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**Acct 201
Introduction to
Financial
Accounting**



The University of Idaho in statewide cooperation with
Boise State University — Idaho State University — Lewis-Clark State College

Course Guide

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Acct 201 Introduction to Financial Accounting

University of Idaho
3 Semester-Hour Credits

Prepared by:

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University of Idaho

RV: September 2019

4 – Acct 201

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Acct 201: Introduction to Managerial Accounting 3 Semester-Hour Credits: U of I

Welcome!

Whether you are a new or returning student, welcome to the Independent Study in Idaho (ISI) program. Below, you will find information pertinent to your course including the course description, course materials, course objectives, as well as information about assignments, exams, and grading. If you have any questions or concerns, please contact the ISI office for clarification before beginning your course.

Policies and Procedures

Refer to the ISI website at www.uidaho.edu/isi and select *Students* for the most current policies and procedures, including information on setting up accounts, student confidentiality, exams, proctors, transcripts, course exchanges, refunds, academic integrity, library resources, and disability support and other services.

Course Description

This course introduces students to the accounting equation, debits and credits and preparation of basic financial statements. Students learn how to use general-purpose financial statement for analysis needed for business decision making purposes.

Students also gain Microsoft Excel™ skills necessary in today's business environment.

Prerequisite: None

Required: Internet access, scientific calculator, and access to a computer with 2016 or 2019 Microsoft Office Excel™

14 graded assignments, 14 Pearson MyLab Accounting Auto-graded textbook homework self-study assignments, 5 Pearson Mylab IT Excel™ Training Auto-graded assignments, 4 proctored exams.

*NOTE: All students are encouraged to sit for the MOS Basic Excel™ Certification Exam once they complete the Basic Excel™ training in Mylab IT. **University of Idaho students MUST** sit for the MOS Basic Excel™ Certification Exam either at the University of Idaho Testing Center on the University of Idaho main campus in Moscow, Idaho OR any Certiport Authorized Testing Center.*

Available online only. [For those students who have special circumstances and do not have access to the internet, arrangements to take the course offline can be made.]

Students may submit 5 assignments at once. Students may submit up to 15 assignments in one week.

Students do not have to wait for grades and feedback on assignments prior to submitting subsequent assignments though it is **ADVISED** that they submit no more than two assignments a week and wait for feedback.

Before taking exams, students are **ADVISED** to wait for grades and feedback on assignments, which may take up to two weeks after date of receipt by the instructor.

ALL assignments and exams must be submitted to receive a final grade for the course.

Course Materials

Required Course Materials

- Miller-Nobles, T., Mattison, B., & Matsumura, E. M. (2018). *Horngrens financial & managerial accounting*. New York: Pearson. (access code required only) ISBN - 9780134486833.
- MyLab IT with Pearson eText -- Access Card -- for Office **2016** Go Series by Shelley Gaskin, Alicia Vargas, Debra Geoghan and Nancy Graviett [INCLUDED IN the access for MyLab Acctg above – no additional cost]
OR
MyLab IT with Pearson eText -- Access Card -- for Office **2019** Go Series by Shelley Gaskin, Alicia Vargas, Debra Geoghan and Nancy Graviett [INCLUDED IN the access for MyLab Acctg above – no additional cost]
- **REQUIRED FOR UNIVERSITY OF IDAHO STUDENTS ONLY** and recommended for all students - MOS Basic *Excel*[™] Certification Exam (\$75.00 for two attempts at the University of Idaho Testing Center or from any Certiport Authorized Testing Center – note: testing prices may vary at other testing site locations)

Course Delivery

All ISI courses are delivered through Canvas, an online management system that hosts the course lessons and assignments and other items that are essential to the course. Upon registration, the student will receive a *Registration Confirmation Email* with information on how to access ISI courses online.

Course Introduction

This course provides an overview of the nature and purpose of general-purpose financial statements provided to external decision makers such as shareholders, creditors, and vendors. This course is set up to give students an understanding of the accounting process so they can understand:

1. How transactions impact the general-purpose financial statements. For example, when a decision is made to purchase equipment or hire an employee what will be the impact on the income statement? All employees, regardless of whether they have day-to-day accounting duties, need to understand how decisions impact the profitability and financial position of the company.
2. How the general-purpose financial statements are all connected.
3. How to calculate ratios from the information on the general-purpose financial statements to understand the company performance.

Students will also gain Microsoft *Excel*[™] skills necessary in today's business environment. The skills highlighted in this course prepare students to sit for the MOS Basic *Excel*[™] Certification exam.

Students will be expected to solve a variety of different problems including multiple choice, essay, short answer, etc. In order to be successful in this course, students must take the time to review the course guide as well as complete all reading assignments.

Course Objectives

In this course students will:

- Learn and apply the accounting equation to simple transactions
- Learn and understand Debits and Credits
- Learn how to prepare and read basic financial statements
- Learn and understand internal controls
- Learn how to use basic financial statement analysis for decision making purposes
- Explore ethical dilemmas that arise during business decisions

Lessons

Overview

Each lesson may include the following components:

- lesson objectives
- reading assignments
- important terms
- lecture
- written assignment, project, or activity

Study Hints:

- Keep a copy of every assignment submitted.
- Complete all reading assignments.
- Set a schedule allowing for course completion one month before your personal deadline. An *Assignment Submission Log* is provided for this purpose.
- Web pages and URL links in the World Wide Web are continuously changing. Contact the instructor if a Web page or URL is broken.

Refer to the **Course Rules** in Canvas for further details on assignment requirements and submission.

Exams

- Students are ADVISED to wait for grades and comments on assignments before taking subsequent exams.
- For exam guidelines, refer to the **Course Rules** in Canvas.

Refer to *Grading* for specific information on assignment/exam points and percentages.

Proctor Selection/Scheduling Exams

It is advised that students take Exam 4 ten business days before:

1. needing their final grade posted to their transcript or,
2. the end date of the course.

All exams require a proctor.

To submit your *Proctor Information Form* online, visit the ISI website and select *Forms, Proctor Information Form*. Submit this form at least two weeks before taking the first exam. Refer to *Students, Assignments and Exams* on the ISI website for information on acceptable and unacceptable proctors.

Grading – Non University of Idaho Students (University of Idaho students see grading schedule below)

The course grade will be based on the following considerations:

Lesson	Points	Percentage
15 Lessons Containing:		
MyLab Accounting Textbook Assignments - 124 problems from 1 to 2 points each	140	14.7%
<i>Accounting Excel™</i> Assignments – 13 Spreadsheets; @ 20 points each	260	27.4%
MyLab IT <i>Excel™</i> Certification Training – 4 lessons @ 15 ea, 1 lesson @ 40	100	10.5%
Annual Report Assignment	50	5.4%
Total	550	58.0%
Exam	Points	Percentage
Exam 1	100	10.5%
Exam 2	100	10.5%
Exam 3	100	10.5%
Exam 4	100	10.5%
Total	400	42.0%
Total for course:	950	100.0%

The grading percentages will be as follows:

A = 90%–100%	855–950 points
B = 80%–89%	760–854 points
C = 70%–79%	665–759 points
D = 55%–69%	523–664 points
F = 54% or below	522 points or below

University of Idaho Students Grading Schedule Next Page

Grading – University of Idaho Students ONLY

University of Idaho students have one additional requirement from Non-University of Idaho students. The course grade will be based upon the following considerations:

Lesson	Points	Percentage
15 Lessons Containing:		
MyLab Accounting Textbook Assignments - 124 problems from 1 to 2 points each	140	14.0%
<i>Accounting Excel™</i> Assignments – 13 Spreadsheets; @ 20 points each	260	26.0%
MyLab IT <i>Excel™</i> Certification Training – 4 lessons @ 15 ea, 1 lesson @ 40	100	10.0%
MOS Basic <i>Excel™</i> Certification Exam (Required for UI students ONLY)	50	5.0%
Annual Report Assignment	50	5.0%
Total	600	60.0%
Exam	Points	Percentage
Exam 1	100	10.0%
Exam 2	100	10.0%
Exam 3	100	10.0%
Exam 4	100	10.0%
Total	400	40.0%
Total for course:	1000	100.0%

The grading percentages will be as follows:

A = 90%–100%	900–1000 points
B = 80%–89%	800–899 points
C = 70%–79%	700–799 points
D = 55%–69%	550–699 points
F = 54% or below	549 points or below

The final course grade is issued after **all** lessons and exams have been graded.

Acts of academic dishonesty, including cheating or plagiarism, are considered a grave transgression and may result in a grade of F for the course.

About the Course Developer

Your course developer is Karin (K.D.) Hatheway-Dial. She is an accounting senior instructor at the University of Idaho, and a Certified Internal Auditor through the Institute of Internal Auditors. She is a graduate of the University of Idaho, where she received bachelor's degrees in both Soil Science and Bacteriology in 1988 and a Master's of Accountancy in 1999. Since 2003, she has been teaching courses at the University of Idaho in Introduction to Financial Accounting, Introduction to Managerial Accounting, Cost Accounting, Fraud Examination, Sustainability Accounting, and Forensic Accounting.

Contacting the Instructor

Instructor contact information is posted on your Canvas site under *Course Rules*.

Assignment Submission Log				
Send the completed <i>Proctor Information Form</i> to the ISI office at least <u>two weeks</u> before taking the first exam.				
Lesson	Projected Date for Completion	Date Submitted	Grade Received	Cumulative Point Totals
1				
2				
3				
It is time to make arrangements with your proctor to take Exam 1.				
Exam 1				
4				
5				
6				
7				
It is time to make arrangements with your proctor to take Exam 2.				
Exam 2				
8				
9				
10				
11				
It is time to make arrangements with your proctor to take Exam 3.				
Exam 3				
11				
12				

Lesson	Projected Date for Completion	Date Submitted	Grade Received	Cumulative Point Totals
13				
14				
It is time to make arrangements with your proctor to take Exam 4.				
Exam 4				

Lesson 1

Accounting and the Business Environment

Lesson Objectives

- 1-1 Learn what is accounting
- 1-2 Learn about the different types of accounting
- 1-3 Understand why accounting information is so valuable
- 1-4 Learn which organizations influence accounting information around the world
- 1-5 Understand the advantages and disadvantages of different types of business organizations
- 1-6 Learn the difference between operating, investing and financing activities
- 1-7 Learn who comprises internal and external users of financial information
- 1-8 Learn how to use the accounting equation to analyze transactions
- 1-9 Learn about the four basic accounting statements and their interrelationship
- 1-10 Learn the basic parts of the annual report
- 1-11 Learn how to calculate and use Return on Assets to evaluate business performance

Reading Assignments

Hornrgren's Financial and Managerial Accounting 6th Ed pp. 1-55

Important Terms

accounting	financing activities	Operating activities
accounting information system	fixed asset	partnerships
accounts payable	GAAP	PCAOB
accounts receivable	income statement	period of time
administrative expenses	income taxes	property taxes payable
AICPA	income taxes payable	property, plant and equipment (PPE)
annual report	interest revenue	regulatory agencies
assets	internal users	retained earnings
auditors report	inventory	return on assets
balance sheet	investing activities	revenue
basic accounting equation	investors	sales revenue
bond payable	IASB	sales taxes payable
Certified Public Accountant	labor unions	Sarbanes-Oxley Act (SOX)
common stock	liabilities	selling expenses
corporation	limited liability corporation LLC	SEC
cost of goods sold	management discussion & analysis	service revenue
creditors	marketing expenses	sole proprietorship
customers	net income	statement of cash flows
dividends	net loss	statement of retained earnings
expenses	note payable	stockholders' equity
external users	notes to the financial statements	taxing authorities
FASB	open book management	unqualified opinion
financial statements		wages payable

Lecture

1.1 What is accounting?

Accounting is a highly interdisciplinary subject. It impacts our lives every day in both a small and big way. Most of us make financial decisions every day with accounting information without ever thinking about it. We make decisions every day on how much to budget for our weekly groceries and if we can afford unlimited texting on our new cell phone. This lesson begins your journey into understanding the fundamentals of financial accounting and how it impacts your professional and personal life.

By definition, accounting is defined as a system for providing “quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions.” Let’s look at those words for a minute. First let’s look at the word “system” which simply means several interdependent or interactive parts that form a whole. You will find that we have many parts to the whole and the whole cannot function without all the parts. Lose one part and the system fails. Another key word is “quantitative” meaning the measurement of an amount. Something you can count and get a value. And finally let’s look at the terms “primarily financial in nature” ...well that means the system is a monetary one. In the United States the system is measured in dollars, in Japan it is measured in Yen and many companies in the European Union measure in Euros. So the system is “primarily” financial, which means that there is a non-financial part of accounting such as how many units of inventory or how many gallons of water used. Do not make the mistake of thinking that accounting is merely numbers on a sheet of paper. These numbers represent people and materials required to accomplish goals and objectives.

It is also important to note that accounting is considered an abstract concept. Yes...accounting is abstract and not black and white as many of us have been led to believe. There is a lot of critical analysis that is conducted by users of accounting information.

1.2 Types of Accounting

Financial accounting is concerned with reporting financial information to interested individuals outside the organization. Basically, financial accounting provides an historic perspective on the organizations past performance to those who require it for decision making purposes. In this class, we will be focused on this type of accounting.

Managerial Accounting is concerned with internal reporting of accounting information. This kind of accounting information is important to managers so that they can make decisions on improving current performance. Decisions made at the managerial accounting level eventually find their way onto those financial reports where a manager’s performances on how they directed the organization can be assessed.

Environmental Accounting is accounting concerned with the reporting of various social and environmental aspects related to a business’s day to day activities. This type of accounting is becoming more prevalent as many countries the United States does business with are interested in this additional information. Large Multinational companies often find that in order to do business in a foreign country these reports need to be prepared. These reports include discussion on water usage, pollution control, employee training and benefits and community leadership.

1.3 Value of Accounting

Accounting is referred to as the “language of business”. Just like chemistry is a predominant language in science so is accounting in business. Without accounting it would be difficult if not impossible to communicate about business goals and objectives. Accounting communicates to users how well resources are being used to achieve goals and objectives. This communication comes in the form of schedules and reports. If you are unable to read these reports you are unable to communicate how well or poorly the business is doing to others in the organization. Think of it as being unable to read when going down the freeway. How would you know which exit to take?

Accounting is quite useful in defining future plans in the form of budgets and capital budgets. We need budgets or plans on how we will allocate resources (usually money) so that we can effectively meet those business goals. Think of it like this...you get in your car and the gas gauge is broken and you don't have any idea on how much gas you still have. Would you take off on a 300 mile trip without knowing? You need to know how much gas you have before leaving town. You wouldn't want to run out of gas in the wrong place. Same with capital budgeting...which is essentially a plan for purchasing big ticket items such as a new car or a house or in the case of a business a new whiz bang piece of equipment or a smaller business to merge into the current business. We have to determine if the investment will be sound. Can we pay for it? Will it help us better reach our goals and objectives?

Accounting is also valuable in providing interested individuals with performance measurements. Employees often receive bonuses if the company reaches its performance goals for the period. Owners or shareholders of a business often see their shares or interest in the business appreciate when performance measurements are met.

1.4 Influential Organizations

There are many organizations which influence the accounting information system both in the United States and in the World. Examples of these influential organizations are the SEC, PCAOB, AICPA, FASB, IASB and GRI.

The **American Institute of Certified Public Accountants (AICPA)** is an organization made up of **Certified Public Accountants (CPA)**. It is a very strong group of individuals with a strong lobbying contingent in Washington D.C. **IASB or the International Accounting Standards Board** is an influential organization at the International level. IASB works towards “harmonizing” or bring to consensus accounting standards for the world. Since 2002, **FASB** and IASB have been working towards convergence of international and US GAAP. In 2007 the SEC no longer required international companies to reconcile their financial statements to US GAAP. The current goal is to have all IASB and FASB projects completed 2011. This convergence is a necessary step to provide better financial communication to the world markets.

The **GRI or Global Reporting Initiative** is a group involved in standardizing environmental and social reporting. This is a new group that is patterning themselves after FASB, who is considered one of the most rigorous standard setting bodies in the world.

In 1929 the **Security and Exchange Commission (SEC)** was created by congress in response to the stock market crash. I'm sure most of you have heard as early as high school history about this stock market crash. It happened on a Monday thus the reason we often refer to the stock market crash as “Black Monday”. Those were dark days for the financial markets of our country. So congress created the SEC and charged them with creating a “fair information environment” for investors. Congress didn't want investors to fear that companies were manipulating or hiding key financial information. So they gave the SEC “LEGAL” authority to establish accounting standards.

Public Company Accounting Oversight Board (PCAOB) was created by Title I of the **Sarbanes-Oxley Act (SOX)** of 2002 which was enacted by congress in response to the 2001 corporate scandals. PCAOB is charged with overseeing auditors of public companies in the preparation of informative, fair an independent audit reports.

Notice the pattern...we have a financial catastrophe...congress rushes in with a new law and a new standard setter. In truth, if the old system had been allowed to function as designed the corporate scandals of 2001 may not have occurred. Many individuals like Arthur Levitt (previous chairman of the SEC) tried unsuccessfully to bring some of the egregious behaviors into check. In fact, the practice many public accounting firms had in providing consulting services to their audit clients has been a concern since the 1970's. Individuals over three decades ago recognized the inherent conflict of interest in this business practice. It is not rocket science.

As previously mentioned, the SEC is legally responsible for setting accounting standards. The SEC has charged the accounting profession with being the accounting standard setter. Accounting Standards are basically rules and principles on how to present accounting information. We call these rules and principles **Generally Accepted Accounting Principles or GAAP**.

Since 2002, FASB and IASB have been working towards convergence of international and US GAAP. In 2007 the SEC no longer required international companies to reconcile their financial statements to US GAAP.

1.5 Types of Business Organizations

The main forms of business organization are the **sole proprietorship** which is a business owned by one person, a **partnership** which is a business owned by two or more people and a **corporation** which is a business organized as a separate legal entity and is owned by a group of people called stockholders.

Over the past few years another form of business called a **Limited Liability Corporation or LLC** has gained favor in the business world. Many think this is a great way to organize a business. LLC's essentially have both corporation and partnership characteristics.

The advantages of a **sole proprietorship** is that it is easy to form and gives the owner complete control of the business. There are some significant disadvantages to organizing your business as a sole proprietorship. One of the biggest disadvantage of a sole proprietorship is the "unlimited personal liability" business owner's shoulder under this business structure. If the business incurs a liability it cannot cover with the business' assets, then the owner must cover it with personal assets like their personal home. Another issue is that sole proprietorships have a limited life. If the owner sells, retires or dies the sole proprietorship ceases to exist. It can be difficult to transfer ownership of the business to another. One of the most important things a person can do when planning to enter a business is to also plan on how to exit the business. Many individuals have built up successful businesses but did not make any succession plans for how to transfer the business to another person when they decide to leave the business.

The advantages of a **partnership** are that it too is easy to form, and partners can bring different skills and resources to the business. As with the sole proprietorship there are some significant disadvantages to organizing as a partnership. The biggest concern is the "unlimited liability". If a partner files for bankruptcy the creditors can come after the entire partnerships assets, and not just the partners share. Ultimately, the bankruptcy will dissolve the partnership, which is another disadvantage. Partnerships have a limited life. Any change in the number of partners will result in the old partnership dissolving and a new partnership emerging. Retirements, adding a new partner or a partner dies are all changes that will result in the partnership ceasing to exist. When partners retire they are usually bought out by the other partners, it can be hard to come up with the funds to make that buy out.

There are several advantages to using the **corporation** form of business organization. First, it has "unlimited life. Corporations are broken up into several shares which can be easily transferred between individuals. The

transfer of these shares does not impact the day to day business of the corporation. Owner's liability is limited to the value of those shares and not their personal assets. And, corporations often find it easier to raise capital or money to expand the business over partnerships and sole proprietors. Corporations have their disadvantages too. First there tends to be more government oversight which can get expensive and there is the issue of double taxation. That is where the profits of the corporation are taxed and if there is any dividends paid out to the owners those monies are taxed at the owner level as well.

The **Limited Liability Corporation** or LLC is essentially a combination of the good things about a corporation and the good things about a partnership. First like a partnership the profits are only taxed once. In addition, it still maintains the limited liability of a corporation. It is not without its problems though. It depends on the state as to whether it enjoys "unlimited life" and members or partners are required to pay Social Security and Medicare taxes on the profits. Many businesses today choose to organize as this form of business.

1.6 Three types of business activities

Business activities are classified into three categories: Financing activities, Investing activities and operating activities

Financing activities are those activities where a business receives or repays cash from investors and creditors. Some examples of this type of activity are:

- borrowing money from a lender (bank)
- Repaying a loan
- Receiving investments from owners in exchange for stock
- Re purchasing stocks or bonds from investors

One way to think of this activity is that you are getting financing to fund an expansion of your business, or you are making a principle payment on a loan you took out sometime in the past.

Investing activities are those activities where a business receives or pays for long term assets used in the day to day activities of the business to make money or to invest its cash into bonds or stocks of some outside firm. Either way, the business is investing into itself. Often an organization must sell those assets and thus the sales of those assets are considered an investing activity as well. Some examples of this type of activity are:

- Selling buildings
- Selling equipment
- Purchasing new equipment
- Purchasing patents or copyrights

Operating activities are those activities where a business receives or makes payments on all those activities related to the day to day operations of the business. Some examples of this type of activity are:

- Paying employees
- Purchasing raw materials or merchandise for resale
- Selling goods or services to customers
- Paying taxes

1.7 Internal and external users of accounting information

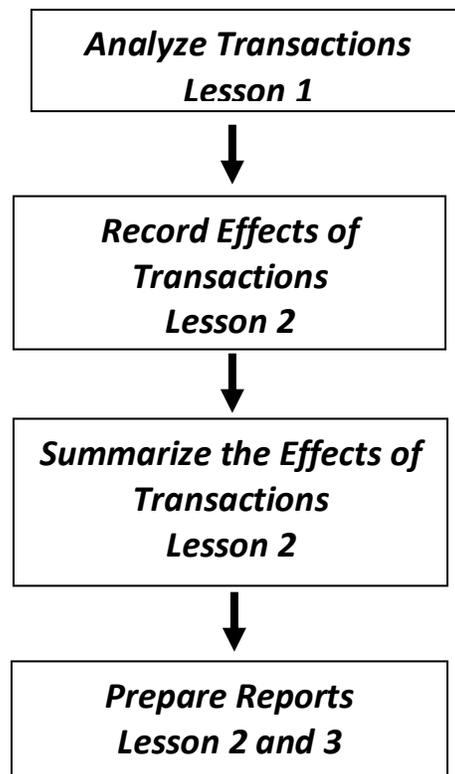
There is much that needs to be understood about the financial information that is communicated with various users. First we have two broad categories of users the "**internal users**" and the "**external users**". Second there is a hierarchy of qualitative characteristics that must be met to ensure that the information provided is of high quality. And third there are several accounting assumptions and principles that one must understand in order to fully understand the financial information provided. Ultimately it is up to the user to determine the quality of that information and to make decisions from that information. When the analysts following Enron, that were giving a "buy" signal were asked if they completely understood Enron's financial statements after its collapse; they all said "no...they had not understood some of the particulars of Enron's annual report but that the stock continued to rise on the exchange so they figured everything was okay".

Internal users primarily consist of managers and employees and external users consist of stockholders, creditors, suppliers and customers to name a few. External users have many different needs for financial information. Stockholders are looking at financial information to see if they can make a profit with an investment into the organization. **Creditors** want to know that if they make a loan to the company it will be paid back. **Suppliers** want to know that if they sell you inventory on credit you will pay the bill when it arrives. **Customers** want to know that you are solvent and will be in business so that they can depend on you to make deliveries of inventory when they need it.

1.8 Analyzing transactions using the accounting equation

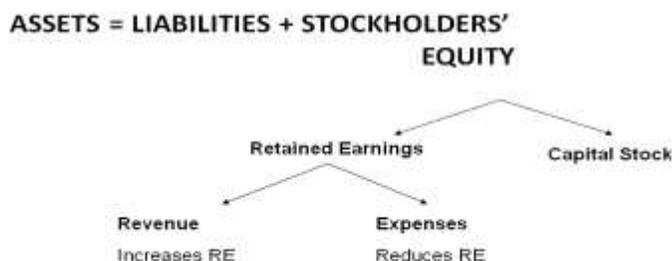
In this topic we review the mechanics of accounting. Below are the four basic steps of the accounting system. The integrity of the information in the annual report is dependent on how accurate the system is maintained. Each step in the process has checks and balances which help ensure the trustworthiness of the system.

Exhibit 1-1 Four basic steps in the accounting system



Before we can post transactions into the accounting system we must first understand how they relate to the accounting equation. In this lesson we begin to learn about the accounting equation and practice analyzing transactions.

Accounting Equation



Above is the expanded accounting equation to include revenues and expenses. Stockholder’s Equity has been broken down into Capital or Common Stock and Retained Earnings.

Retained Earnings are simply retained or saved income or profits. And...Net income is simply Revenue minus Expenses. Thus to increase retained earnings we add revenue. To reduce retained earnings we subtract expenses.

To best understand the effects of transactions on the accounting equation, several transactions have been listed below. Use the following template to analyze the impact these transactions have on the accounting equation.

Exhibit 1-3 basic and equation analysis template

Basic Analysis							
Equation Analysis							
			=			Retained Earnings	
Cash	Inventory	Equipment		Accounts Payable	Common Stock	Revenue	Expenses

Transaction 1:

The first transaction is “investment of \$10,000 cash by stockholders”.

Exhibit 1-4 basic and equation analysis of transaction 1

Basic Analysis							
Cash increases by \$10,000 and Common Stock increases \$10,000							
Equation Analysis							
			=			Retained Earnings	
Cash	Inventory	Equipment		Accounts Payable	Common Stock	Revenue	Expenses
\$10,000			=		\$10,000		

Transaction 2:

The second transaction is “\$5,000 in inventory purchased on account”.

Exhibit 1-5 basic and equation analysis of transaction 2

Basic Analysis							
Inventory increases by \$5,000 and Accounts Payable increases by \$5,000							
Equation Analysis							
Cash	Inventory	Equipment	=	Accounts Payable	Common Stock	Retained Earnings	
						Revenue	Expenses
	\$5,000			\$5,000			

Transaction 3:

The third transaction is “purchased \$5,600 worth of office equipment for cash”.

Exhibit 1-6 basic and equation analysis of transaction 3

Basic Analysis							
Equipment increases \$5,600 and cash decreases \$5,600							
Equation Analysis							
Cash	Inventory	Equipment	=	Accounts Payable	Common Stock	Retained Earnings	
						Revenue	Expenses
(5,600)		5,600					

Transaction 4

The fourth transaction is “services rendered for \$11,200 cash”.

Exhibit 1-7 basic and equation analysis of transaction 4

Basic Analysis							
Cash increases \$11,200 and Revenue increases \$11,200 or Retained Earnings increases \$11,200							
Equation Analysis							
Cash	Inventory	Equipment	=	Accounts Payable	Common Stock	Retained Earnings	
						Revenue	Expenses
\$11,200						\$11,200	

Transaction 5

The fifth transaction is “payment of \$4,000 for employee salaries”.

Exhibit 1-8 basic and equation analysis of transaction 5

Basic Analysis							
Cash decreases \$4,000 and retained earnings decreases \$4,000 (expenses increased)							
Equation Analysis							
Cash	Inventory	Equipment	=	Accounts Payable	Common Stock	Retained Earnings	
						Revenue	Expenses
(\$4,000)							(\$4,000)

1.9 The financial statements

In this section, we will begin the discussion about the final reports or **financial statements** that both internal and external users rely upon to make day to day and long-term business decisions. The most commonly used statements are:

- Income Statement
- Balance Sheet
- Statement of Retained Earnings
- Statement of Cash Flows

The **Income statement** reports the operating performance of the organization for the entire period which is commonly measured in months, quarters or years. Performance is measured by taking revenue (money that was earned during the period) and subtracting expenses (money that was used during the year to generate the revenue). The positive difference between **revenue** and **expenses** is known as **net income** or net earnings. If the difference is negative it is called a **net loss**.

The Income statement is reported in two main formats - single step and multi-step. Below are examples of both formats using the same company performance information.

Exhibit 1-9 Single Step Income Statement

Company Name	
Income Statement	
For the Year Ending December 31, 2010	
Sales Revenue	\$125,000
Gain on Sale of Equipment	11,000
Total Revenue	\$136,000
Less Expenses	
Cost of Goods Sold	(85,000)
General and Administrative Expenses	(22,050)
Selling and Advertising Expense	(4,500)
Interest Expense	(2,350)
Income before Taxes	22,100
Income tax expense	(8,840)
Net Income	\$13,260
Earnings Per Share	\$2.21/share

In exhibit 1-9 the revenue is grouped together, and the expenses are grouped together. In exhibit 1-10 the information is grouped based upon type of operations. **Sales Revenue** less **Cost of Goods Sold** equals gross profit which gives the reader performance information on the core operations of the business. The next section details how well the company managed the administrative side of the business, and the last section shows any non-core business related gain or loss. These gains or losses are revenue and expenses outside normal day to day business operations. Having the revenue and expenses defined in this manner allows for a reader to see where the profits of the company are being generated.

Exhibit 1-10 Multi-step Income Statement

Company Name	
Income Statement	
For the Year Ending December 31, 2010	
Sales Revenue	\$125,000
Less Cost of Goods Sold	(85,000)
Gross Profit	<u>40,000</u>
Less General and Administrative Expenses	(22,050)
Less Selling and Advertising Expenses	(4,500)
Operating Profit	<u>13,450</u>
Gain on Sale of Equipment	11,000
Interest Expense	(2,350)
Income before Taxes	<u>22,100</u>
Income tax expense	(8,840)
Net Income	<u><u>\$13,260</u></u>
 Earnings Per Share	 \$2.21/share

Retained Earnings is just what the words mean. It is earnings that are retained. All or part of net income is retained by the company to use for future expansion and growth. Many companies pay a portion of the earnings to the shareholders or owners of the company. These payments are called dividends. Dividends reduce retained earnings.

Exhibit 1-11 Statement of Retained Earnings

Company Name		
Statement of Retained Earnings		
For the Year Ending December 31, 2010		
Beginning Retained Earnings	\$37,520	← Must equal Net Income on the Income
Add Net Income	13,260	
Less Dividends	<u>(1,306)</u>	
Ending Retained Earnings	<u><u>\$49,474</u></u>	

The balance sheet reports assets or resources owned by the company and the claims to those assets or resources on a specific day. Where the income statement and statement of retained earnings report performance over “a period of time”, the balance sheet reports the financial position of the company on a specific day. Notice that total assets equal total liabilities and stockholders’ equity. This is where the balance sheet gets its name. The assets must equal the claims against those assets.

Exhibit 1-12 Balance Sheet

Company Name
Balance Sheet
December 31, 2010

Assets			
Cash	\$14,000	}	Assets or resource owned by the company
Accounts Receivable	21,000		
Less Allowance for Bad Debt	(1,050)		
Inventory	28,700		
Land	122,000		
Buildings	162,000		
Equipment	16,200		
Less Accumulated Depreciation	(5,500)		
Total Assets	\$357,350		
Liabilities			
Accounts Payable	\$8,876	}	Creditor claims to Assets
Mortgage Payable	115,000		
Total Liabilities	123,876		
Stockholders' Equity			
Common Stock	184,000	}	Owner claims to Assets
Retained Earnings	49,474		
Total Stockholders' Equity	233,474		
Total Liabilities and Stockholders' Equity	\$357,350		

These totals must equal

The last statement in this list is the **statement of cash flows**. The statement of cash flows breaks down the cash listed in the balance sheet into three activities – operating, investing and financing. This shows the reader where cash was generated and used. How a company receives and uses cash can tell a reader if the company has a strong or weak future outlook. Companies can show profitability on the income statement yet be so cash poor that they find themselves in bankruptcy court.

Exhibit 1-13 Statement of Cash Flows

Company Name
Statement of Cash Flows
For the Year Ending December 31, 2010

Cash from Operating Activities	
Cash receipts from Customers	\$120,000
Cash payments for Salaries	(20,000)
Cash payments for interest	(2,350)
Cash payments for inventory	(12,000)
Other Cash payments	(55,000)
Net cash from operating activities	30,650
Cash from Investing Activities	
Cash from sale of equipment	11,000
Purchase of equipment	50,000
Net cash from investing activities	(\$39,000)

Cash from Investing activities		
Cash from issuance of stock	67,650	
Cash payment of dividend	(1,300)	
Cash payment of mortgage	(55,000)	
Net cash from financing activities	11,350	
Net increase (decrease) in cash	3,000	
Beginning Cash	11,000	Must equal
Ending Cash	\$14,000	← Cash on the balance sheet

1.10 How financial information is communicated

Financial information is generally communicated by annual or quarterly reports. Annual reports are often glossy reports published by the company with all the requisite information plus some company public relations or PR. All of the serious stuff in the glossy reports can be found at the Securities and Exchange Commission (SEC) website. They have a database called Edgar which you can access all the filed financial information of publicly traded companies. In order to trade on any of the United States stock exchanges a business must file certain reports with the SEC. The annual financial information is called a 10K and the quarterly financial information is called a 10Q. These files are very plain and have no pictures or PR.

In addition to the annual and quarterly reports, companies are required by the SEC to send their shareholders proxy statements. These proxy statements provide material facts concerning matters on which the shareholders will vote at upcoming shareholder meetings. Proxy statements also report the salaries of the top executives of a company.

Another report that is becoming more and more widespread is the social responsibility report. These reports contain information regarding environmental, social and financial performance. This is often referred to as the triple bottom line.

The basic annual report contains the following items:

- Income Statement
- Balance Sheet
- Statement of Cash Flows
- Statement of Stockholders' Equity
- Management's Discussion and Analysis (MDA)
- Notes to the Financial Statements
- Five-year Summary of Earnings and Financial Highlights
- Auditors report

The **management's discussion and analysis (MDA)** is the section of the annual report where a senior executive, usually the CEO, discusses the state of the company. He/she discusses the past and present condition of the company in this section. Readers should look at both what is discussed and what is not discussed when reviewing this section of the annual report.

Notes to the financial statements consist of information that expands on sections of the statements. For instance, the inventory note discusses the inventory value on the balance sheet in more detail.

The auditor's report is prepared by an outside auditing firm that is independent of the company. The auditors review the annual report or presentation of the company's financial position and provide an opinion on the annual report and how it conforms to **generally accepted accounting principles**. If the company's annual report meets these standards, then the auditor issues an "**unqualified opinion**". Anything less than an unqualified opinion means the information in the annual report cannot be fully relied upon.

1.11 Using Return on Assets to evaluate business performance

One of the tools used to evaluate a business' performance is **Return on Assets**. Return on Assets is a ratio that measures how well a company has used its assets to make a profit. Return on Assets can be calculated by dividing net income by average total assets.

Return on Assets = Net Income/(Total Average Assets)

Return on Assets = Net Income/[(Beginning Total Average Assets + Ending Total Average Asset)/2]

Homework Assignment



Please read the **Appendix** in the back of this study guide for essential Independent Study in Idaho policies and procedures, and forms you will need to successfully complete this course. You are responsible for understanding and following ISI policies and procedures. If there is anything on these pages you do not understand, contact the ISI office for clarification. Before starting the written assignment for Lesson 1, see the letter in your registration packet for your instructor's requirements: **how to format and submit lessons, number of lessons you may submit at one time, and lesson guidelines.**

Homework Assignment

1. Please complete and submit the following textbook assignments on Canvas:
Short Exercise S1-1, S1-7, S1-9, and S1-11; Exercise E1-18, E1-24, E1-27, E1-31, and E1-32 E1-33.
2. Please complete and submit the following Excel assignments on Canvas:
Problem P1-24, P1-55
3. Please complete and submit the following Fraud Case 1-1 on Canvas.
4. Complete Chapter 1 Simulation, Training and Grader problem on Pearson's My Lab IT