CHAPTER

1 INTRODUCTION

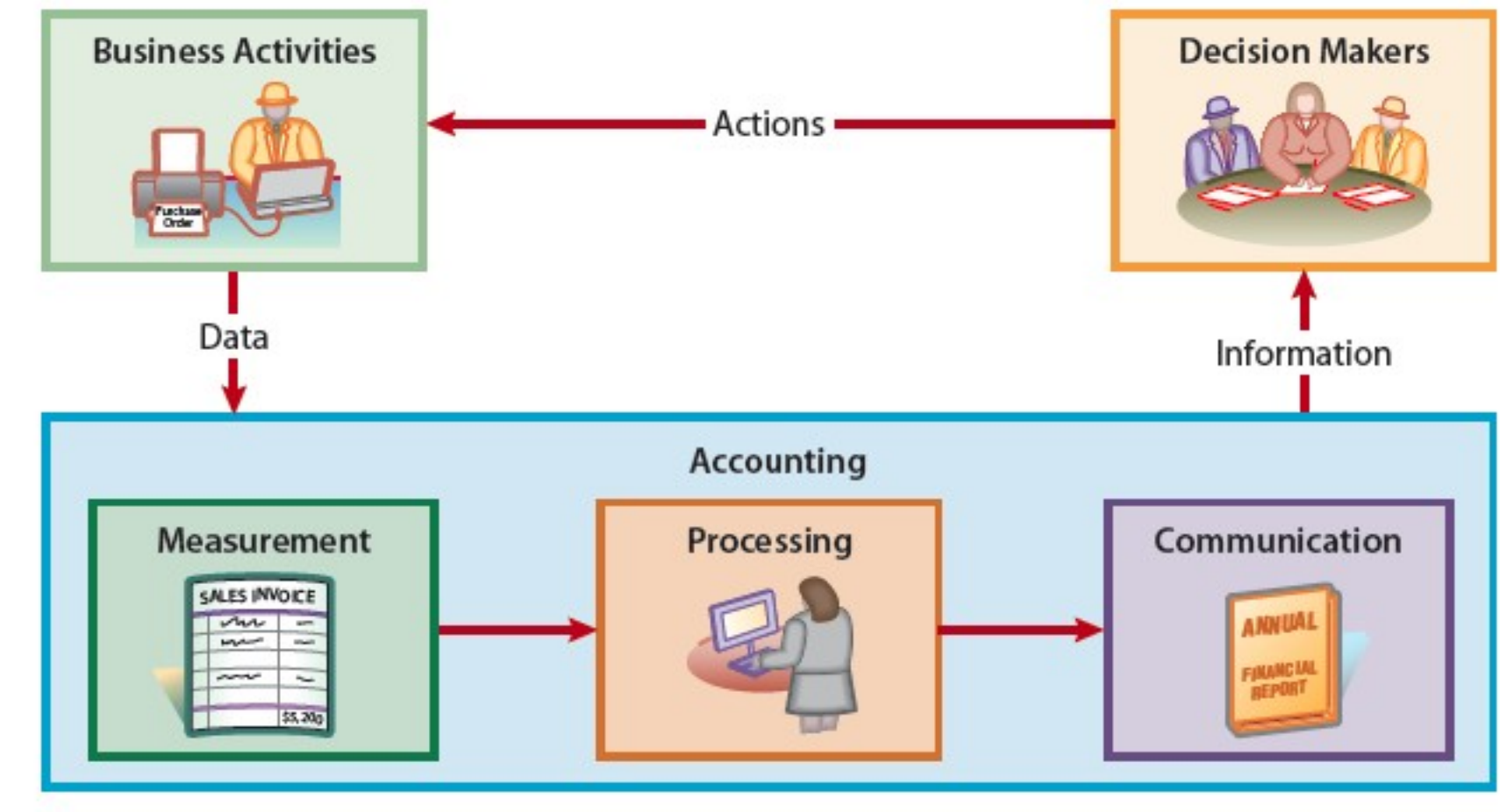
Learning Objectives

1. Definition, Evolution & Importance of Accounting.
2. Characteristics of Accounting Information & Its Users.
3. The Profession of Accountancy.
4. The Distinction Between Bookkeeping & Accounting.
5. Business Transactions & the Accounting Equation.
6. Financial Statements.
7. Accounting Principles & Concepts (in brief)

1.1 Definition & Importance of Accounting

- **Accounting** is an information system that measures, processes, and communicates financial information about a business or other economic entity to permit informed judgments and decisions byusers of the information or interested parties. Such that it [essential characteristcs]:
  - **Measures** business financial activities
    - descriptive/analytical discipline
  - **Processes** that information into reports
  - **Communicates** that information to decision makers
    - Service activity
    - Language of business
    - Link or bridge between business activities and decision makers

1.1 Definition & Importance of Accounting



1.1 Definition & Importance of Accounting

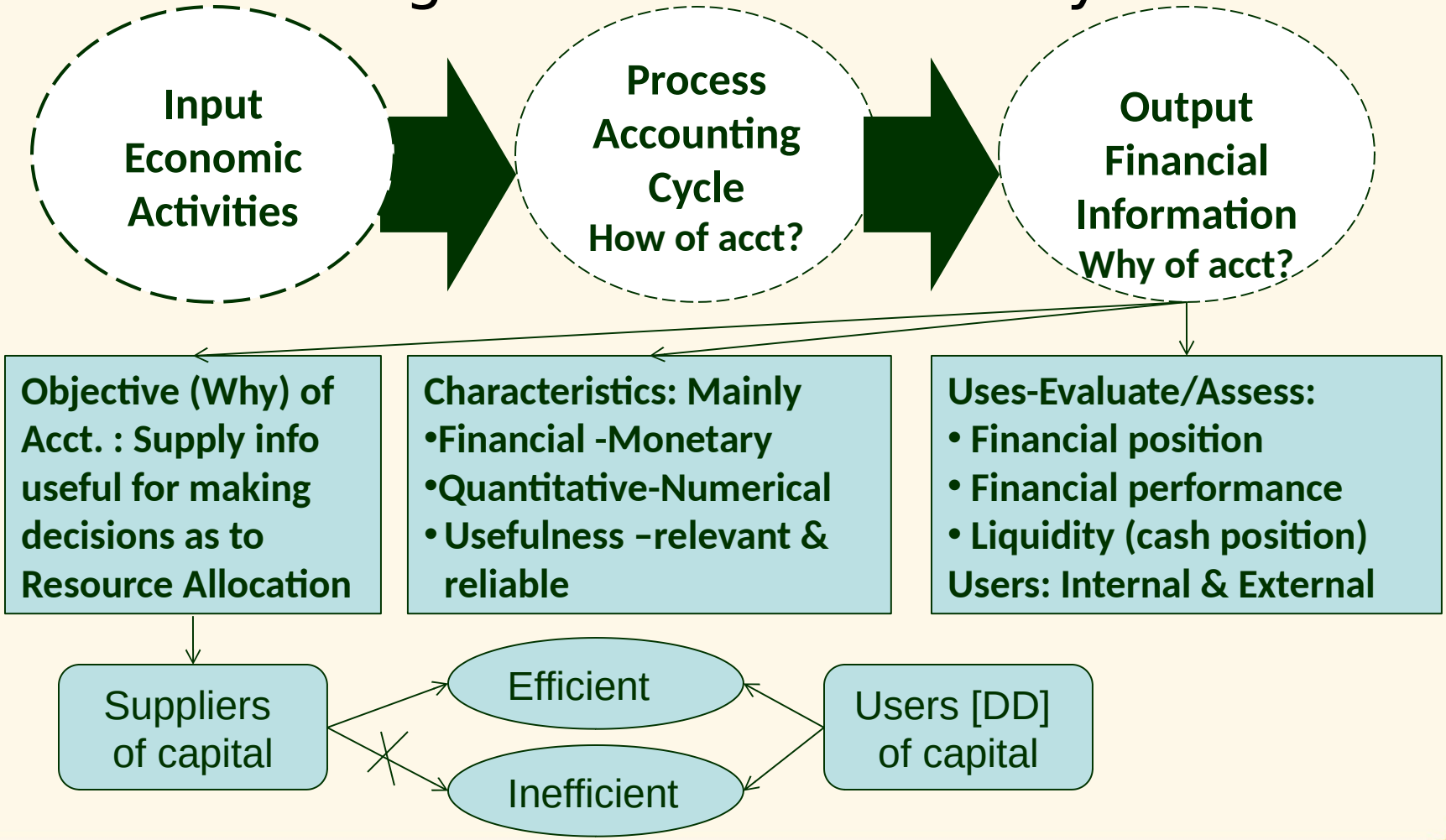
- Accounting is an art of recording, classifying, and summarizing in a significant manner and in terms of money transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.
- As a **descriptive/analytical discipline**, it defines the great mass of events and transactions that characterize economic activity and through measurement, classification, and summarization, reduces those data to relatively small, highly significant, and interrelated items that, when properly assembled and reported, describe the financial condition, and results of operation of a specific economic activity.

1.1 Definition & Importance of Accounting

- As a **service activity** its function is to provide interested parties with quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions [decisions about the deployment and use of resources in business and non-business entities and in the economy]., in making reasoned choices among alternative courses of action.
- As an **information system**, it collects and communicates economic information about a business enterprise or other entity to a wide variety of persons whose decision and actions are related to the activity.

1.1 Definition & Importance of Accounting

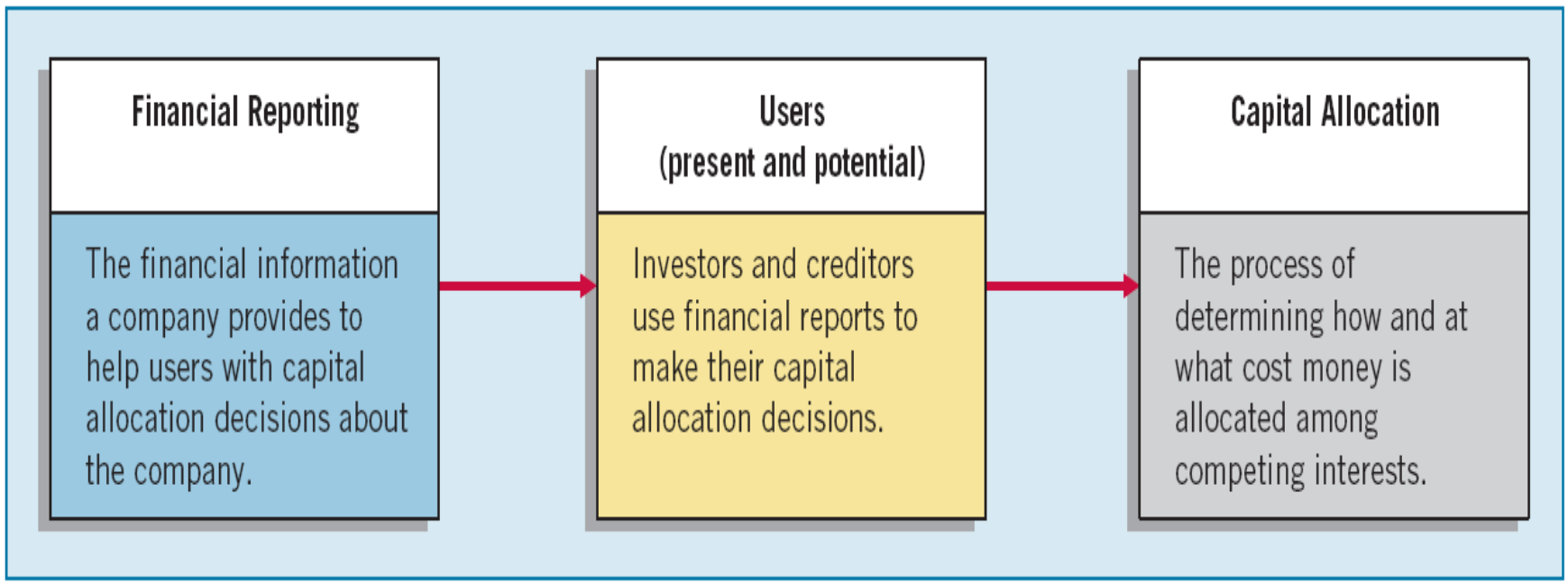
- Accounting as an information system.



1.1 Definition & Importance of Accounting

- ***Role of Accounting in Capital Allocation- accounting assists in the efficient use of scare resources.***

Resources are **limited**. Efficient use of resources often determines whether a business thrives.



1.1 Definition & Importance of Accounting

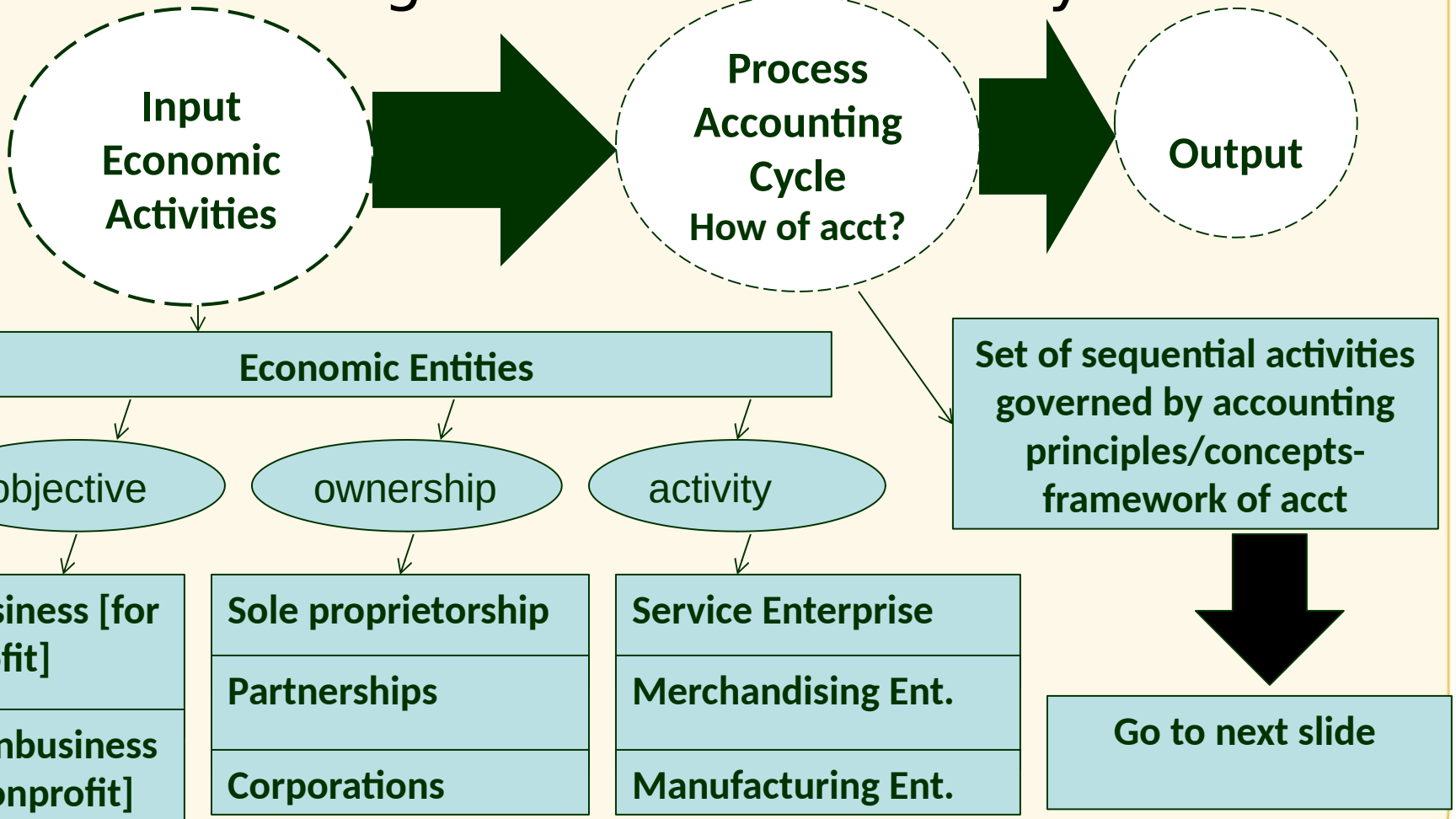
User group	Use
Managers	To help them to make decisions and plans for the business and to help them to exercise control to try to ensure that plans come to fruition
Employees (non-management)	To assess the ability of the business to continue to provide employment and to reward employees for their labor.
Owners [Investors]	To assess how effectively the managers are running the business and to make judgments about likely levels of risk and return in the future.
Creditors [Lenders]	To assess the ability of the business to meet its obligations and to pay interest and to repay the principal. [Solvency/Creditworthiness].
Government	To assess how much tax the business should pay, whether it complies with agreed pricing polices [regulation], whether financial support is needed etc.

1.1 Definition & Importance of Accounting

Customers	**To assess the ability of the business to continue in business and to supply the needs of the customers.**
Suppliers	**To assess the ability of the business to pay for the goods and services supplied.**
Investment analysts	**To assess the likely risks and returns associated with the business in order to determine its investment potential and to advise clients accordingly.**
Community representatives	**To assess the ability of the business to continue to provide employment for the community and use community resources, to help fund for environmental improvements, etc.**

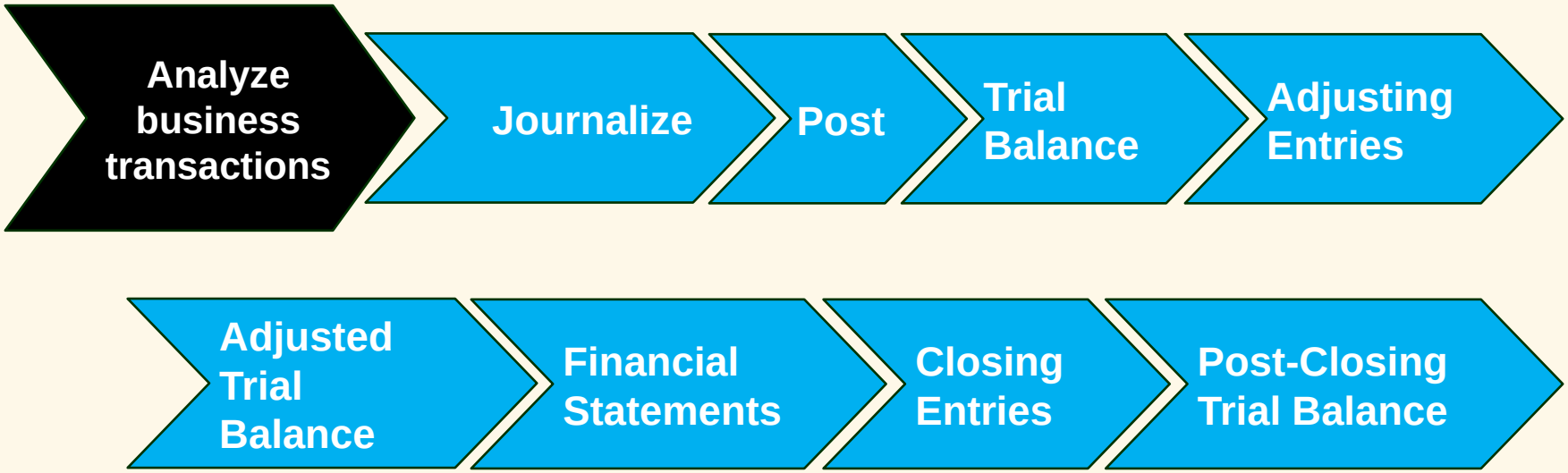
1.1 Definition & Importance of Accounting

- Accounting as an information system.



1.1 Definition & Importance of Accounting

Accounting information systems rely on a process referred to as the accounting cycle.



1.1 Definition & Importance of Accounting

- Three basic forms of business organization are recognized as separate entities.

1. **Sole proprietorship** simply **proprietorship**—a business owned by 1 person
   - The owner takes all the profits or losses of the business and is liable for all its obligations.

2. **Partnership**—a business with 2 or more owners
   - The partners share the profits or losses according to a prearranged formula.
   - A partnership must be dissolved if a partner leaves or dies.
   - The partners have unlimited liability, which can be avoided by organizing as a limited liability partnership.

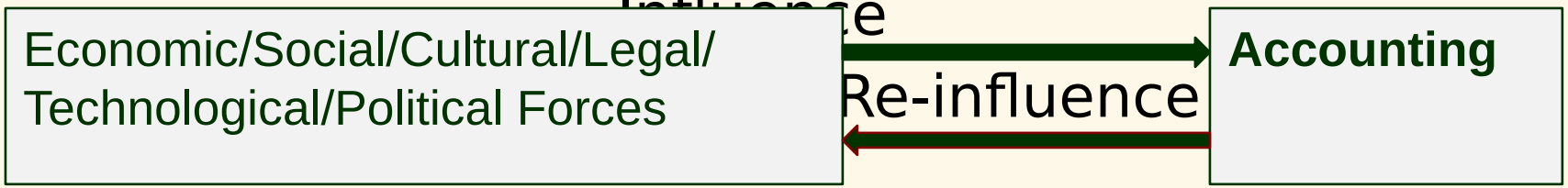
1.1 Definition & Importance of Accounting

Corporation—a business unit chartered by the state and legally separate from its owners

- The owners are called **stockholders** because their ownership is represented by shares of stock.
- The stockholders do not directly control the corporation's operations but elect a board of directors to run the corporation for their benefit.
- Stockholders enjoy limited liability, which means that their risk of loss is limited to the amount they paid for their shares.
- Stockholders can sell their shares without dissolving the corporation, so the life of a corporation is unlimited.

1.2 Evolution of Accounting

- Accounting is highly affected by the economic, social, cultural, legal, technological and political developments of a society. Interplay below.



- Higher-level economic, social, cultural, legal, technological, and political developments of a society need more elaborated and sophisticated accounting systems. In line with the changes in the aforementioned environmental factors, accounting has evolved through several phases. These phases may be grouped into two major classes: *primitive* and *modern*.

1.2 Evolution of Accounting

- Primitive - primitive accounting is believed to have begun about 4000 BC. At this stage, accounting was identified to be unsystematic and incomplete dealing with certain aspects and types of economic affairs (like receipts or payments of money), which does not provide information sufficient enough to evaluate the financial performance and position of an economic entity.
- *Modern* - modern accounting emerges with the invention of the "*Double-entry accounting system*" in 1494 by an Italian monk named Luca Pacioli. Double-entry accounting system provides for recording the *dual,* commonly called *debit* and *credit*, *aspects* of financial affairs of an entity which enhances the accuracy of records and facilitates

1.2 Evolution of Accounting

- Influencing Factors
  - Industrial revolution
    - England & USA
    - Mid 18th –Mid 19th century
    - Small scale (handicraft) to large scale (factory) production
    - Need for determination of cost of large volume of machine made identical products
    - Cost accounting-specialized field of accounting accumulating & providing cost data for:
      - Product pricing
      - Planning future operations
      - Measuring efficiency of current operations
      - Solve management problems

1.2 Evolution of Accounting

- Corporate organization
  - England in 1845
  - Industrial revolution

Large scale production

Demand for large capital

Corporate Enterprises

Separation of Ownership & Management

Increased Demand for Accounting Information

Owners	Government Agencies	Employees, Labor unions, Customers	Etc
Appraise mgt Performance	Taxation & Regulation	Judge Stability & Profitability	

FINANCIAL ACCOUNTING [EXTERNAL REPORTING]

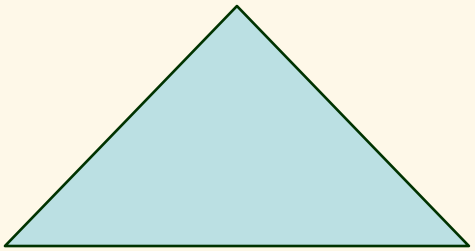
1.2 Evolution of Accounting

- Public accounting
  - Industrial revolution
    - Large scale production
      - Demand for large capital
        - Corporate Enterprises
          - Separation of Ownership & Management

Demand for Credibility of Management Representations [Accounting Information] by Various Stakeholders

Auditing (Public Accounting]

AUDITOR



USER PRODUCER

Mgt Advisory [Consultancy Services)-Non Audit

1.2 Evolution of Accounting

Income Tax

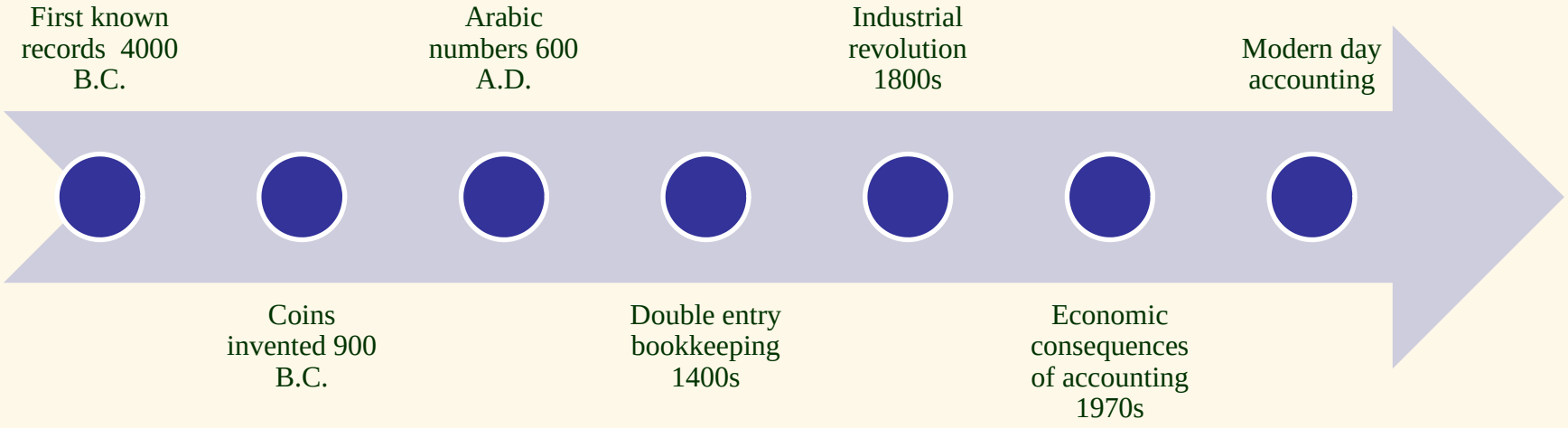
- Need for accounting information for enactment and enforcement of income tax laws and regulations
- Requirement to maintain [keep] sufficient records to enable companies file accurate tax returns
- Reliance on both private and public accountants for advice on legal methods of tax minimization, for preparation of tax returns, handle tax disputes, etc

1.2 Evolution of Accounting

Government Influence

- Increased intervention of government in economic and social matters =Increased demand for large vol. of accounting data
  - Regulate investment activities [e.g. protect rights of investors, encourage savings]
  - Regulate price of goods and services [e.g. permit “fair return” on invested capital or control excessive charges- Control INFLATION]
  - Regulate financing activities [e.g. operations of financial institutions]
  - Regulate social activities [e.g. Discourage consumption through taxation]

1.2 Evolution of Accounting



1.3 The Accounting Profession

Accountants employed by a business firm or a not-for-profit organization are said to be engaged in ***private accounting***.

Accountants and their staff who provide services on a fee basis are said to be employed in ***public accounting***.

.3 The Accounting Profession

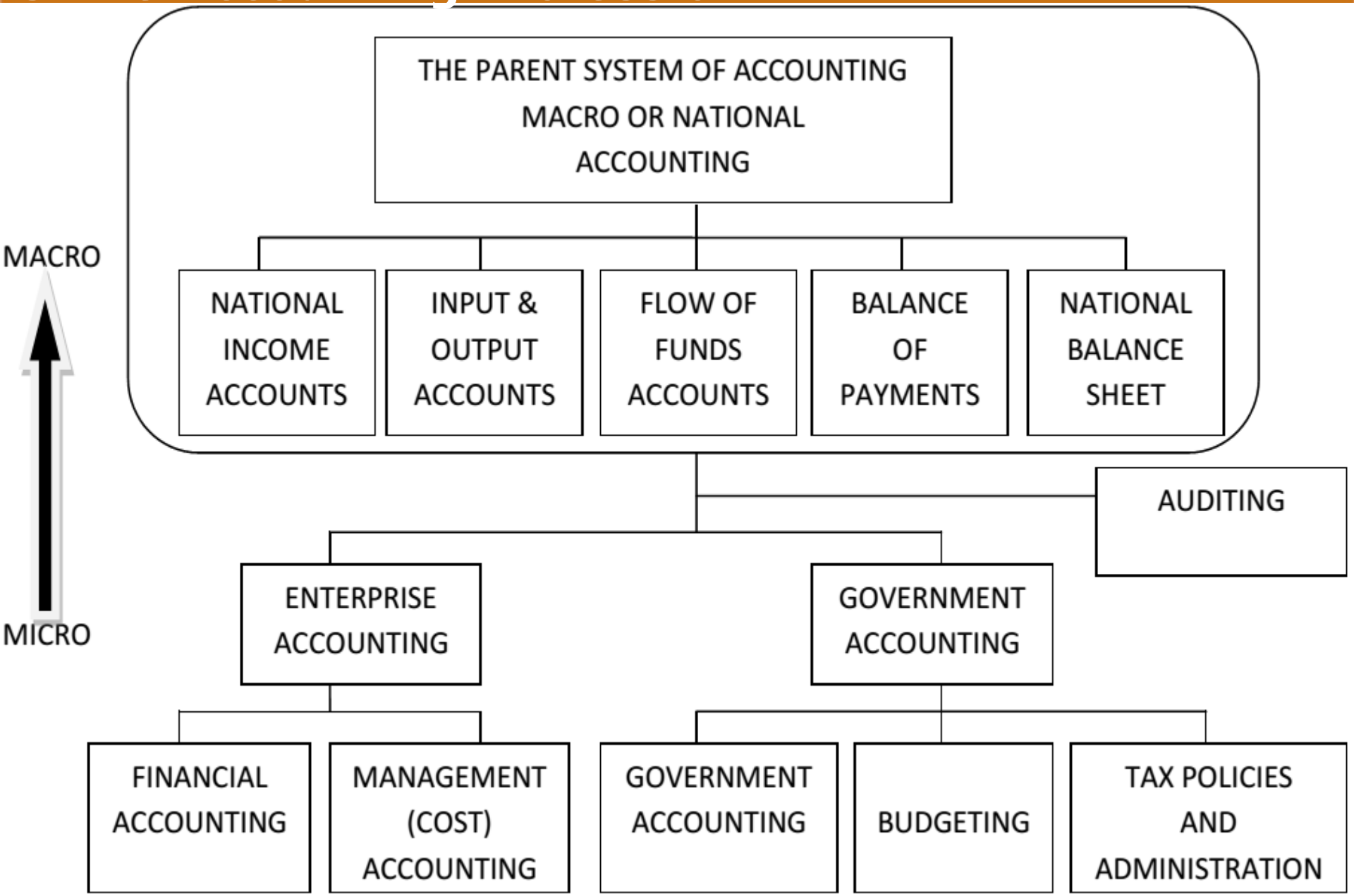


FIG. HIERARCHY OF ACCOUNTING INFORMATION MEASUREMENT SYSTEM

1.3 The Accounting Profession

Accountants may specialize in different accounting fields some of which include the following.

- *Financial* accounting - area of accounting aimed at serving information needs of external users.
- *Managerial* accounting - field of accounting concerned with serving information needs of internal users - managers.
- *Cost* accounting - a managerial accounting activity designed to help managers in identifying, measuring and controlling operating costs.
- *Tax* accounting - field of accounting that includes preparing tax returns and planning future transactions to manage the amount profit tax

1.3 The Accounting Profession

- Governmental Accounting, also known as public accounting or federal accounting, refers to the type of accounting information system used in the public sector.
- Forensic Accounting is the use of accounting, auditing and investigative techniques in cases of litigation or disputes.
- Social Accounting, also known as *Corporate Social Responsibility Reporting and Sustainability Accounting,* refers to the process of reporting implications of an organization's activities on its ecological and social environment.
- Auditing-assure the credibility of accounting information

1.3 The Accounting Profession

Bookkeeping refers to the art of recording, in a prescribed and systematic way, the economic activities of an organization. It is routine and clerical in nature. [BK is the mechanical and repetitive recordkeeping aspect of accounting] Accounting, on the other hand, goes beyond bookkeeping and is concerned with:

- *Designing* accounting and reporting systems
- *Recording* economic activities
- *Preparing* reports and statements
- *Interpreting* reported information and
- *Reviewing* records and reports for their accuracy.

Thus, it can be safely concluded that bookkeeping is one and the simplest part of accounting. Accounting plays three important roles:

1. Scorekeeping-Bookkeeping *3. Problem*

1.4 Business Transactions

- **Business transactions** are economic events that affect a business's financial position.
  - Business's economic events recorded by accountants.
  - A transaction can be an exchange of value (a purchase, sale, payment, collection, or loan) between two or more parties-External.
  - A transaction also can be an economic event that does not involve an exchange, such as losses from fire, flood, explosion, and theft; physical wear and tear on machinery and equipment-Internal.
  - Each transaction has a dual effect on the accounting equation.

1.4 Business/Accounting Transactions

Question: Are the following events recorded in the accounting records?

	Purchase computer	An employee is hired	Pay rent
Event			
Criterion	Is the financial position (assets, liabilities, or stockholders' equity) of the company changed?		
Record/ Don't Record	Yes 	No 	Yes 

1.4 The Accounting Equation

The Basic Accounting Equation

Assets = Liabilities + Owner's Equity

This is the same idea as

Investing = Financing

Resources = Sources of Resources

Resources = Claims on Resources

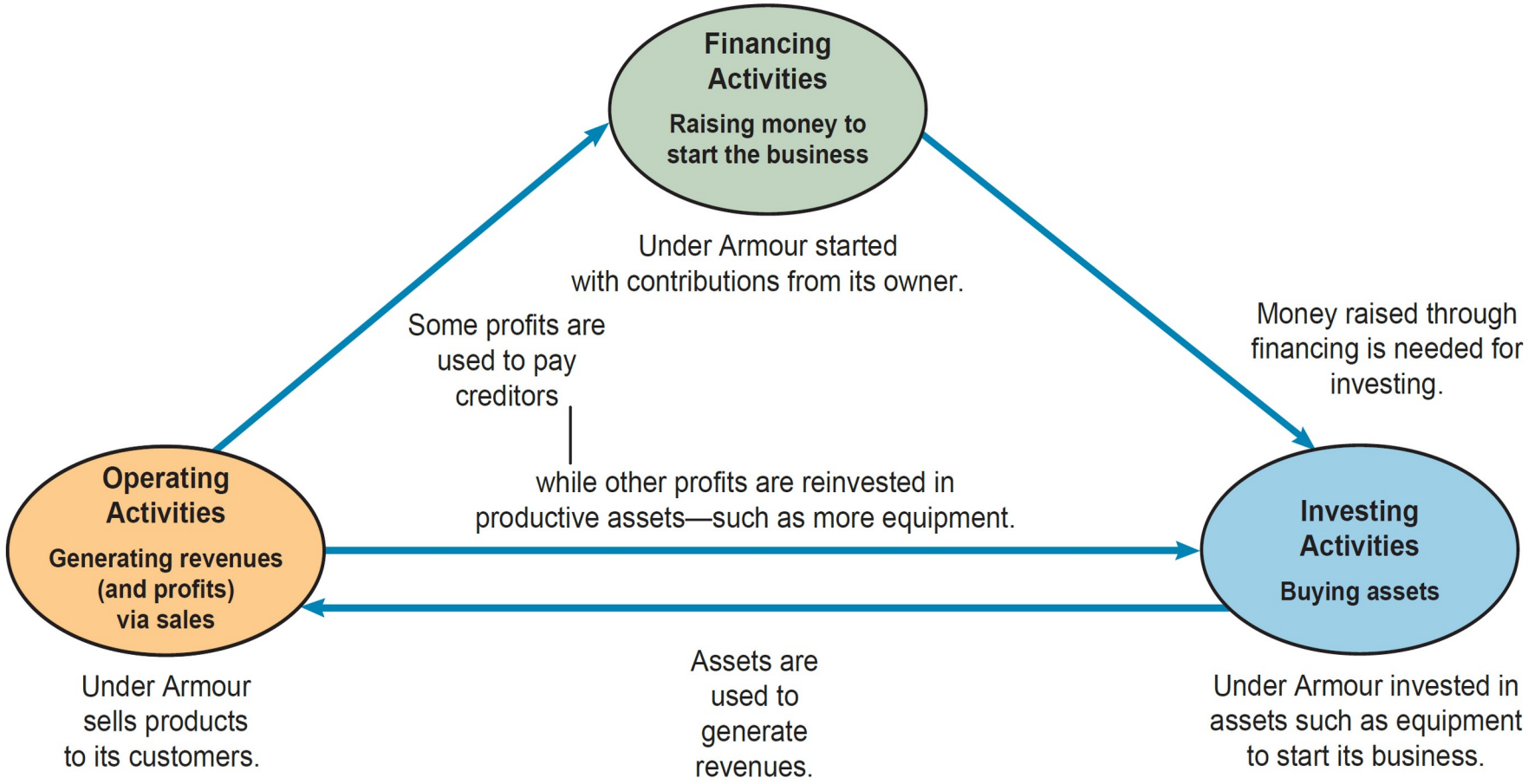
1.4 The Accounting Equation

- Provides the **underlying framework** for recording and summarizing economic events
- It is derived from the four principal business activities

1. Establishing goals and strategies
   - **Goals:** End results toward which the firm directs its energies
   - **Strategies**: Means for achieving goals
     - For example: A corporate goal may be to provide a good working environment for employees and a strategy to achieve this may be to offer enhanced benefits and training leading to opportunities for advancement
2. Obtaining financing
3. Making investments
4. Conducting operations
   - Purchasing, Marketing, Production, Administration

1.4 The Accounting Equation

Model of Business Activities



1.4 The Accounting Equation

- **Financial position** refers to a company's economic resources, such as cash, inventory, and buildings, and the claims against those resources at a particular time. Another term for claims is *equities*.
- Every company has two types of equities: creditors' equities, such as bank loans, and owner's equity. The sum of these equities equals a company's resources:

  Economic Resources = Creditors' Equities + Owner's Equity
- In accounting terminology, economic resources are called *assets* and creditors' equities are called *liabilities*, so the equation can be written:

  Assets = Liabilities + Owner's Equity

  -This equation is known as the **accounting equation (A = L + OE)**.

  -The two sides of the equation must always be equal, or

1.4 The Accounting Equation

- **Assets**
  - Economic resources a business owns and controls.
  - Provide future services or benefits.
  - They include:
    - monetary items (cash and money owed from customers called account receivables)
    - nonmonetary, physical items (inventories, land, buildings, equipment)
    - nonphysical items (rights granted by patents, trademarks, and copyrights)

1.4 The Accounting Equation

- **Liabilities**
  - present obligations to pay cash, transfer assets, or provide services to other entities in the future.
  - claims against assets (debts and obligations).
  - debts and amounts owed, that are payable to outsiders (often called creditors- party to whom money is owed.
  - they include:
    - amounts to suppliers for goods or services bought on credit (called *accounts payable*)
    - borrowed money such as bank loans
    - salaries and wages owed to employees
    - taxes owed to the government
    - services to be performed

1.4 The Accounting Equation

Owner's equity

- represents the claims by the owner of a business to the assets of the business
- ownership claim on total assets.
- referred to as residual equity or net assets because theoretically, owner's equity is what would be left if all liabilities were paid, hence, Owner's Equity = Assets − Liabilities



1.4 The Accounting Equation

Basic Equation:	**Assets = Liabilities**	**+**	**Owner's Equity**
Expanded Equation:	**Assets = Liabilities**	**+**	**Owner's Capital − Owner's Drawings + Revenues − Expenses**

Revenues

- result from **business activities** entered into for the purpose of earning income.
- are increases in owner's equity that result from operating a business.
- **common sources of revenue** are: sales, fees, services, commissions, interest, dividends, royalties, and rent.

1.4 The Accounting Equation

Basic Equation:	Assets = Liabilities	+	Owner's Equity
Expanded Equation:	Assets = Liabilities	+	Owner's Capital − Owner's Drawings + Revenues − Expenses

Expenses

- the cost of assets **consumed** or services **used** in the process of earning revenue.
- decreases in owner's equity that result from operating a business.
- **common expenses** are: salaries expense, rent expense, utilities expense, tax expense, etc.

1.4 The Accounting Equation

- **Owners' investments** are assets that the owner puts into the business.
- **Withdrawals** are assets that the owner takes out of the business.
- When revenues exceed expenses and when expenses exceed revenues the difference is called **net income** and net loss, respectively, i.e. Net income (loss) = Revenues – Expenses
- **Dual-Entry [Double-Entry] Recording Framework**
  - Every economic event has two sides, a give and a take.
  - Accountants record both sides economic events as a *transaction*.
  - The two sides of a transaction must balance so that the

1.4 The Accounting Equation

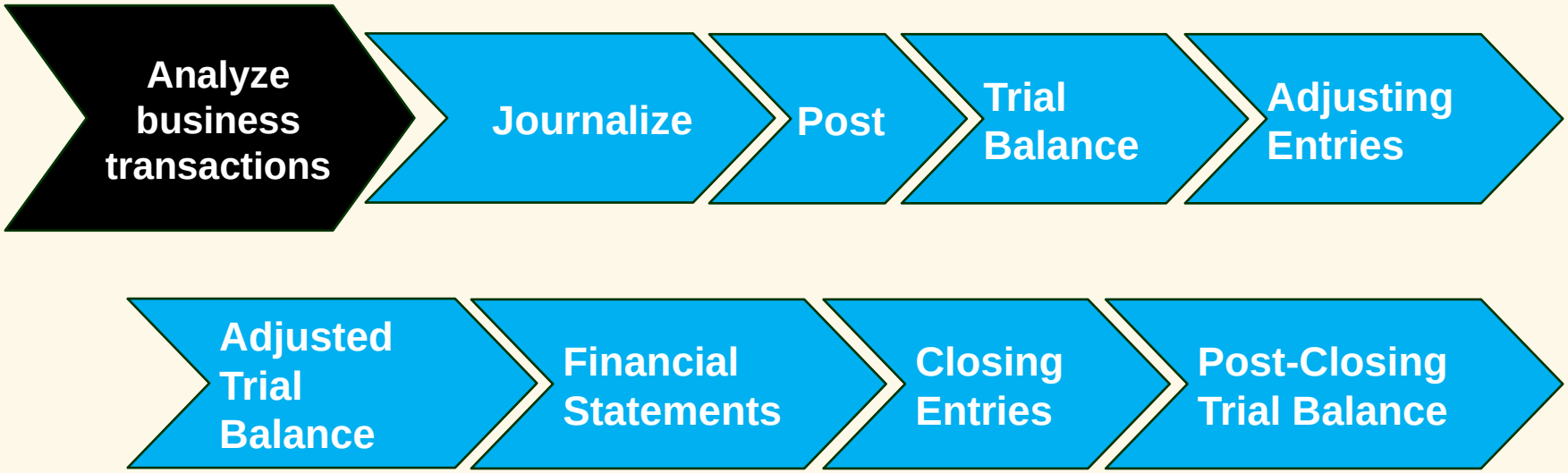
- Dual Effect of a Transaction on the Equation
  - Remember that the transaction must balance, and that the basic equation must balance.
  - Remember the basic rule of math, you can do whatever you want to an equation as long as you do it to both sides of the equal sign.

There are four general combinations:

1. Increase an asset and a liability or owners' equity by the same amount,
2. Decrease an asset and a liability or owners' equity by the same amount,
3. Increase an asset & decrease another by the same amount, &
4. Increase a liability or owners' equity and decrease another liability or owners' equity by the same amount.

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

Accounting information systems rely on a process referred to as the accounting cycle.



1.4 Tabular Analysis of Business Transactions using the Accounting Equation

On January 3, 2016, Alemu H., an ex-manager of the CBE Finfinne Branch, established his own consultancy business. He named his business "AH Consultancy Services". The objective of the business is to render financial consultancy services to clients on a fee basis. The following business activities occurred during the first month of operations of the business (January 3 to January 31, 2016).

1. Alemu deposited 20,000 cash in a bank account in the name of his business - AH Consultancy Services. He has 250,000 cash in his personal bank account with Dashen Bank and 50,000 cash in a safe deposit box at his residence.
2. Alemu transferred furniture worth 30,000 from his home for office purposes by AH Consultancy Services. He also has extra home furniture, residential house and personal car worth 620,000, 800,000 and 360,000, respectively.

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

3. Alemu purchased office supplies worth 5,000 from various suppliers agreeing to pay the sum in the near future. Two-fifth [2000] of the supplies will be used for personal purposes while the remaining [3,000] is for use by AH. Three-fifth [3,000] of the liability is arranged to be settled from business cash sources.
4. AH received 20,000 cash for consultancy services it rendered to a cash client.
5. AH paid 3,000 cash for advertising aired through ETV.
6. AH forecasted that services fees in the next two weeks will amount to 5,000.
7. AH received 10,000 additional cash investment from Alemu - its owner.
8. AH rendered consultancy services worth 15,000 to

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

9. AH sold one of the furniture invested by its owner for 5,000 cash. The furniture had a recorded value of 5,000.
10. AH collected 5,000 cash from clients who received services in item-8 above.
11. AH paid 2,000 cash to suppliers on credit.
12. AH purchased a computer for business purposes. The business paid 8,000 cash for the computer.
13. AH borrowed 4,000 cash from Dashen Bank. The loan is repayable over ten months.
14. AH employed an accountant and a secretary for monthly salary of 1,200 and 700, respectively.
15. AH incurred and paid for the following expenses

Wages.....	6,000
Rent.....	4,500
Utilities.....	1,200
Others.....	800

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

16. AH determined that cost of supplies remained on hand at the end of the current month total 1,300.
17. AH paid 450 cash to Dashen Bank consisting of 400 principal and 50 one month interest on the loan due in January.
18. AH paid its owner 5,000 cash for personal uses (to pay house utility expenses).

Required:

1. Analyze the above transactions in terms of their effect on the elements of financial statement
2. Prepare financial statements for the business for the month of January 2016.

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

Transaction	Assets					= Liabilities		+ Capital	
	Cash	A/R	Supplies	Furniture	Equipment	A/Payable	Bank Loan	Alemu, Capital	
1	+20000							+20000	original investment
balance	20000							20000	
2	-			+30000				+30000	additional investment
balance	20000			30000				50000	
3	-		+3000	-		+3000		-	
balance	20000		3000	30000		3000		50000	
4	+20000		-	-		-		+20000	cash fees earned
balance	40000		3000	30000		3000		70000	
5	-3000		-	-		-		-3000	advertizing expenses
balance	37000		3000	30000		3000		67000	
6	-		-	-		-		-	
balance	37000		3000	30000		3000		67000	
7	+10000		-	-		-		+10000	additional investment
balance	47000		3000	30000		3000		77000	

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

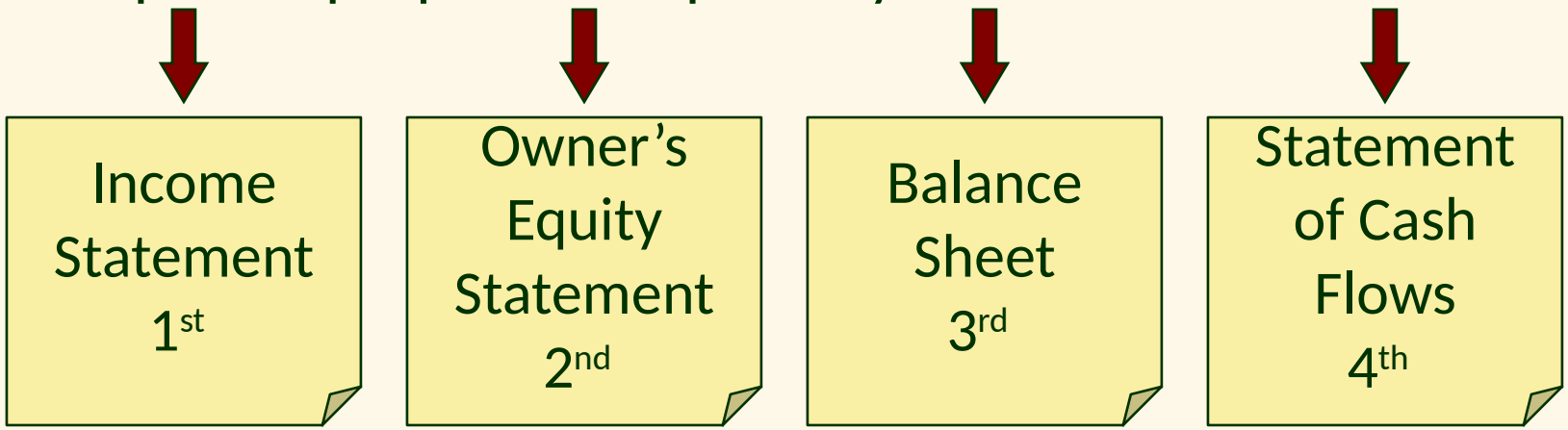
	Assets					=	Liabilities		+ Capital	
Transaction	Cash	A/R	Supplies	Furniture	Equipment		A/Payable	Bank Loan	Alemu, Capital	
balance	47000		3000	30000			3000		77000	
8	-	+15000	-	-			-		+15000	credit fees earned
balance	47000	15000	3000	30000			3000		92000	
9	+5000	-	-	-5000			-		-	
balance	52000	15000	3000	25000			3000		92000	
10	+5000	-5000	-	-			-		-	
balance	57000	10000	3000	25000			3000		92000	
11	-2000	-	-	-			.-2000		-	
balance	55000	10000	3000	25000			1000		92000	
12	-8000	-	-	-	+8000		-		-	
balance	47000	10000	3000	25000	8000		1000		92000	
13	+4000	-	-	-	-		-	.+4000	-	
balance	51000	10000	3000	25000	8000		1000	4000	92000	

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

Transaction	Assets					=	Liabilities		+ Capital	
	Cash	A/R	Supplies	Furniture	Equipment		A/Payable	Bank Loan	Alemu, Capital	
						-				
14	-	-	-	-	-		-	-	-	
balance	51000	10000	3000	25000	8000		1000	4000	92000	
15	-6000	-	-	-	-	-	-	-	-6000	wages expenses
	-4500	-	-	-	-	-	-	-	-4500	rent expenses
	-1200	-	-	-	-	-	-	-	-1200	utilities expenses
	-800	-	-	-	-		-	-	-800	miscellaneous expen.
balance	38500	10000	3000	25000	8000		1000	4000	79500	
16	-	-	-1700	-	-		-	-	-1700	supplies expenses
balance	38500	10000	1300	25000	8000		1000	4000	77800	
17	-450	-	-	-	-		-	-400	-50	interest expenses
balance	38050	10000	1300	25000	8000		1000	3600	77750	
18	-5000	-	-	-	-		-	-	-5000	withdrawals
balance	33,050	10,000	1,300	25,000	8,000		1,000	3,600	72,750	

1.5 Financial Statements

Companies prepare **four** primary financial statements :



- **Headings**

  Each financial statement has a heading that provides three pieces of data:

1. Name of the business
2. Name of the financial statement (income statement, balance sheet, or other financial statement)
3. Date or time period covered by the statement

1.5 Financial Statements

Income Statement

- A summary of [Reports] the revenue and expenses for a specific period of time.
- Lists revenues first, followed by expenses.
- Shows net income (or net loss).
- Does not include investment and withdrawal transactions between the owner and the business in measuring net income.
- Expenses could be listed

  alphabetically or from largest to

  smallest in amount

Alternative Terminology
The income statement is sometimes referred to as the *statement of operations, earnings statement,* or *profit and loss statement.*

1.5 Financial Statements

Owner's Equity Statement

- A summary of [Reports] the changes in the owner's equity that have occurred during/for a specific period of time.
  - Owner's equity is affected by investments in the business by the owner, net income (or loss), and withdrawals by the owner.
  - The net income or loss on the statement of owner's equity comes from the income statement.
- To show the period to which the statement applies, it is dated "For the [Month/Year] Ended [Date]"

LO 5

1.5 Financial Statements

Balance Sheet

- Reports the assets, liabilities, and owner's equity at a specific date.
- Lists assets at the top, followed by liabilities and owner’s equity.
- Total assets must equal total liabilities and owner's equity.
- Is a snapshot of the company’s financial condition at a specific moment in time (usually the month-end or year-end) For this reason, it is often called the statement of financial

1.5 Financial Statements

- **Statement of Cash Flows**
  - A summary of the cash receipts and disbursements for a specific period of time.
  - The statement of cash flows focuses on liquidity, that is, it Shows where the firm:
    - Generates cash-Sources/cash inflows
    - Spends or uses cash-Uses/cash outflows
  - The statement of cash flows is organized according to three major business activities:
    - Cash flows from operating activities
    - Cash flows from investing activities
    - Cash flows from financing activities

1.5 Financial Statements

- **Operating activities**—buying, producing, and selling goods and services; hiring managers and other employees; paying taxes.
- **Investing activities**—buying resources for operating the business, such as land, buildings, and equipment; selling those resources when no longer needed.
- **Financing activities**—obtaining capital from creditors and from the company's owners; repaying creditors; paying a return to owners.

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

AH Consultancy Services
Income Statement
For the month ended January 31, 2016

Revenues:		
Fees earned		35,000
Expenses:		
Wages expense	6,000	
Rent expense	4,500	
Advertising expense	3,000	
Supplies expense	1,700	
Utilities expense	1,200	
Interest expense	50	
Miscellaneous expenses	800	
Total expenses		(17,250)
Net income		**17,750**

AH Consultancy Services
Statement of Owner's Equity
For the month ended January 31, 2016

Alemu, Capital, January 1, 2016	0
Add: Investment during the month	60,000
Net income	17,750
Less: Withdrawals	(5,000)
Alemu, Capital, January 31, 2016	**72,750**

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

AH Consultancy Services
Statement of Owner's Equity
For the month ended January 31, 2016

Alemu, Capital, January 1, 2016	0
Add: Investment during the month	60,000
Net income	17,750
Less: Withdrawals	(5,000)
Alemu, Capital, January 31, 2016	**72,750**

AH Consultancy Services
Balance Sheet
January 31, 2016

Assets:		
Cash		33,050
A/Receivable		10,000
Supplies		1,300
Furniture		25,000
Equipment		8,000
Total assets		**77,350**
Liabilities:		
A/Payable	1,000	
Bank loan	3,600	
Total liabilities		**4,600**
Owner's equity:		
Alemu, Capital		72,750
Total liabilities & owner's equity		**77,350**

1.4 Tabular Analysis of Business Transactions using the Accounting Equation

AH Consultancy Services
Statement of Cash Flows
For the month ended January 31, 2016

Cash flows from operating activities:		
Cash received from customers	25,000	
Less: cash payments for expenses and suppliers on account	(17,550)	
Net cash inflow from operating activities		*7,450*
Cash flows from investing activities:		
Cash purchase of computer	(8,000)	
Cash sale of furniture	5,000	
Net cash outflow in investing activities		*(3,000)*
Cash flows from financing activities:		
Cash received from the owner	30,000	
Cash received from bank loan	4,000	
Cash withdrawal by the owner	(5,000)	
Cash repayment of bank loan	(400)	
Net cash inflow from financing activities		*28,600*
Net increase in cash for the month		33,050
Add: Cash balance, January 1, 2016		0
Cash balance, January 31, 2016		**33,050**

1.6 Accounting Concepts

nomic Entity Concept [Business is separate/independ

- **Who Reports [Reporting Entity] ?**
- The concept that a business organization is distinct from its owners, creditors, and customers.
- Single, identifiable unit must be accounted for in all situations
- Specific entity be the subject of a set of financial statements
- Does not intermingle the personal assets and liabilities of the employees or any of the other stockholders

oing Concern [Business economic life is indefinite!]

- **Operating life**
- Assumes an entity is not in the process of liquidation and that it will continue indefinitely unless there is evidence to the contrary.

1.6 Accounting Concepts

Monetary Unit [Money is stable!]

- **Unit of measurement?**
- Yardstick used to measure amounts in financial statements
- Assumes monetary unit is relatively stable; no adjustment for inflation made in financial statements
- Money is the common denominator in business.

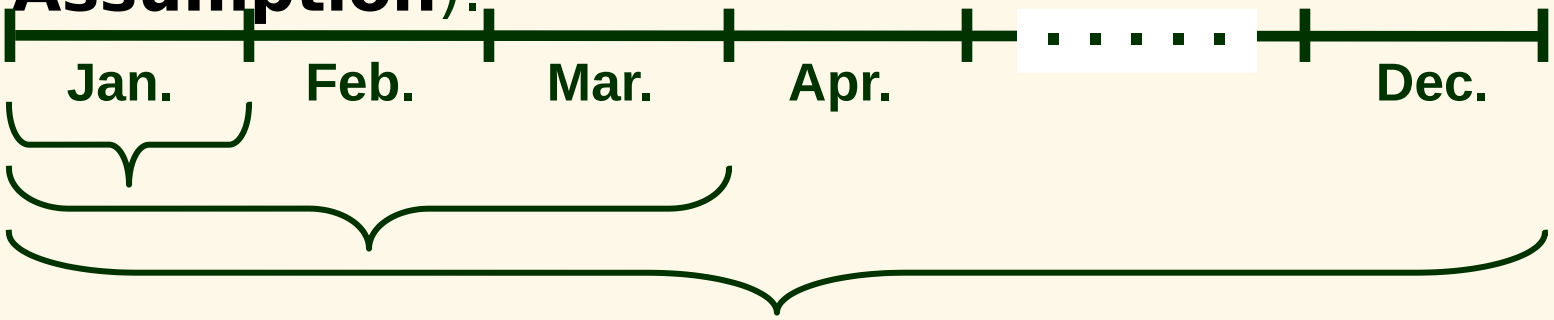
ne Period Assumption [Business economic life is divis

- ***When to report?***
- Presumes that the life of a company can be divided into time periods, such as months and years called accounting period.
  - Arbitrary or artificial equal intervals of reporting time periods.
  - Fiscal year-conventional, longest, and 12

1.6 Accounting Concepts

Periodicity Assumption

Accountants divide the economic life of a business into artificial time periods (**Periodicity Assumption**).



- Generally a **month**, a **quarter**, or a **year**.
- Fiscal year vs. calendar year.

▼ **HELPFUL HINT**
An accounting time period that is one year long is called a **fiscal year**.

CLASS EXERCISE

Presented below is selected information related to 3F Company at December 31, 2017. 3F reports financial information monthly.

Equipment	$10,000	Utilities Expense	$ 4,000
Cash	8,000	Accounts Receivable	9,000
Service Revenue	36,000	Salaries and Wages Expense	7,000
Rent Expense	11,000	Notes Payable	16,500
Accounts Payable	2,000	Owner's Drawings	5,000

(a) Determine the total assets of at December 31, 2017.

(b) Determine the net income reported for December 2017.

(c) Determine the owner's equity at December

CLASS EXERCISE

(a) The total assets are $27,000, comprised of

Cash	**$ 8,000.00**
Accounts Receivable	**9,000.00**
Equipment	**10,000.00**
Total Assets	**$ 27,000.00**

(b) Determine the net income reported for December 2017.

Revenues		
Service revenue		$36,000
Expenses		
Rent expense	$11,000	
Salaries and wages expense	7,000	
Utilities expense	4,000	
Total expenses		22,000
Net income		$14,000

CLASS EXERCISE

(c) Determine the owner's equity at December 31, 2017.

Total assets [as computed in (a)]		$27,000
Less: Liabilities		
Notes payable	$16,500	
Accounts payable	2,000	18,500
Owner's equity		$ 8,500