

Principles of Accounting I

ACC 121

GENERAL ACCOUNTING INFORMATION

Accounting is the historical, financial record of a business. (Probably the simplest and most descriptive definition).

Accounting is the process of identifying, measuring, and communicating financial information, in order to allow the users of that information to make more informed judgements and better decisions.

ACCUMULATION \longrightarrow MEASUREMENT \longrightarrow COMMUNICATION

Accounting is the process for a) recording, b) classifying c) reporting and analyzing, the financial information of an organization.

Accounting is an information system. Even in a small organization, a manager is confronted with many complex variables. Not even the most brilliant manager can be sufficiently informed just by observing daily operations. Instead he or she must depend on the accounting process to convert business transactions into useful statistical data that can be abstracted and summarized in accounting reports¹. These reports, based upon historical financial information, provide the manager additional information to assist him or her in making better management decisions.

Accounting provides a method of systematically recording and evaluating business activities. It provides a means by which managers are informed of the financial status and progress of their companies, thus contributing to the continuing processes of planning, control of operations, and decision making.²

Accounting calls attention to both problems and opportunities that confront business and suggests possible courses of action.

Accounting information is used by many people and organizations.

Company management - decision making, problem solving.

Stockholders - evaluate their investment, measure management performance.

Potential investors - compare strength of different investments.

Creditors - determine financial strength of organization.

Labor Unions, Governmental Organizations, Financial Analysts, Regulatory Agencies.

Accrual Basis of Accounting

1. Recognize and record revenue when it has been earned.
 - a. When services are rendered or the job is complete; when product is sold.
 - b. Regardless whether money has been received or it is an A/R.
2. Recognize and record expense when it has been incurred or used or consumed.
 - a. When company has received benefits from something; utilities have been used, employee has worked, insurance coverage has been used.
 - b. Makes no difference whether it has been paid or is owed as an A/P.

Accounting Equation

ASSETS	=	LIABILITIES	+	OWNERS' EQUITY
Business Resources		Outsiders' Claims		Owners' Claims
Things we own		Things we owe		Book value
		Debts, obligations		Net assets

¹ Paul Walgenbach, Ernest Hanson, and James Hamre, Principles of Accounting, 5th ed. (San Diego, Harcourt Brace Jovanovich, Inc., Publishers, 1990), p. 3

² Ibid

- A. There are four major financial statements.
1. **Income Statement**
 - a. Always first statement to be prepared.
 - b. Indicates profit (net income) or loss from operating a business for a period of time.
Revenues less expenses equals net income or loss.
 2. **Statement of Changes in Owner's Equity**
 - a. This statement would be prepared second.
 - b. It analyzes the increases and decreases to the balance of the Capital account.
 - c. Increases to the Capital account would include additional contributions by the owner and amount of net income for the accounting period. Decreases would include withdrawals by the owner and any net loss for the accounting period.
 3. **Balance Sheet**
 - a. This statement is prepared third.
 - b. Indicates the financial positions of the business on a specific date. The balance of certain accounts (Assets, Liabilities, Equity) at the end of an accounting period (month, quarter, year).
 4. **Statement of Cash Flows**
 - a. The last financial statement to be prepared.
 - b. Describes the sources (inflows) and uses (outflows) of cash.
 - c. Explains the change in cash from the beginning to the end of the period.
- B. An **account** is an individual or separate record of the increases and decreases to a specific item that the business wants to keep track of or wants information about. It would want a record on items like Cash, Accounts Receivable, Prepaid Insurance, Accounts Payable, Service Fees Revenue, Rent Expense, etc.
- C. Five Categories or types of accounts.
1. **Assets** - Economic resources or things we own expressed in dollars.
 2. **Liabilities** - Outsiders' claims against the company; amounts that we owe to others; debts or obligations that the firm must pay in money or services at some time in the future.
 3. **Equity** - Owner's claim against the company; the owner's residual interest in the assets of the business after deducting liabilities; also referred to as net assets.
 4. **Revenue** - Amounts earned by selling a product or providing a service to customers. It is earned at the time the product is sold or the job is completed. It may be in the form of Cash or A/R.
 5. **Expenses** - Costs incurred or Assets used by a firm in the process of earning revenue.
- D. **Asset Accounts (Resources)**
- Cash
 - Accounts Receivable
 - Prepaid Insurance
 - Prepaid Rent
 - Supplies on Hand
 - Equipment
 - Land
 - Building
- E. **Liability Accounts (Debts/Obligations)**
- Accounts Payable
 - Wages Payable
 - Utilities Payable
 - Notes Payable
 - Unearned Rent Revenue
 - Unearned Service Fees
- F. **Owner's Equity Account**
- Capital
 - Withdrawal (Contra Equity)
- G. **Revenue Accounts**
- Service Fees Earned
 - Professional Fees Earned
 - Sales
 - Rent Earned
 - Interest Revenue
- H. **Expense Accounts**
- Rent Expense
 - Supplies Expense
 - Insurance Expense
 - Utility Expense
 - Wages Expense
 - Advertising Expense
 - Miscellaneous Expense