

# Business, Accounting, and You

Assignment 1 introduces three types of business and the entities used in creating these businesses. *Generally Accepted Accounting Principles (GAAP)* and *International Financial Reporting Standards (IFRS)* are shown to govern the standards, practices, and reporting of accounting information. The accounting equation, transactions, and financial statements (and their relationship to each other) are discussed.

Assignment 2 introduces the concept of double-entry bookkeeping and fundamentals for analyzing, journalizing, and posting transactions as they occur in business.

Assignment 3 shows the adjusting and closing process in preparation of an adjusted trial balance to be used to prepare financial statements.

When you complete this lesson, you'll be able to

- Understand important accounting principles and concepts in order to prepare basic financial statements
- Understand the fundamentals of bookkeeping while using the general journal, general ledger, and trial balance to prepare financial statements
- Understand adjustments and closing entries to prepare financial statements and a post-closing trial balance

## ASSIGNMENT 1: INTRODUCTION TO ACCOUNTING

Read Assignment 1 in this study guide. Then read in your textbook, *Financial Accounting*, pages 2–29.

### Why Study Accounting?

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An often-asked question is “Why do I need to take Accounting? I’m not going to be an accountant.” Accounting teaches the language of business. When students go to school, they



receive a report card. The report cards for business are the financial statements. Everything that happens in a business is quantified into numbers that show up on the financial statements. If business professionals don't understand how the numbers are put together and used, how can they effectively run their business? The numbers should provide an objective look at the health of a company at a specific point in time.

## What Is Accounting?

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*Accounting* is keeping score of what's happening in the business. This is known as *financial accounting*, and the results are reported on the financial statements. The *financial statements* allow investors and creditors to make investment decisions, suppliers and customers to determine the financial condition of the company, and managers to make corrections and better decisions concerning the operations of the business.

## How Are Businesses Organized?

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There are three common types of businesses—service, merchandising, and manufacturing. The organization of the business can be set up as a sole proprietorship, partnership, corporation, or limited liability company. Each has advantages and disadvantages. Exhibit 1-1 in the textbook summarizes the different types.

## What Accounting Principles and Concepts Govern the Field of Accounting?

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*Generally Accepted Accounting Principles (GAAP)* and *Financial Accounting Standards Board (FASB)* set the principles and concepts that govern the reporting of financial information. The *International Financial Reporting Standards (IFRS)* were created for businesses located in countries that didn't have their own accounting standards.

## How Is the Accounting Equation Used to Record Business Transactions?

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The basic *accounting equation* states that the assets must equal the liabilities plus the owner's equity. This sets the basic framework for accounting. For example, assets can be broken down into current assets and long-term assets. Liabilities can be broken down into current liabilities and long-term liabilities. Equity can be broken down into common stock and retained earnings. Each of these can be broken down even further. It's important to build a framework (a structure) in your mind as to where everything goes and how they're interrelated. As transactions occur in a business, they're recorded in these categories of accounts. For example, if you invest capital in the form of cash, then the assets and equity increase, keeping the accounting equation in balance.

## What Do Financial Statements Report, and How Are They Prepared?

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The four most common financial statements are

1. *Balance sheet*—A statement that shows what a company owns (assets), what it owes (liabilities), and what the owners can claim (owner's equity) as of a particular date
2. *Income statement*—A statement that shows how much a company has earned (revenue) and spent (expenses) for a period of time
3. *Statement of retained earnings*—A statement that shows how owner's equity has changed over a period of time. (Don't be confused by the introduction of the term *stockholders' equity*. In a corporation, owner's equity is called stockholders' equity because the owners hold stock certificates. But the definition is the same; a stockholder is an owner.)
4. *Statement of cash flows*—A statement that accounts for the cash position of a company as of a particular date

Every business has a balance sheet and income statement. The statement of retained earnings and statement of cash flows are optional. Also, additional statements can be created as needed. For example, a manufacturing concern will have statements of manufactured goods. There isn't a set number of statements a particular business may have, but all businesses will have the first two.

Exhibit 1-2 in the textbook illustrates the relationship between the first three financial statements. The net income from the income statement is shown as a line item on the statement of retained earnings. The retained earnings is shown as a line item on the balance sheet.

## Demo Doc

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Pages 21–27 in the textbook provide an illustration of a transaction analysis using the accounting equation and the preparation of the financial statements. It's vital that you comprehend the materials presented in the chapter of the textbook after reading through it, but you must also understand the concepts and be able to apply them. This is where the *demo doc* comes in. If you understand the solutions to the demo doc—how the transactions are created, where the numbers come from, and where they're going—you'll grasp the fundamentals and building a framework to further understand the principles and concepts of accounting.

Before moving on to your next assignment, work through the following accounting exercises and practice problems. When you've completed the work, check your answers against the answers provided online on your My Courses Web page. Then, take time to complete *Self-Check 1* found below.

### **TEXTBOOK EXERCISES AND PROBLEMS FOR ASSIGNMENT 1**

At the end of each assignment, you'll be asked to complete selected exercises and practice problems from the text as a review of what you've learned. We urge you to complete the exercises and problems, as accounting is best learned by doing. The more you practice, the more proficient you'll become.

1. Short Exercises: S1-1 through S1-14 (pages 32–35)
2. Exercises (Group A): E1-15A through E1-22A (pages 35–38)
3. Problems (Group A): P1-31A through P1-35A (pages 41–44)

**Check your answers in the *Financial Accounting Solutions Supplement*.**



## **Self-Check 1**

**At the end of each section of *Financial Accounting*, you'll be asked to pause and check your understanding of what you've just read by completing a "Self-Check" exercise. Answering these questions will help you review what you've studied so far. Please complete *Self-Check 1* now.**

1. Which statement is *false*?
  - a. The proprietorship form of business organization protects the personal assets of the owners from creditors of the business.
  - b. A proprietorship has a single owner.
  - c. Accounting is the information system that measures business activities, processes that information into reports, and communicates the results to decision makers.
  - d. The FASB determines how accounting is practiced in the United States.
2. The primary objective of financial reporting is to
  - a. present information in an ethical manner.
  - b. provide information useful to managers in making daily decisions.
  - c. provide information to the federal government.
  - d. provide information useful for investment and lending decisions.

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# Self-Check 1

3. Wilbur Corp. operates a fishing tackle shop. The company needs to borrow money to expand; therefore, it prepared financial statements to present to the banker. Wilbur Corp. obtained appraisals of all the assets of the business to ensure that the balance sheet would reflect the most current value of the assets. Wilbur Corp. has violated which principles or concepts?
- a. Reliability principle
  - b. Cost principle
  - c. Going-concern principle
  - d. Stable-monetary-unit concept
4. Which statement is *false*?
- a. Assets are economic resources that are expected to benefit future periods.
  - b. Expenses are decreases in stockholders' equity that result from delivering goods and services to customers.
  - c. Revenues are assets that represent economic benefits.
  - d. Liabilities are economic obligations to outsiders.
5. A payment on account
- a. decreases assets.
  - b. increases liabilities.
  - c. increases stockholders' equity.
  - d. increases assets.
6. Which transaction increases stockholders' equity?
- a. Collection of an account receivable
  - b. Issuance of common stock for cash
  - c. Payment of salaries
  - d. Cash purchase of land
7. A balance sheet reports the
- a. assets, liabilities, and stockholders' equity on a particular date.
  - b. difference between revenues and expenses during the period.
  - c. change in the retained earnings during the period.
  - d. cash receipts and cash payments during the period.
8. If assets increase \$40,000 during the period and liabilities decrease \$8,000 during the period, stockholders' equity must have
- a. increased \$32,000.
  - b. decreased \$48,000.
  - c. decreased \$32,000.
  - d. increased \$48,000.

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