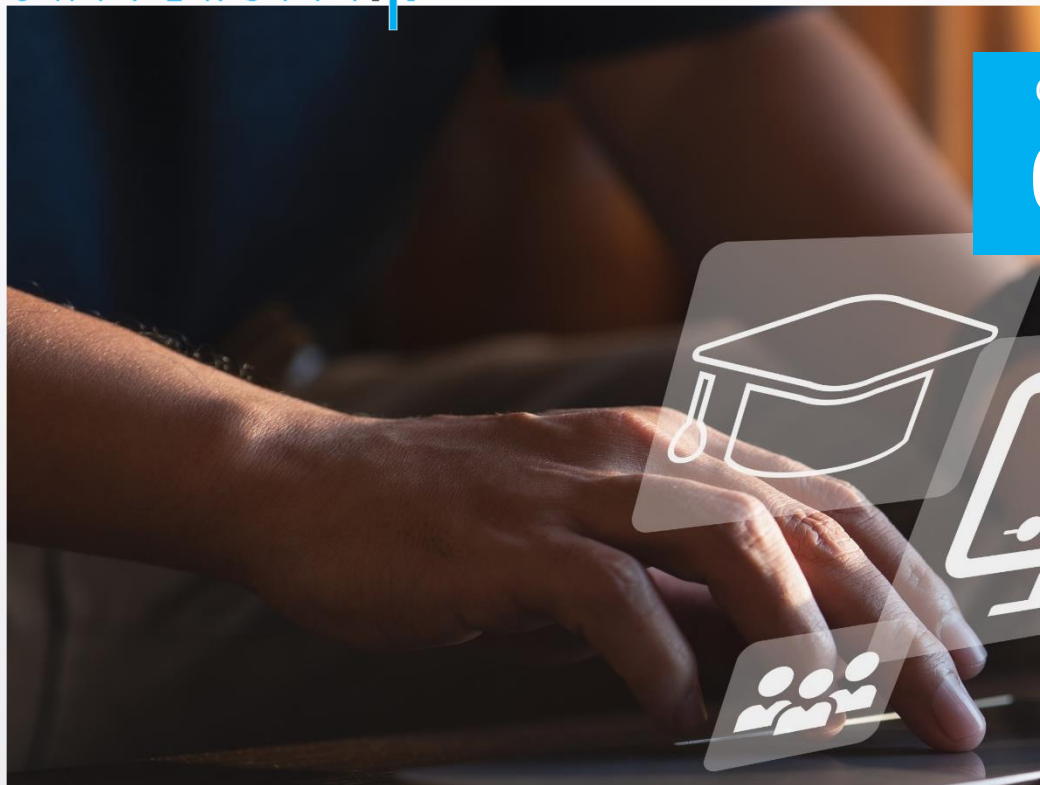
***Chapter 1 with practices Will be covered with more than one lecture**

Reference:, Tracie Nobles, Brenda Mattison, Ella Mae Matsumura, 2015, “**Horngren’s Accounting**”, (Tenth edition, Pearson Education Limited, United States).

Chapter

01

Why Is Accounting Important?



1

Explain why accounting is
important

Chapter

01

Why Is Accounting Important?

October 24, 2007, Mr. Buffett was interviewed by CCTV.

Reporter: "you read more than 10000 annual reports a year. Is that true?"

Buffet: "like other people reading newspapers, I read thousands of them every year. I don't know how much I read. But like PetroChina, I read the annual report of 2002 and 2003. Then I decided to invest 500 million yuan in PetroChina. I have not met the management or read the reports of analysts, but the annual reports are easy to understand, and it is a good investment."





Why Is Accounting Important?

During the 2008 financial crisis, criticisms of the accounting field were widespread, particularly from financial institutions.

The US Congress authorized an investigation into the root causes of the crisis by the Securities and Exchange Commission (SEC).

Financial institutions argued that fair value accounting was the cause of the crisis. The accounting field maintained that it was not fair value measurement that caused the financial crisis; fair value measurement just accurately and timely reflected the problems in the crisis.

Following the investigation, it was determined that while fair value accounting was not the primary cause of the financial crisis, it may have played a contributing role.



Define accounting vocabulary

What is Accounting ?

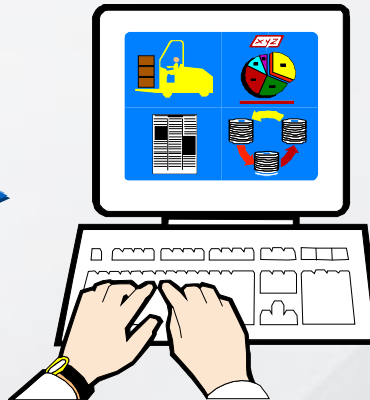
- Accounting is the **information system** that:
 - **Identify** business activity
 - Measures and **record** business activity
 - Processes the data into **reports**(Financial statements)
 - **Presents** information in monetary terms
 - **Communicates** the results to decision makers

**The language of
business.**

THE ACCOUNTING PROCESS



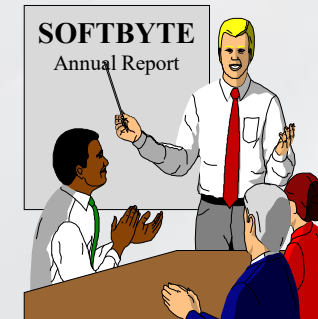
**Identify transactions
(select economic events)**



**Measure and
record business
activities**



**Process data into
reports(financial statements)**



**Communicate and
Presents information
for decision makers.**

What is the Difference Between Bookkeeping and Accounting?

Parameters	Bookkeeping	Accounting
Scope	Bookkeeping involves identifying, measuring, recording & classifying financial transactions in the ledger accounts.	In addition to bookkeeping, Accounting also includes summarizing, interpreting and communicating the financial data to the users of financial statements.
Objective	The main aim is to maintain systematic records of financial transactions.	The main aim is to ascertain the profitability and financial position of the business.
Stage	It is a primary stage of accounting	It is a second stage and begins where book-keeping ends.
Nature of job	This job is in routine and repetitive in nature.	This job is analytical in nature.
Level of skills	Bookkeeping does not require special skills. It is performed by Junior Staff.	It requires specialized skill to analyze, so it is performed by senior staff.



list the users of accounting
information

Decision Makers

Individuals

Businesses

Creditors

Investors

Taxing Authorities

Suppose you are the manager of Greg's Tunes. The company needs a bank loan in order to purchase music equipment. In evaluating the loan request, the banker asks about the assets and liabilities of the business. In particular, the banker wants to know the amount of the business's owner's equity.

Requirements:

1. Is the banker considered an internal or external user of financial information?
2. Which financial statement would provide the best information to answer the banker's questions?



Chapter

01

S1-2: USERS OF FINANCIAL INFORMATION

1. Is the banker considered an internal or external user of financial information?

The banker is an external user.

2. Which financial statement would provide the best information to answer the banker's questions?

The balance sheet would include assets, liabilities and equity.

Chapter

01

S1-2: USERS OF FINANCIAL INFORMATION



Two Fields of Accounting

Financial Accounting

Mainly provides information for **external** decision makers

- Investors
- Creditors
- Taxing Authorities
- Competitors
- Suppliers

Managerial Accounting

Focuses on information for **internal** decision makers

- Managers
- Business Owners

Which one have more rules?

MA uses FA information.

1. Certified management accountants

2. Accounting

3. Managerial accounting

4. Certified public accountants

5. Financial accounting

6. Creditor

a. the information system that measures business activities, processes that information into reports, and communicates the results to decision makers

b. licensed professional accountants who serve the general public

c. any person or business to whom a business owes money

d. the field of accounting that focuses on providing information for internal decision makers

e. certified professionals who work for a single company

f. the field of accounting that focuses on providing information for external decision makers

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1. e

2. a

3. d

4. b

5. f

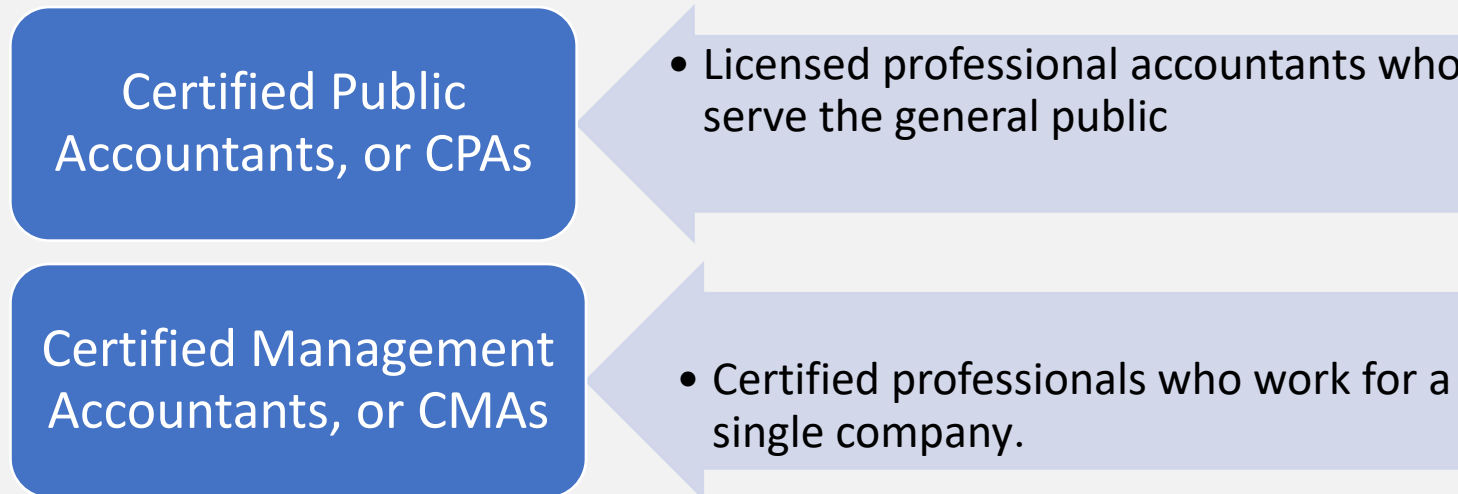
6. c

4

Describe the accounting
profession and the organizations
that govern it

The Accounting Profession

- Lucrative career with many opportunities
- Certified Public Accountants (CPA)
 - Pass qualifying exam
 - Meet education and/or experience requirements



Governing Organizations

FASB

- Financial Accounting Standards Board
- A privately funded organization, formulates accounting standards.

SEC

- Securities and Exchange Commission
- U.S. governmental agency that oversees U.S. financial markets.

AICPA

- American Institute of Certified Public Accountants
- Private organization of public accountants

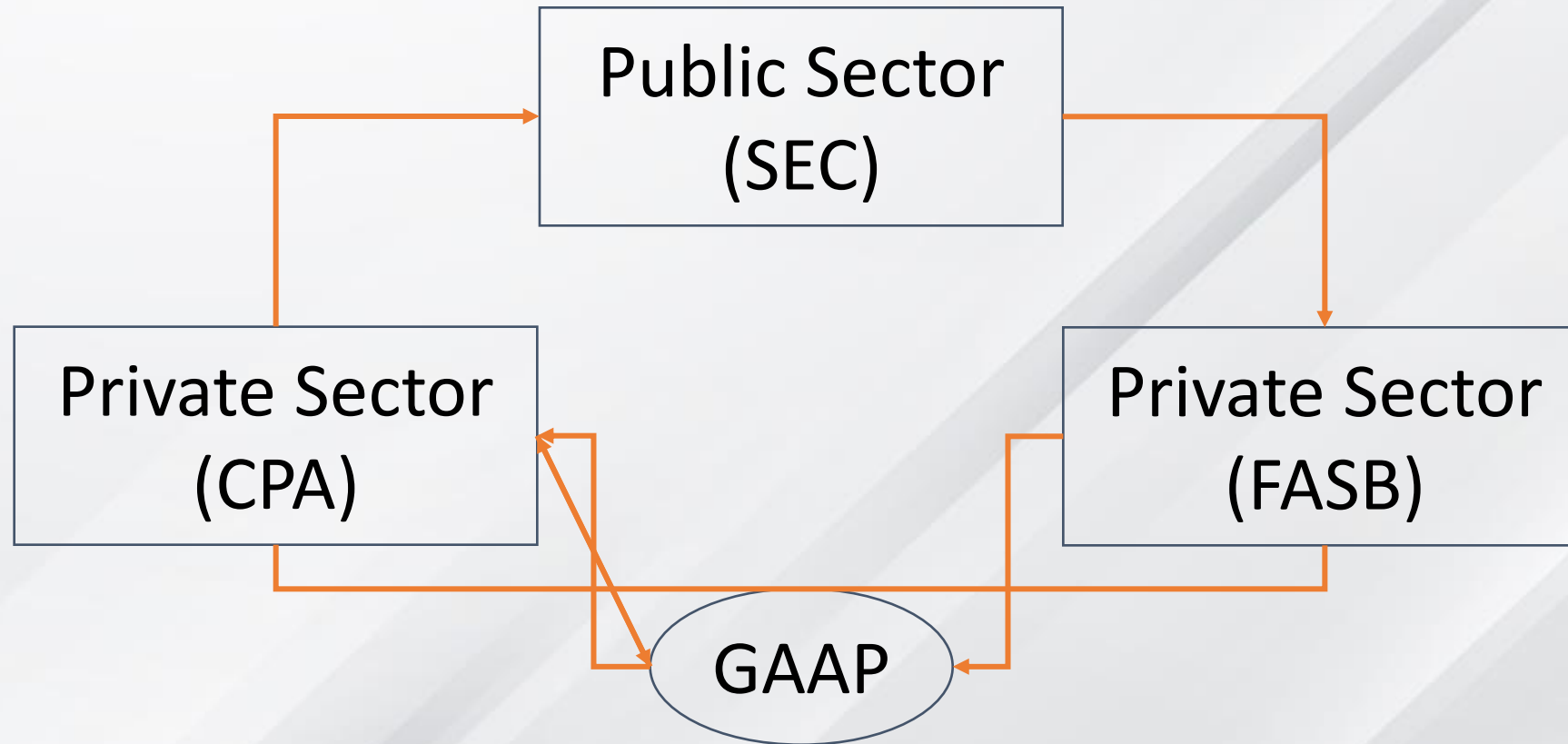
GAAP

- Generally Accepted Accounting Principles
- Main U.S. accounting rule book

IASB

- International Accounting Standards Board publishes the International Financial Reporting Standards(IFRS), the international accounting rule book

Governing Organizations





Identify the different types
of business organizations

Business Types

Most businesses exist so their owners can earn a profit.

**Service
Companies**

**Provide a service
to customers or
clients.**



Manufacturers

**make products
from raw inputs.**



Merchandisers

**sell goods that
manufacturers
produce.**



Types of Business Organizations

Proprietorship

Partnership

Corporation

Not-for-profit

Others

Types of Business Organizations

1. Proprietorship

- -owned by one individual (single owner)
- -usually a small local business

Advantage:

- Unification of Ownership and Management: total undivided authority
- Business Taxation: only tax on the owner's personal income
- Government regulation: minimal
- Easiest to start

Disadvantage:

- no continuous life/transferability of ownership
- unlimited liability of owners.
- limited financial resources available to the business

Types of Business Organizations

2.Partnership

- -owned by two or more individuals
- -each owner is called “artner”
- -Partnership agreement
- -small or medium-sized business,specifically, professional organizations
- **Advantage:**
 - more brain power
 - only tax on the each partner’s personal income
- **Disadvantage:**
 - unlimited liability



Types of Business Organizations

3. Corporations

- -ownership divided into shares of stock
- -owned by shareholders/stockholders
- **Advantage:**
 - Separation of ownership and management
 - large amounts of resources
 - transferability of ownership relatively easy
 - unlimited life
 - limited liability of stockholders .

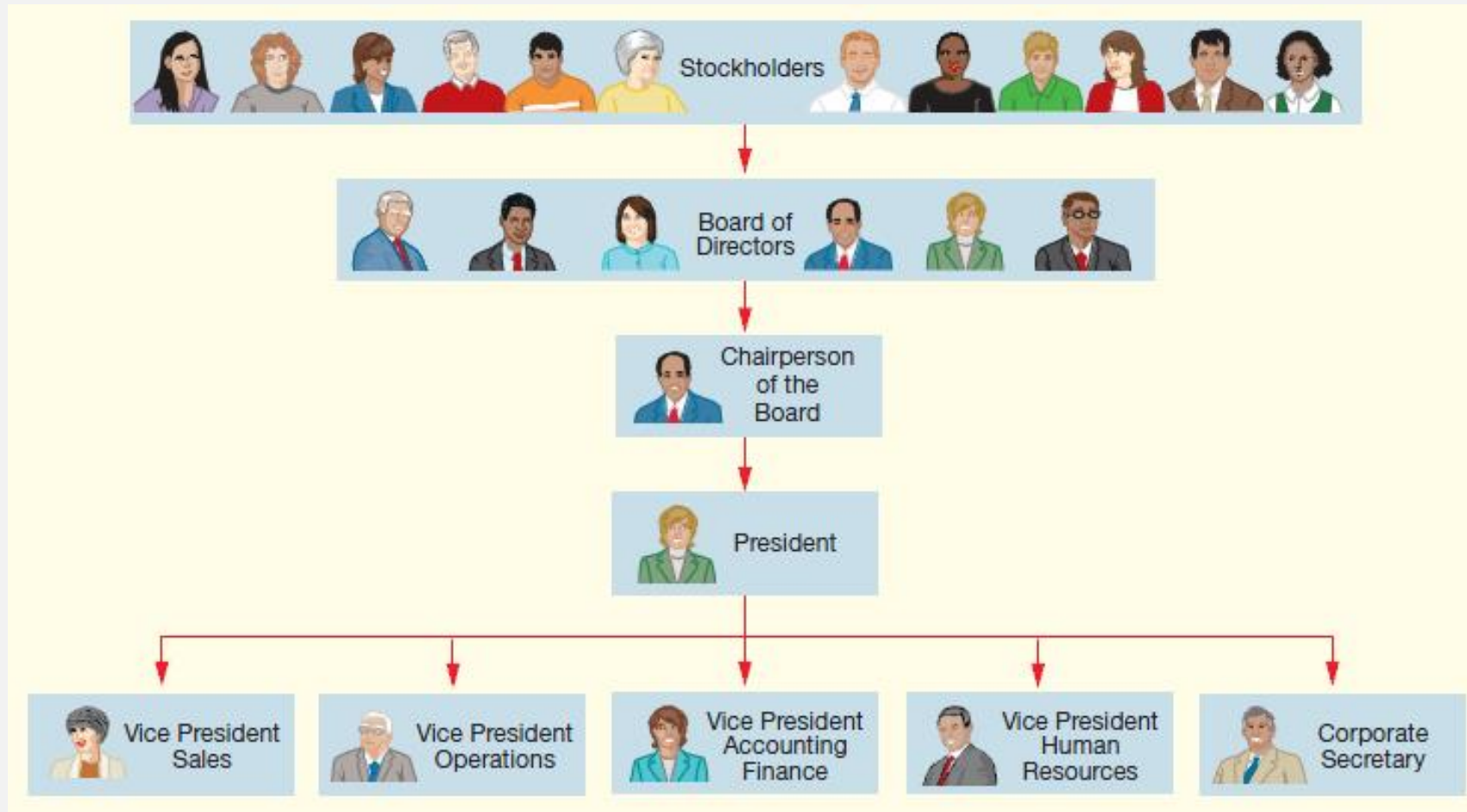
Types of Business Organizations

3. Corporations

Disadvantage:

- separation of ownership and management
- extensive governmental regulation
- double taxation: corporate income tax and personal income tax

Structure of a Corporation



S1-4: TYPES OF BUSINESS ORGANIZATION

Chloe Michaels plans on opening Chloe Michaels' Floral Designs. She is considering the various types of business organizations and wishes to organize her business with **unlimited life** and **limited liability** features. Additionally, Chloe wants the option to **raise additional equity easily** in the future. Which type of business organization will meet Chloe's needs best?

S1-4: TYPES OF BUSINESS ORGANIZATION

Chloe Michaels plans on opening Chloe Michaels' Floral Designs. She is considering the various types of business organizations and wishes to organize her business with **unlimited life** and **limited liability** features. Additionally, Chloe wants the option to **raise additional equity easily** in the future. Which type of business organization will meet Chloe's needs best?

A corporation has all the requirements of Chloe's request. A corporation has an unlimited life, shareholders have limited liability and additional stock can be sold to raise additional equity.



Apply accounting concepts and
principles

GAAP

- Generally Accepted Accounting Principles
- Guidelines that govern accounting
 - Based on a conceptual framework
 - Goals include:
 - Provide useful information for investment and lending decisions

Accounting Principles

Entity
Concept

Faithful
Representation
Principle

Cost
Principle

Going- Concern
Concept

Stable
Monetary Unit
Concept

Accounting Principles

Entity Concept

- A business is separate from its owners
- All activities of an entity are kept and recorded separate from the activities of its owners and other economic entities.
- accountant hired by BMW. stockholder A of BMW bought a car using his money

Faithful Representation Principle

- Accounting information is complete, neutral, and free from material error

Cost Principle

- Assets are recorded at historical purchase price
- land bought 10years ago at\$1000, now estimated MV \$2million.
- proof

Accounting Principles

(continued)

Going-Concern

- Assumption that business will remain in operation for the foreseeable future

Stable Monetary Unit Concept

- In the U.S. amounts are recorded in dollars
- The dollar is considered a stable unit of measure
- inflation?

- | | |
|--------------------------------|--|
| 7. Cost principle | a. oversees the creation and governance of accounting standards in the United States |
| 8. GAAP | b. requires an organization to be a separate economic unit |
| 9. Faithful representation | c. oversees U.S. financial markets |
| 10. SEC | d. states that acquired assets and services should be recorded at their actual cost |
| 11. FASB | e. creates International Financial Reporting Standards |
| 12. Monetary unit assumption | f. the main U.S. accounting rule book |
| 13. Economic entity assumption | g. assumes that an entity will remain in operation for the foreseeable future |
| 14. Going concern assumption | h. assumes that items on the financial statements are recorded in a monetary unit |
| 15. IASB | i. requires information to be complete, neutral, and free from material error |

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Thank You