

Financial Accounting

Prepared by Dr. Sara Ahmed

MGM 611

Lecture 1





مجموعة جامعة
الجميع الذكية
للتعليم القابضة

MIDOCEAN
UNIVERSITY
BY EVERYONE'S SMART UNIVERSITY

Accounting in Business

Lecture 1

MGM 611

Prepared by
Dr. Sara Ahmed

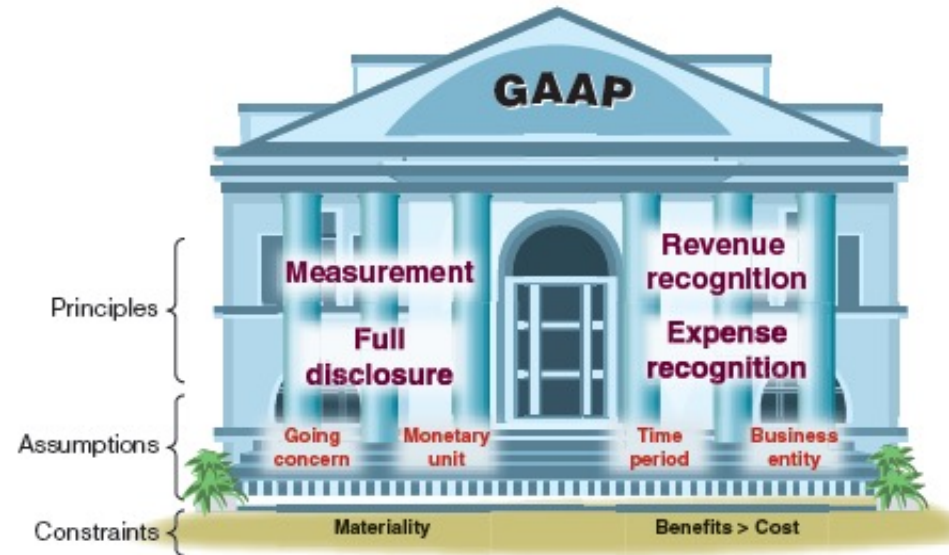
www.midocean.ae

TOPIC
01

LEARNING OBJECTIVES

- Explain generally accepted accounting principles and define and apply several accounting principles.
- Identify and describe the three major activities of organizations.
- Define and interpret the accounting equation and each of its components.
- Compute and interpret return on assets.
- Explain the relation between return and risk.
- Analyze business transactions using the accounting equation.
- Identify and prepare basic financial statements and explain how they interrelate.

Principles and Assumptions of Accounting



General principles are the basic assumptions, concepts, and guidelines for preparing financial statements. General principles stem from long-used accounting practices.

Specific principles are detailed rules used in reporting business transactions and events. Specific principles arise more often from the rulings of authoritative groups.

Accounting Principles

Measurement Principle (or Cost Principle)

Accounting information is based on actual cost. Actual cost is considered objective.

Revenue Recognition Principle

1. Recognize revenue when it is earned.
2. Proceeds need not be in cash.
3. Measure revenue by cash received plus cash value of items received.

Expense Recognition Principle (or Matching Principle)

A company must record its expenses incurred to generate the revenue reported.

Full Disclosure Principle

A company is required to report the details behind financial statements that would impact users' decisions.

Accounting Assumptions

Going-Concern Assumption

Reflects assumption that the business will continue operating instead of being closed or sold.

Monetary Unit Assumption

Express transactions and events in monetary, or money, units.

Business Entity Assumption

A business is accounted for separately from other business entities, including its owner.

Time Period Assumption

Presumes that the life of a company can be divided into time periods, such as months and years.

Proprietorship, Partnership, and Corporation

Here are some of the major attributes of proprietorships, partnerships, and corporations:

Attribute Present	Proprietorship	Partnership	Corporation
One owner allowed	yes	no	yes
Business taxed	no	no	yes
Limited liability	no*	no*	yes
Business entity	yes	yes	yes
Legal entity	no	no	yes
Unlimited life	no	no	yes

* Proprietorships and partnerships that are set up as LLCs provide limited liability.

Accounting Constraints

Materiality

Only information that would influence the decisions of a reasonable person need be disclosed.

Cost-benefit

Only information with benefits of disclosure greater than their cost need be disclosed.

Identify the following terms/phrases as either an accounting (a) principle, (b) assumption, or (c) constraint.

Materiality	
Measurement	
Business entity	
Going concern	
Expense recognition	
Time period	
Full disclosure	
Revenue recognition	

Principles: Govern the amount and/or timing of information to be reported in financial statements.

Measurement principle	Also called the cost principle Cost is measured on a cash or equal-to-cash basis. Governs valuation of assets and liabilities on the balance sheet.
Revenue recognition principle	Governs the timing of revenues recognized on the income statement. Revenue is recognized when earned.
Expense recognition principle	Also called the matching principle Governs the timing of expenses reported on the income statement. Expenses are recognized in the same time period as the revenues they help generate.
Full disclosure principle	A company must report the details behind financial statements that would impact users' decisions. Disclosures are often in the footnotes to the financial statements.

Assumptions: Generally related to the financial statement headings.

Going concern assumption	Presumption that the business will continue operating instead of being closed or sold.
Monetary unit assumption	We can express transactions and events in monetary units. (i.e., Dollars, Pesos, Euros)
Time period assumption	Presumes that the life of a company can be divided into time periods, and that useful reports can be prepared for those periods.
Business entity assumption	A business is accounted for separately from other business entities, including its owner(s).

Accounting constraints: Reasonableness of information to be reported.

Materiality	Only information that would influence the decisions of a reasonable person needs to be disclosed. Materiality is a function of the nature of the item and/or dollar amount.
Benefits exceed cost	The benefits of the information disclosed must be greater than the costs of providing the information.

Identify the following terms/phrases as either an accounting (a) principle, (b) assumption, or (c) constraint.

Materiality	c) Constraint
Measurement	a) Principle
Business Entity	b) Assumption
Going Concern	b) Assumption
Expense Recognition	a) Principle
Time Period	b) Assumption
Full Disclosure	a) Principle
Revenue Recognition	a) Principle

Complete the following table with either a yes or a no regarding the attributes of a partnership and a corporation.

Attribute Present	Partnership	Corporation
Business taxed	no	yes
Limited liability	no	yes
Legal entity	no	yes
Unlimited life	no	yes

Define and interpret the accounting equation and each of its components.

Transaction Analysis and the Accounting Equation

The Accounting Equation

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

Expanded Accounting Equation:

$$\text{Assets} = \text{Liabilities} + \overbrace{\text{Owner, Capital} - \text{Owner, Withdrawals} + \text{Revenues} - \text{Expenses}}^{\text{Equity}}$$

Net Income

Use the accounting equation to compute the missing financial statement amounts.

Assets = Liabilities + Equity				
Bose	\$150	=	\$30	+ \$120
Vogue	\$400	=	\$100	+ \$300

Use the expanded accounting equation to compute the missing financial statement amounts.

Assets = Liabilities + Equity				+ Owner, Capital	- Owner, Withdrawals	+ Revenues	- Expenses
Tesla	\$200	\$80	\$120	\$100	\$0	\$60	(\$40)
YouTube	\$400	\$160	\$240	\$220	(\$10)	\$120	(\$90)

Analyze business transactions using the accounting equation.

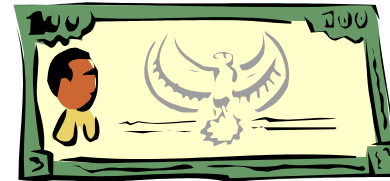
Transaction 1:



Chas Taylor invests \$30,000 cash to start a company.

The accounts involved are:

- (1) Cash (asset) ↑
- (2) C. Taylor, Capital (equity) ↑



Accounting Equation:

Chas Taylor invests \$30,000 cash to start the business, *Fast Forward*.

Assets			=	Liabilities		+	Equity
Cash	Supplies	Equipment		Accounts Payable	Notes Payable		C.Taylor, Capital
(1) \$ 30,000							\$ 30,000
\$ 30,000	\$ -	\$ -		\$ -	\$ -		\$ 30,000
\$ 30,000			=	\$ 30,000			

Transaction 2:

Company purchased supplies paying \$2,500 cash.

The accounts involved are:

- (1) Cash (asset) ↓
- (2) Supplies (asset) ↑



Accounting Equation:

Company purchased supplies paying \$2,500 cash.

Assets			=	Liabilities		+	Equity
Cash	Supplies	Equipment		Accounts Payable	Notes Payable		C.Taylor, Capital
(1) \$ 30,000							\$ 30,000
(2) (2,500)	\$ 2,500						
\$ 27,500	\$ 2,500	\$ -		\$ -	\$ -		\$ 30,000
\$ 30,000			=	\$ 30,000			

Accounting Equation must remain in balance!!

↙ ↘

Transaction 3:

Purchased equipment for \$26,000 cash.

The accounts involved are:

- (1) Cash (asset) 
- (2) Equipment (asset) 

Accounting Equation:

Purchased equipment for \$26,000 cash.

Assets			=	Liabilities		+	Equity
Cash	Supplies	Equipment		Accounts Payable	Notes Payable		C.Taylor, Capital
(1) \$ 30,000							\$ 30,000
(2) (2,500)	\$ 2,500						
(3) (26,000)		\$ 26,000					
\$ 1,500	\$ 2,500	\$ 26,000		\$ -	\$ -		\$ 30,000
\$ 30,000			=	\$ 30,000			

Accounting Equation still remains in balance!!

Transaction 4:

Purchased supplies of \$7,100 on credit.

The accounts involved are:

(1) Supplies (asset) ↑

(2) Accounts Payable (liability) ↑



Accounting Equation:

Purchased Supplies of \$7,100 on credit.

Assets			=	Liabilities		+	Equity
Cash	Supplies	Equipment		Accounts Payable	Notes Payable		C.Taylor, Capital
(1) \$ 30,000							\$ 30,000
(2) (2,500)	\$ 2,500						
(3) (26,000)		\$ 26,000					
(4)	7,100			\$ 7,100			
<u>\$ 1,500</u>	<u>\$ 9,600</u>	<u>\$ 26,000</u>		<u>\$ 7,100</u>	<u>\$ -</u>		<u>\$ 30,000</u>
<u>\$ 37,100</u>			=	<u>\$ 37,100</u>			

Accounting Equation still
remains in balance!!

Transaction Analysis

Now, let's look at transactions involving revenues, expenses and withdrawals.



Transaction 5:

Provided consulting services to a customer and received \$4,200 cash right away.

The accounts involved are:

(1) Cash (asset) ↑

(2) Revenues (equity) ↑



Accounting Equation:

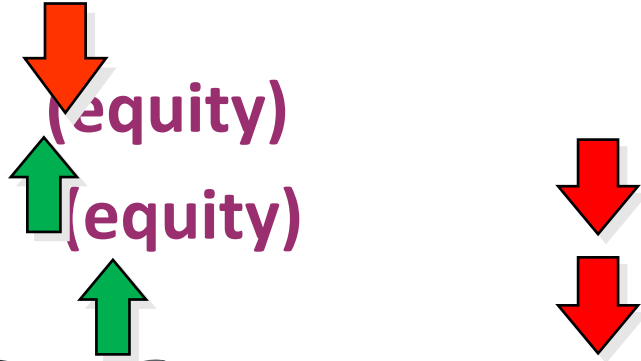
Provided consulting services to a customer and received \$4,200 cash right away.

Assets			=	Liabilities		+	Equity	
	Cash	Supplies	Equipment	Accounts Payable	Notes Payable		C.Taylor, Capital	Revenue
Bal.	\$ 1,500	\$ 9,600	\$ 26,000	\$ 7,100			\$ 30,000	
(5)	4,200							\$ 4,200
	\$ 5,700	\$ 9,600	\$ 26,000	\$ 7,100	\$ -		\$ 30,000	\$ 4,200
	\$ 41,300			=	\$ 41,300			

Transactions 6 and 7:

Paid rent of \$1,000 and salaries of \$700 to employees.

The accounts involved are:

- (1) Cash (asset)
 - (2) Rent expense
 - (3) Salaries expense
- 

Remember that the balance in the *Expense* accounts actually increase.

But, total Equity decreases, because expenses reduce equity.



Accounting Equation:

Paid rent of \$1,000 and salaries of \$700 to employees.

	Assets			=	Liabilities		+	Equity		
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		C.Taylor, Capital	Revenue	Expenses
Bal.	\$ 5,700	\$ 9,600	\$ 26,000		\$ 7,100			\$ 30,000	\$ 4,200	
(6)	(1,000)									(1,000)
(7)	(700)									\$ (700)
	<u>\$ 4,000</u>	<u>\$ 9,600</u>	<u>\$ 26,000</u>		<u>\$ 7,100</u>	<u>\$ -</u>		<u>\$ 30,000</u>	<u>\$ 4,200</u>	<u>\$ (1,700)</u>
	<u>\$ 39,600</u>			=	<u>\$ 39,600</u>					

Remember that expenses **decrease** equity.

Transaction 8:

Provided consulting services of \$1,600 and rents facilities for \$300 to a customer for credit.

The accounts involved are:

- (1) Accounts receivable (asset) 
- (2) Consulting Revenues (equity) 
- (3) Rental Revenue (equity) 

Accounting Equation:

Provided consulting services of \$1,600 and rents facilities for \$300 to a customer for credit.

Assets					=	Liabilities	+	Equity		
	Cash	Accounts Receivable	Supplies	Equipment		Accounts Payable		C.Taylor, Capital	Revenue	Expenses
Bal.	\$ 4,000		\$ 9,600	\$ 26,000		\$ 7,100		\$ 30,000	\$ 4,200	(1,700)
(8)		1,900							\$ 1,600	
									300	
	\$ 4,000	\$ 1,900	\$ 9,600	\$ 26,000		\$ 7,100		\$ 30,000	\$ 6,100	\$ (1,700)
	\$ 41,500				=	\$ 41,500				

Transaction 9:

Client in transaction 8 pays \$1,900 for consulting services from account receivable.

The accounts involved are:

(1) Cash (asset)

(2) Accounts receivable  (asset)



Accounting Equation:

Client in transaction 8 pays \$1,900 for consulting services.

Assets				=	Liabilities	+	Equity		
Accounts					Accounts		C. Taylor,		
	Cash	Receivable	Supplies	Equipment	Payable		Capital	Revenue	Expenses
Bal.	\$ 4,000	1,900	\$ 9,600	\$ 26,000	\$ 7,100		\$ 30,000	\$ 4,200	(1,700)
(9)	1,900	(1,900)						\$ 1,600	
								300	
	\$ 5,900	0	\$ 9,600	\$ 26,000	\$ 7,100		\$ 30,000	\$ 6,100	\$ (1,700)
	\$ 41,500				=	\$ 41,500			

Transaction 10:

FastForward pays \$900 as partial payment for supplies purchased in transaction 4.

The accounts involved are:

(1) Cash (asset)

(2) Accounts payable (liability)



Accounting Equation:

FastForward pays \$900 as partial payment for supplies purchased in transaction 4.

Assets					=	Liabilities		+	Equity		
	Accounts					Accounts			C.Taylor,		
	Cash	Receivable	Supplies	Equipment		Payable	Capital		Revenue	Expenses	
Bal.	\$ 5,900	0	\$ 9,600	\$ 26,000		\$ 7,100	\$ 30,000		\$ 4,200	(1,700)	
(10)	(900)					(900)			\$ 1,600		
									300		
	\$ 5,000	0	\$ 9,600	\$ 26,000		\$ 6,200	\$ 30,000		\$ 6,100	\$ (1,700)	
	\$ 40,600				=	\$ 40,600					

Transaction 11:

Withdrawal of Cash by Owner.

The accounts involved are:

(1) Cash (asset)

(2) Withdrawals



Remember that the *Withdrawal* account actually increases (just like our Expenses account . . .)



But, total Equity decreases because withdrawals cause equity to go down !!

Accounting Equation:

\$200 cash is withdrawn by owner.

Assets				=	Liabilities + Equity				
	Accounts				Accounts	C.Taylor,	C.Taylor,		
	Cash	Receivable	Supplies	Equipment	Payable	Capital	Withdrawals	Revenue	Expenses
Bal.	\$ 5,000	0	\$ 9,600	\$ 26,000	\$ 6,200	\$ 30,000		\$ 4,200	(1,700)
(11)	(200)						(200)	\$ 1,600	
								300	
	\$ 4,800	0	\$ 9,600	\$ 26,000	\$ 6,200	\$ 30,000	\$ (200)	\$ 6,100	\$ (1,700)
	\$ 40,400				=	\$ 40,400			

Assume Tata began operations on January 1 and completed the following transactions during its first month of operations.

- Jan. 1 Jamsetji invested \$4,000 cash in the Tata company.
- Jan. 5 The company purchased \$2,000 of equipment on credit.
- Jan. 14 The company provided \$540 of services for a client on credit.
- Jan. 21 The company paid \$250 cash for an employee's salary

Arrange the following asset, liability, and equity titles in a table: Cash; Accounts Receivable; Equipment; Accounts Payable; J. Tata, Capital; J. Tata, Withdrawals; Revenues; and Expenses.

	Assets			=	Liabilities	+ Equity		
	Cash	Accounts Receivable	Equipment		Accounts Payable	+ J. Tata, Capital	- J. Tata, Withdrawals	+ Revenues - Expenses
Jan. 1	\$4,000					\$4,000		
Jan. 5			\$2,000		\$2,000			
Jan. 14		\$540						\$540
Jan. 21	(\$250)							(\$250)
	<u>\$3,750</u>	<u>\$540</u>	<u>\$2,000</u>		<u>\$2,000</u>	<u>\$4,000</u>	<u>\$0</u>	<u>\$540 (\$250)</u>

Total Assets	\$6,290
Total Liabilities	<u>2,000</u>
Total Equity	<u>\$4,290</u>

Identify and prepare basic financial statements and explain how they interrelate.

Financial Statements

The four financial statements and their purposes are:

- 1. Income statement** — describes a company's revenues and expenses along with the resulting net income or loss over a period of time due to earnings activities.
- 2. Statement of owner's equity**— explains changes in equity from net income (or loss) and from any owner investments and withdrawals over a period of time.
- 3. Balance sheet** — describes a company's financial position (types and amounts of assets, liabilities, and equity) at a point in time.
- 4. Statement of cash flows** — identifies cash inflows (receipts) and cash outflows (payments) over a period of time.

Exhibit 1.10 Financial Statements and Their Links

FASTFORWARD Income Statement For Month Ended December 31, 2017		
Revenues		
Consulting revenue (\$4,200 + \$1,600)	\$ 5,800	
Rental revenue	<u>300</u>	
Total revenues		\$ 6,100
Expenses		
Rent expense	1,000	
Salaries expense	<u>700</u>	
Total expenses		<u>1,700</u>
Net income		<u><u>\$ 4,400</u></u>

FASTFORWARD Statement of Owner's Equity For Month Ended December 31, 2017		
C. Taylor, Capital, December 1, 2017	\$ 0	①
Plus: Investments by owner	\$30,000	
Net income	<u>4,400</u>	<u>34,400</u>
		34,400
Less: Withdrawals by owner		<u>200</u>
C. Taylor, Capital, December 31, 2017		<u><u>\$34,200</u></u>

FASTFORWARD Balance Sheet December 31, 2017			
Assets		Liabilities	
Cash	\$ 4,800	Accounts payable	\$ 6,200
Supplies	9,600	Total liabilities	<u>6,200</u>
Equipment	26,000		
		Equity	
		C. Taylor, Capital	<u>34,200</u>
Total assets	<u><u>\$40,400</u></u>	Total liabilities and equity	<u><u>\$ 40,400</u></u>

(cont. next slide)

Exhibit 1.10 Financial Statements and Their Links

FASTFORWARD Balance Sheet December 31, 2017			
Assets		Liabilities	
Cash	\$ 4,800	Accounts payable	\$ 6,200
Supplies	9,600	Total liabilities	6,200
Equipment	26,000		
		Equity	
		C. Taylor, Capital	34,200
Total assets	<u>\$40,400</u>	Total liabilities and equity	<u>\$ 40,400</u>

FASTFORWARD Statement of Cash Flows For Month Ended December 31, 2017			
Cash flows from operating activities			
Cash received from clients (\$4,200 + \$1,900)	\$ 6,100		
Cash paid for expenses (\$2,500 + \$900 + \$1,000 + \$700)	<u>(5,100)</u>		
Net cash provided by operating activities		\$ 1,000	
Cash flows from investing activities			
Purchase of equipment	<u>(26,000)</u>		
Net cash used by investing activities		(26,000)	
Cash flows from financing activities			
Investments by owner	30,000		
Withdrawals by owner	<u>(200)</u>		
Net cash provided by financing activities		29,800	
Net increase in cash		\$ 4,800	
Cash balance, December 1, 2017		0	
Cash balance, December 31, 2017		<u>\$ 4,800</u>	

Prepare the (a) income statement, (b) statement of owner's equity, and (c) balance sheet, for Apple using the following condensed data from its fiscal year ended September 26, 2015.

Accounts payable	\$35,490	Investments and other assets	\$230,039
Other liabilities	135,634	Land and equipment (net)	22,471
Cost of sales	140,089	Selling, general and other expenses	40,232
Cash	21,120	Accounts receivable	16,849
Owner, Capital, September 27, 2014	111,547	Net income	53,394
Withdrawals in fiscal year 2015	45,586	Owner, Capital, September 26, 2015	119,355
Revenues	233,715		

Income Statement		Statement of Owner's Equity	Balance Sheet
Assets			Detail of Assets
Liabilities			Detail of Liabilities
Equity:		Beginning Capital	
+ Owner investments		+ Owner investments	
- <i>Owner withdrawals</i>		- <i>Owner withdrawals</i>	
+ Revenues	Detail of Revenues	<u>± Net income (loss)</u>	Ending Owner, Capital
- <i>Expenses</i>	<u>Detail of <i>Expenses</i></u>	Ending Capital	
	Net income (loss)		

NEED-TO-KNOW

Accounts payable	\$35,490	Investments and other assets	\$230,039
Other liabilities	135,634	Land and equipment (net)	22,471
Cost of sales	140,089	Selling, general and other expenses	40,232
Cash	21,120	Accounts receivable	16,849
Owner, Capital, September 26, 2014	111,547	Net income	53,394
Withdrawals in fiscal year 2015	45,586	Owner, Capital, September 26, 2015	119,355
Revenues	233,715		

APPLE Income Statement For Fiscal Year Ended September 26, 2015

Revenues	\$233,715
Expenses	
Cost of sales (expense)	\$140,089
Selling, general and other expenses	<u>40,232</u>
Total expenses	<u>180,321</u>
Net income	<u>\$53,394</u>

APPLE Statement of Owner's Equity For Fiscal Year Ended September 26, 2015

Owner, Capital, September 27, 2014	\$111,547
Plus: Net income	53,394
Less: Withdrawals by owner	<u>45,586</u>
Owner, Capital, September 26, 2015	<u>\$119,355</u>

APPLE Balance Sheet September 26, 2015

Assets		Liabilities	
Cash	\$21,120	Accounts payable	\$35,490
Accounts receivable	16,849	Other liabilities	135,634
Land and equipment (net)	22,471	Total liabilities	171,124
Investments and other assets	230,039		
		Equity	
		Owner, Capital, September 26, 2015	119,355
Total assets	<u>\$290,479</u>	Total liabilities and equity	<u>\$290,479</u>

Sustainability and Accounting

Sustainability Accounting Standards Board (SASB)

- Nonprofit entity engaged in creating and disseminating sustainability accounting standards for companies.
- **Sustainability** refers to environmental, social and governance.
- Environmental aspects include programs to reduce pollution and support green activities.
- Standards intended to complement financial accounting standards.
- SASB created their own Conceptual Framework.

Compute and interpret
return on assets.

Return on Assets

Return on assets (ROA) is stated in ratio form as net income divided by the average total assets invested.

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Average total assets}}$$

Fiscal Year	Return on Assets	
	Verizon	Industry
2015	7.7%	4.8%
2014	4.7	4.1
2013	9.4	5.4
2012	4.6	3.3
2011	4.5	3.1

Explain the relation
between return and risk.

Return and Risk Analysis

Many different
returns may be
reported.

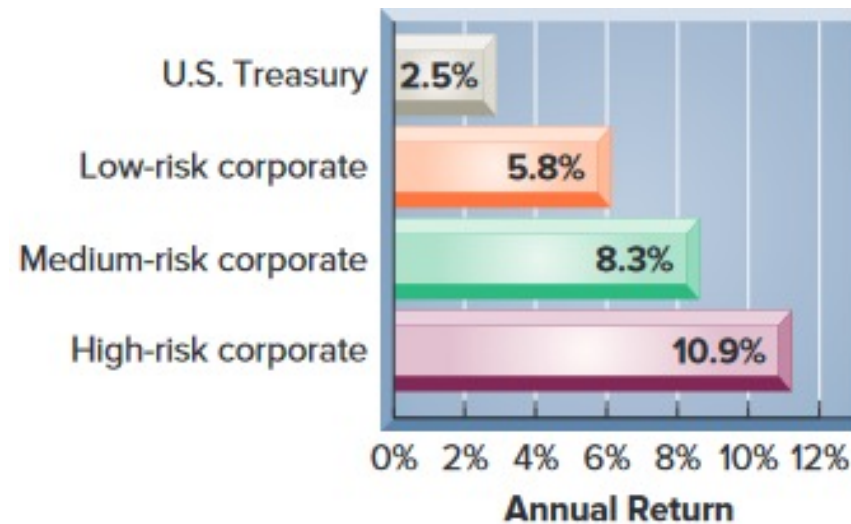
→ ROA

→ Interest return on
savings accounts.

→ Interest return on
corporate bonds.

Risk is the uncertainty
about the return we will
earn.

The lower the risk, the lower our expected return.



Identify and describe the
three major activities of
organizations.

Business Activities and the Accounting Equation

Three major types of business activities:

Financing activities provide the means organizations use to pay for resources such as land, buildings, and equipment to carry out plans.

- *Owner financing*—resources contributed by the owner along with any income the owner leaves in the organization.
- *Nonowner financing*—resources contributed by creditors (lenders).
- *Financial management* —the task of planning how to obtain these resources and to set the right mix between owner and creditor financing.

Business Activities and the Accounting Equation

Three major types of business activities:

Investing activities are the acquiring and disposing of resources (assets) that an organization uses to acquire and sell its products or services.

- *Asset management*—determining the amount and type of assets for operations.
- *Assets*—invested amounts.
- *Liabilities*—creditors' claims.
- *Equity*—owner's claim.

Business Activities and the Accounting Equation

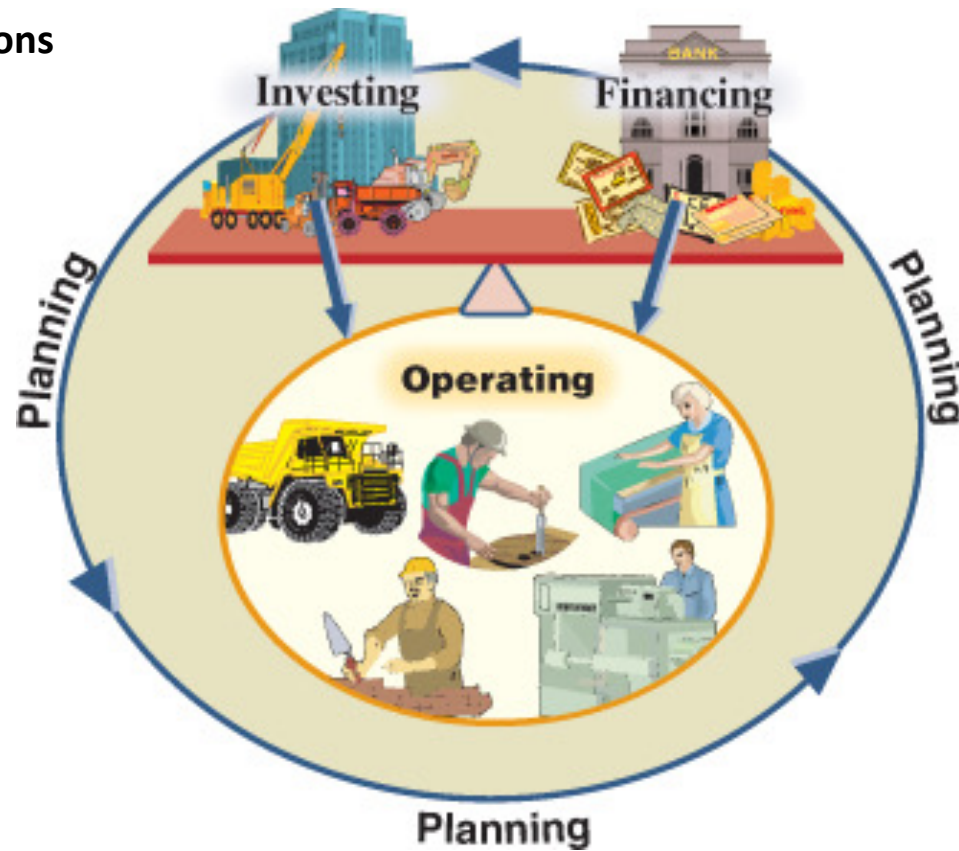
Three major types of business activities:

Operating activities involve using resources to research, develop, purchase, produce, distribute, and market products and services.

- *Strategic management* —the process of determining the right mix of operating activities for the type of organization, its plans, and its market.

Business Activities and the Accounting Equation

Activities of Organizations





مجموعة جامعة
الجميع الذكية
للتعليم القابضة

MIDOCEAN
UNIVERSITY
BY EVERYONE'S SMART UNIVERSITY



Thank You

