

INTRODUCTION TO ACCOUNTING

Accounting = a service-based profession that provides reliable and relevant financial information useful in making decisions.

❖ **Financial accounting:** provides information that is designed to satisfy the needs of external users.

External users: parties outside the reporting entity (company) who are interested in the accounting information. Example: investors, creditors, taxing authorities, customers.

❖ **Managerial accounting:** provides information that is useful in running a company by internal users.

Internal users: parties inside the reporting entity (company) who are interested in the accounting information. Example: company's management, employees.

TO PREPARE ACCOUNTING INFORMATION:

- 1) Identify economic events.
- 2) Record, classify & summarize economic events.
- 3) Communicate information to interested parties.

FINANCIAL STATEMENT ELEMENTS:

- ❖ **Assets:** economic resources of a business used to accomplish its main goal(s)
- ❖ **Liabilities:** debts and obligations of a company
- ❖ **Equity:** what the company "owes" to owners
- ❖ **Contributed Capital:** component of equity resulting from contributions of capital resources

FINANCIAL STATEMENTS:

- ❖ **Income Statement:** results in revenue and expense
- ❖ **Statement of Owner's Equity:** results in owner's investment and withdrawal
- ❖ **Balance Sheet:** results in assets, liabilities, and equity
- ❖ **Cash Flow Statement:** results in cash inflows and outflows

SAMPLE STUDY NOTES

Accounting rules in the USA are grouped and called **Generally Accepted Accounting Principles (GAAP)**, which are common standards that indicate how to report economic events.

Some organizations regulating to the accounting profession:

- ❖ Financial Accounting Standards Board (FASB)
 - Private companies (primarily)
- ❖ Securities and Exchange Commission (SEC)
 - Public companies (primarily)
- ❖ Public Company Accounting Oversight Board (PCAOB)

TRANSACTIONS (TWO OF FOUR TYPES):

- ❖ **Asset source transaction:** results in an increase in an asset account and in one of the claim accounts.
 - Example: contribution of cash by owners; revenue.
- ❖ **Asset use transaction:** results in a decrease in an asset account and in one of the claim accounts
 - Example: distribution to owners; expense.

BASIC ACCOUNTING EQUATION:

$$\text{ASSETS} = \text{CLAIMS}$$

$$\text{ASSETS} = \text{LIABILITIES} + \text{EQUITY}$$

ACCOUNTS:

- ❖ **Permanent:** are not closed each period (e.g., balance sheet accounts)
 - Other name(s): *real accounts*
- ❖ **Temporary:** are closed at the end of each period. They are mostly income statement accounts (revenue, expenses), except distribution is an equity account.
 - Other name(s): *nominal accounts*

Closing the books (accounts): process of transferring balances from temporary accounts to Retained Earnings (permanent account).