

# FINANCIAL ACCOUNTING

Business Administration – 1<sup>st</sup> year

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# FINANCIAL ACCOUNTING

## ● Assessment

-evaluation during semester (EDS) 50%

-test 80% (week 5)

-test quizzes 20%

-exam 50%

# ***References***

- **Horngren, C.T., Sundem, G.L., Elliot, J.A., Philbrick, D, *Introduction to Financial Accounting*, 11<sup>th</sup> edition, Pearson, 2014**
- **Harrison W.T., Horngren C.T., *Financial Accounting*, 7<sup>th</sup> edition, Pearson, Prentice Hall, 2008**
- **Pollard M., Mills S. K., Harrison W. T., *Principles of Accounting*, Pearson Prentice Hall, New Jersey, 2007**
- **Weygandt J.J., Kieso D.E., Kimmel P.D., *Financial accounting*, Wiley&Sons, 2002**
- **The PPT presentations and the seminar drafts will be available on Blackboard, prior to the meetings.**

**Course description:**

**Financial statements**

**Recording Transactions**

**Accrual Accounting and Income**

***Balance Sheet: A +B +C***

***A. Assets***

**A1. Short-term Investments and Receivables**

**A2. Inventory and Cost of Goods Sold**

**A3. Long-lived assets**

**A4. Intercorporate investments and International Operations**

***B. Liabilities and Interest***

***C. Stockholders' equity***

***Income statement and the statement of stockholders' equity***

***Statement of cash flows***

***Financial Statement Analysis***

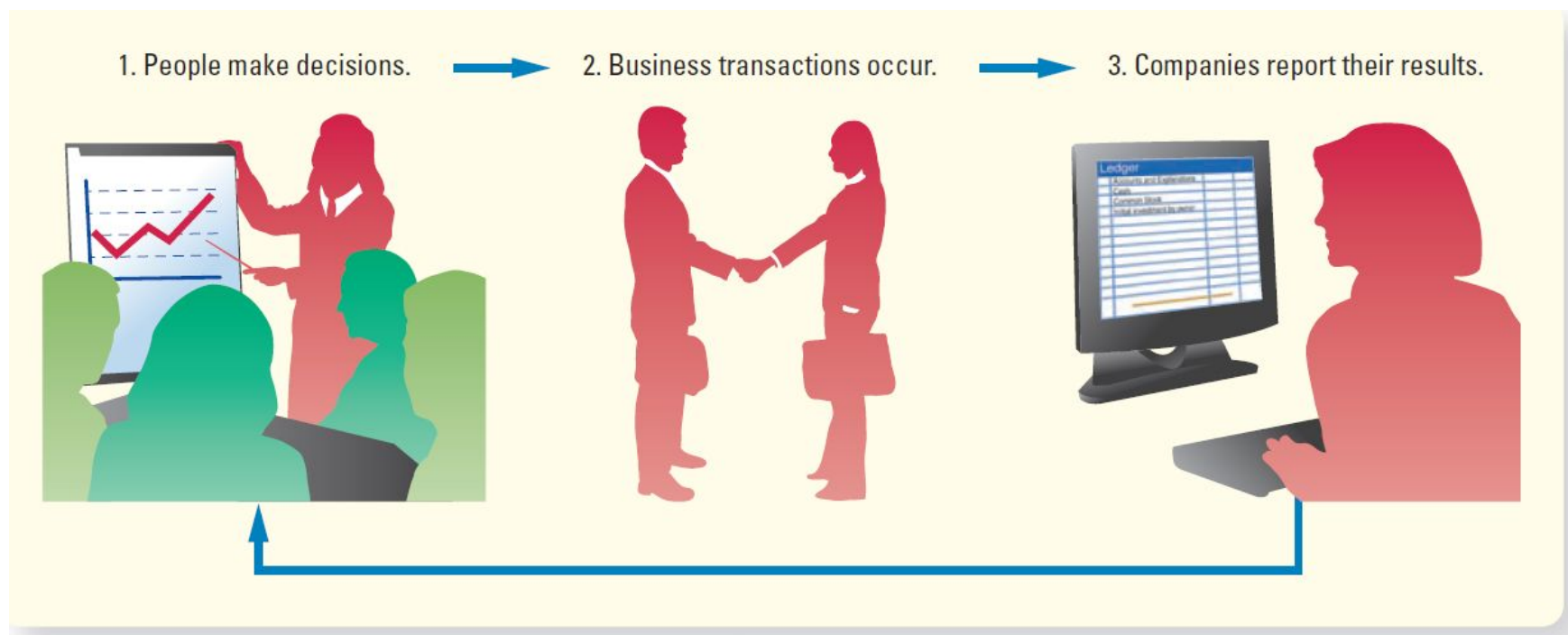
# The Financial Statements

Course 1

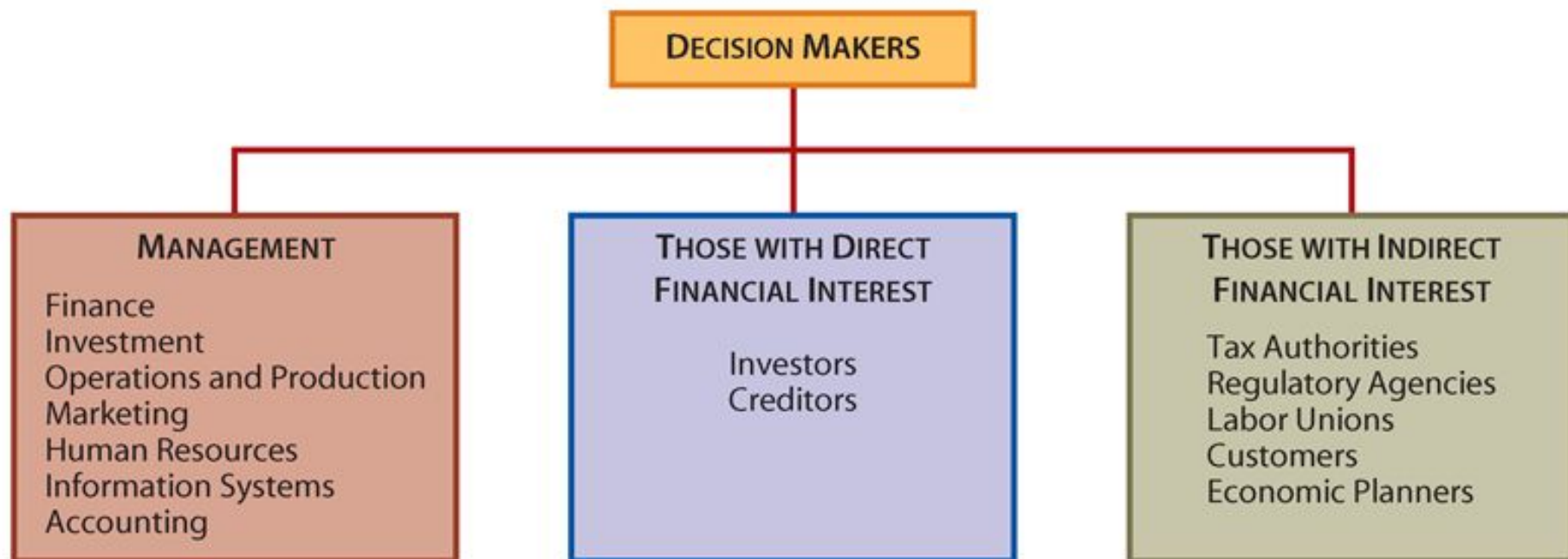
# Learning Objective 1

Use accounting vocabulary

# Accounting as an Information System



# The Users of Accounting Information





Match each term with one of the three types of users of accounting information that follow:

- |   |                         |
|---|-------------------------|
| _____ 1. Tax authorities                  | a. Internal user        |
| _____ 2. Investors                        | b. Direct external user |
| _____ 3. Management                       | c. Indirect user        |
| _____ 4. Creditors                        |                         |
| _____ 5. Regulatory agencies              |                         |
| _____ 6. Labor unions and consumer groups |                         |

# Types of Accounting

## Exhibit 1-2 | Decision Making: Financial Versus Managerial Accounting

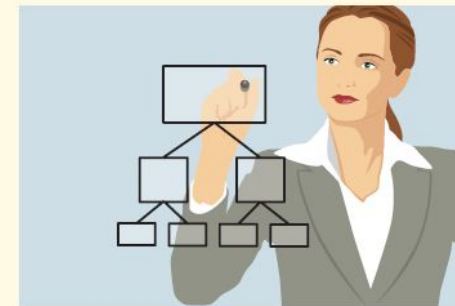
### Financial Accounting



#### External Decision Makers:

Should I invest in the business?  
Is the business profitable?  
Should we lend money to the business?  
Can the business pay us back?

### Managerial Accounting



#### Internal Decision Makers:

How much money should the business budget for production?  
Should the business expand to a new location?  
How do actual costs compare to budgeted costs?

# Forms of Business Organization

## Accounting is used in every type of business.

### Exhibit 1-4 | Business Organizations

	Sole Proprietorship	Partnership	Corporation	Limited-Liability Company (LLC)
<b>Definition</b>	A business with a single owner	A business with two or more owners and not organized as a corporation	A business organized under state law that is a separate legal entity	A company in which each member is only liable for his or her own actions
<b>Number of owners</b>	One (called the proprietor)	Two or more (called partners)	One or more (called stockholders)	One or more (called members or partners)
<b>Life of the organization</b>	Terminates at owner's choice or death	Terminates at a partner's choice or death	Indefinite	Indefinite
<b>Personal liability of the owner(s) for the business's debts</b>	Owner is personally liable	Partners are personally liable	Stockholders are not personally liable	Members are not personally liable
<b>Taxation</b>	Not separate taxable entities. The owner pays tax on the proprietorship's earnings.	Partnership is not taxed. Instead partners pay tax on their share of the earnings.	Separate taxable entity. Corporation pays tax.	LLC is not taxed. Instead members pay tax on their share of earnings.
<b>Type of business</b>	Small businesses	Professional organizations of physicians, attorneys, and accountants	Large multinational businesses	An alternative to the partnership

Match each of the descriptions with the terms that follow:

- |  |                        |
|--|------------------------|
| _____ 1. Issues stock                                  | a. Sole proprietorship |
| _____ 2. Owned by only one person                      | b. Partnership         |
| _____ 3. Multiple co-owners                            | c. Corporation         |
| _____ 4. Management appointed by<br>board of directors |                        |
| _____ 5. Most numerous but usually<br>small in size    |                        |
| _____ 6. Biggest segment of the economy                |                        |

# Learning Objective Two

Learn the underlying concepts, assumptions and principles of accounting

## The *Conceptual Framework*

- Generally the “Why, Who, What, How” of financial reporting, it:
  - lays the foundation for resolving the big issues in accounting
  - prescribes the nature, function, and boundaries within which financial accounting and reporting operate
  - is a joint publication by the IASB and the FASB, used as a foundation for reviewing existing and developing new accounting standards

Objective

To provide financial information that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity

Financial Information

General purpose financial reports which provide information on the entity's economic resources, claims, and changes in resources and claims

Qualitative Characteristics

Fundamental: Relevance and Faithful Representation  
Enhancing: Comparability, Verifiability, Timeliness, Understandability

Constraint and Assumptions

Cost Constraint

Accrual Accounting

Going Concern

Elements

Assets

Liabilities

Equity

Income

Expenses

Definition, Recognition, Measurement, Presentation, and Disclosure

# Assumptions & Principles

## Entity assumption

- A business is a separate economic unit

## Continuity (going- concern) assumption

- Entity will continue to exist indefinitely

## Historical cost principle

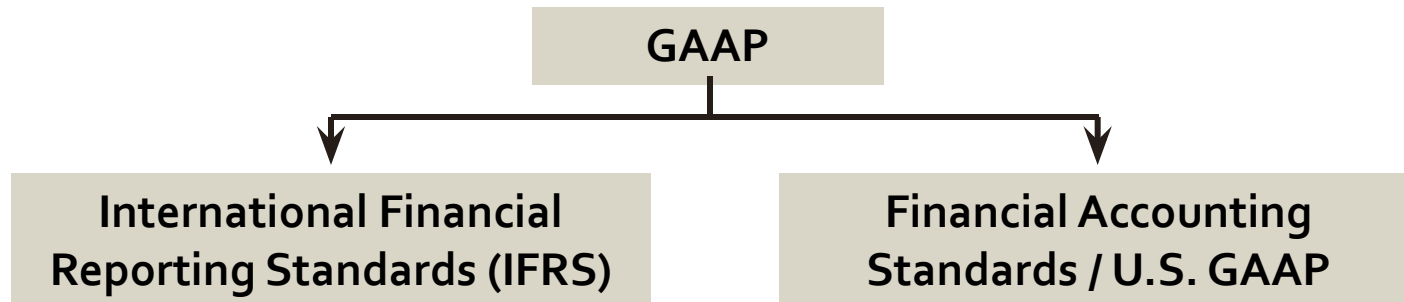
- Assets recorded at purchase price

## Stable monetary unit assumption



# Generally Accepted Accounting Principles (GAAP)

- ❑ Applies to all broad concepts and detailed practices to be followed in preparing and distributing financial statements
  - Includes all the conventions, rules, and procedures which comprise acceptable accounting practice



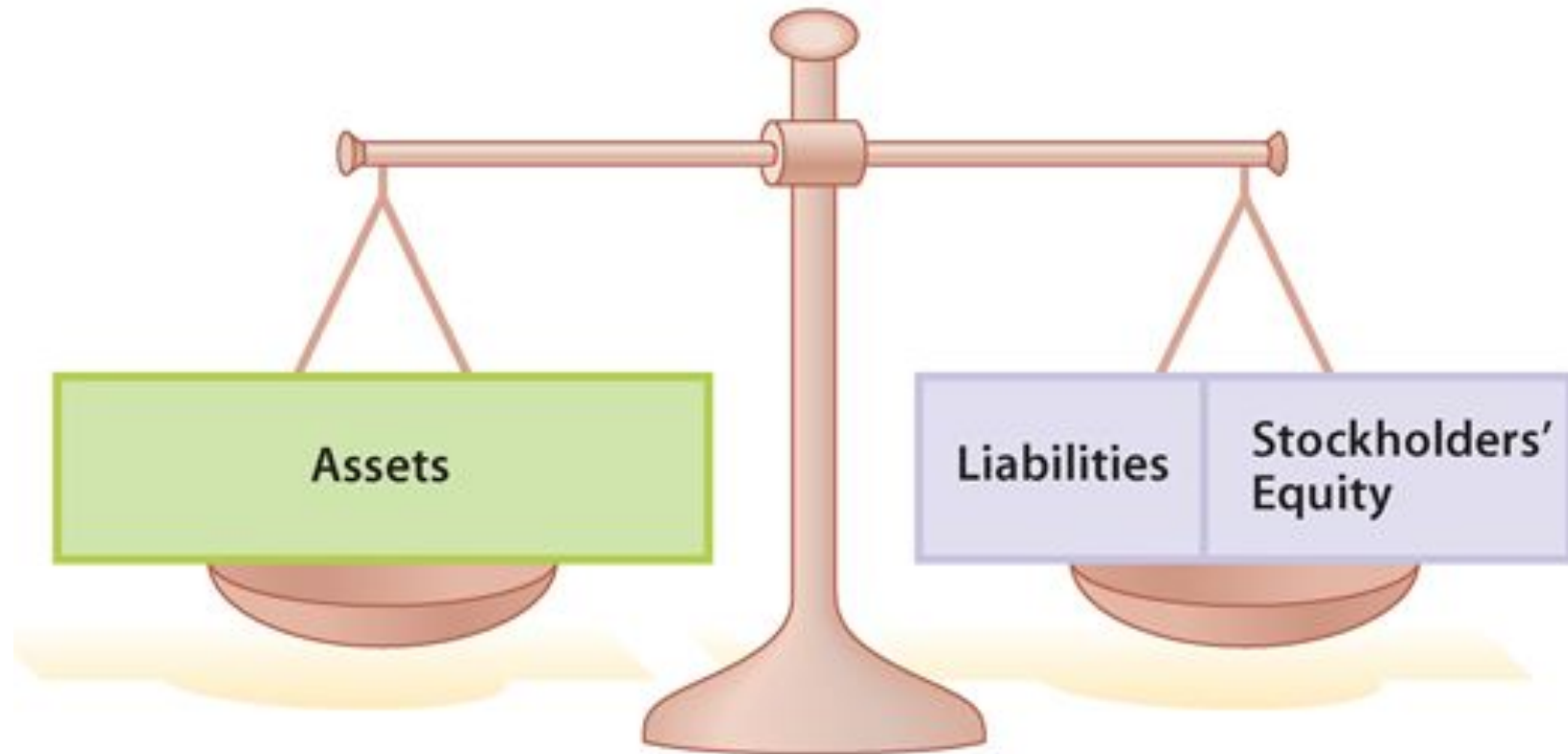
# GAAP

- ❑ **U.S. GAAP: published by FASB**
- ❑ Applies to financial reporting in the U.S.
  - Used by companies with stock traded on U.S. stock exchanges
- ❑ **IFRS: published by IASB**
- ❑ Applies to companies reporting in more than 100 countries around the world
  - Used by foreign companies listed on U.S. exchanges
  - In future U.S. regulators may allow all U.S. companies to use IFRS as well

# Learning Objective Three

Apply the accounting equation to business organizations

# The Accounting Equation



$$\mathbf{A = L + SE}$$

# Accounting Equation Elements

## Assets

- Economic resources
- Produce future benefit

## Liabilities

- Outsider claims
- Debts payable to others (creditors)

## Owners' equity

- Insider claims
- Represents ownership by stockholders

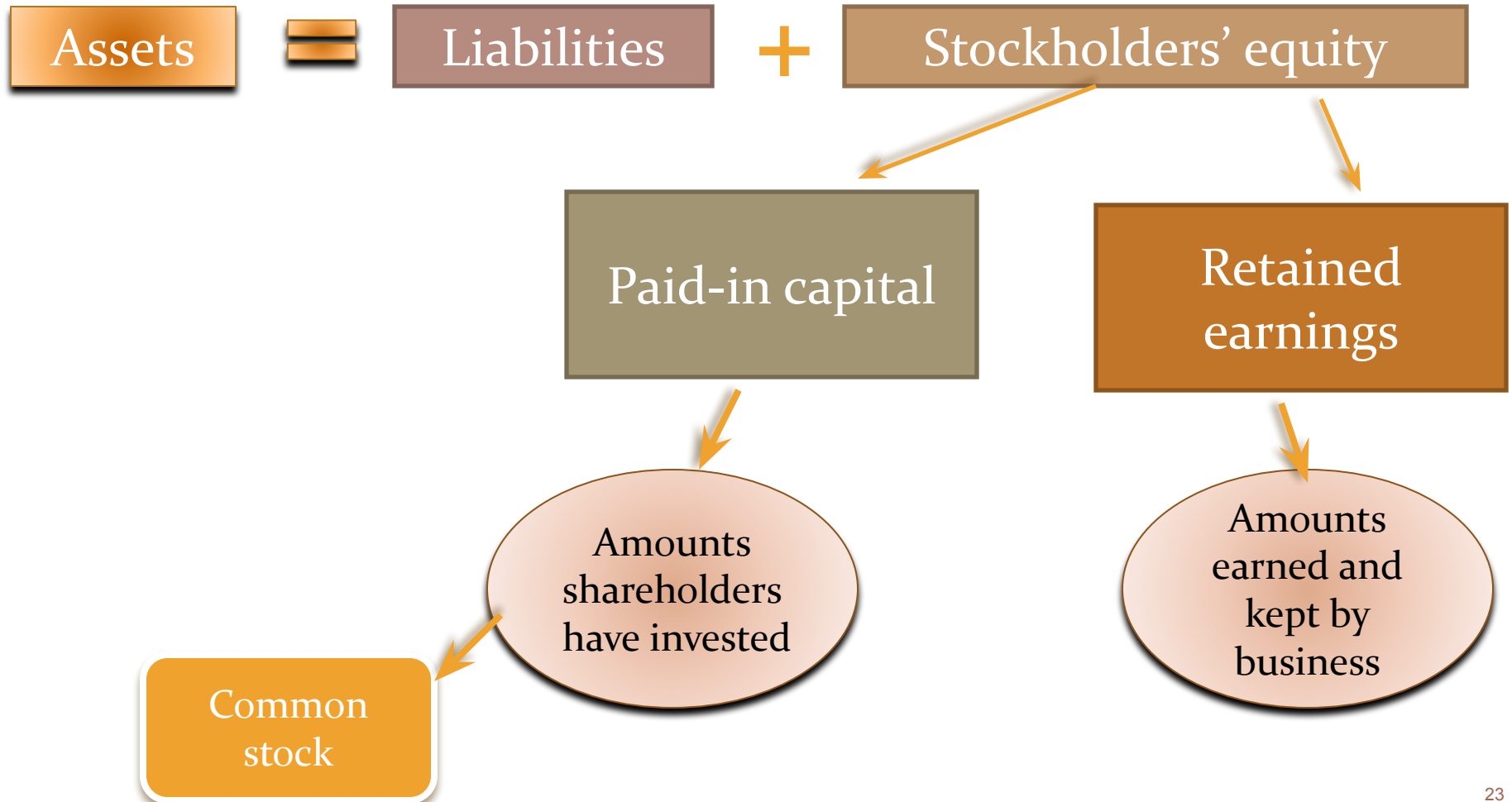
## ASSETS

- Cash and cash equivalents
- Merchandise inventory
- Property, plant and equipment

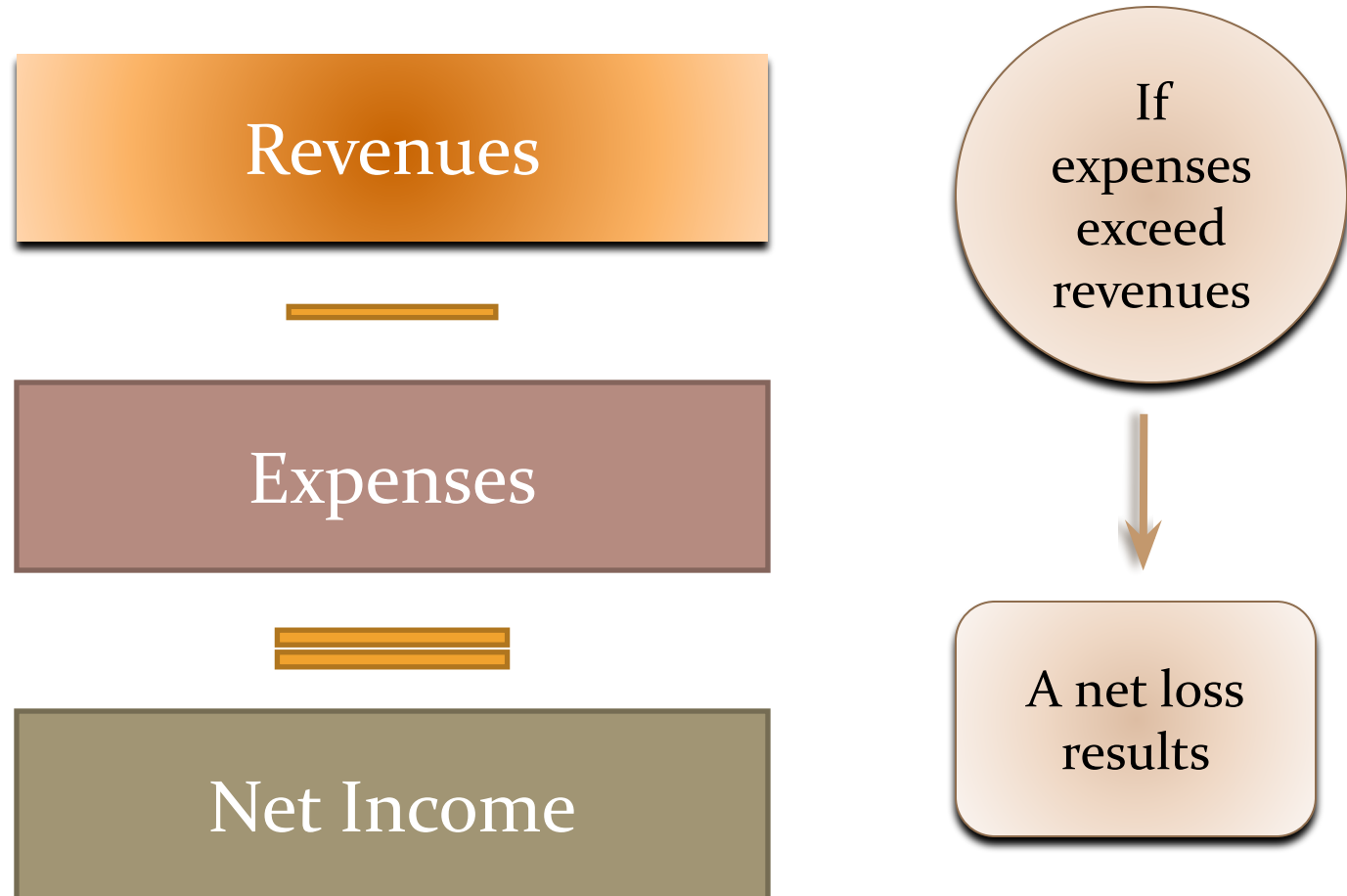
## LIABILITIES

- Accounts payable
- Income taxes payable
- Notes payable

# Corporate Accounting Equation



# Net Income





# Retained Earnings

## Revenues that increase RE

- Inflows of resources earned by delivering goods and services to customers

## Expenses that decrease RE

- Resources outflows from the cost of doing business

## Dividends that decrease RE

- Distributions of profits to stockholders

# Exercise

Hombran Doughnuts has:

- current assets of \$290 million;
- property, plant, and equipment \$490 million
- other assets totaling \$150 million.
- current liabilities are \$150 million and
- long-term liabilities total \$310 million.

# Exercise

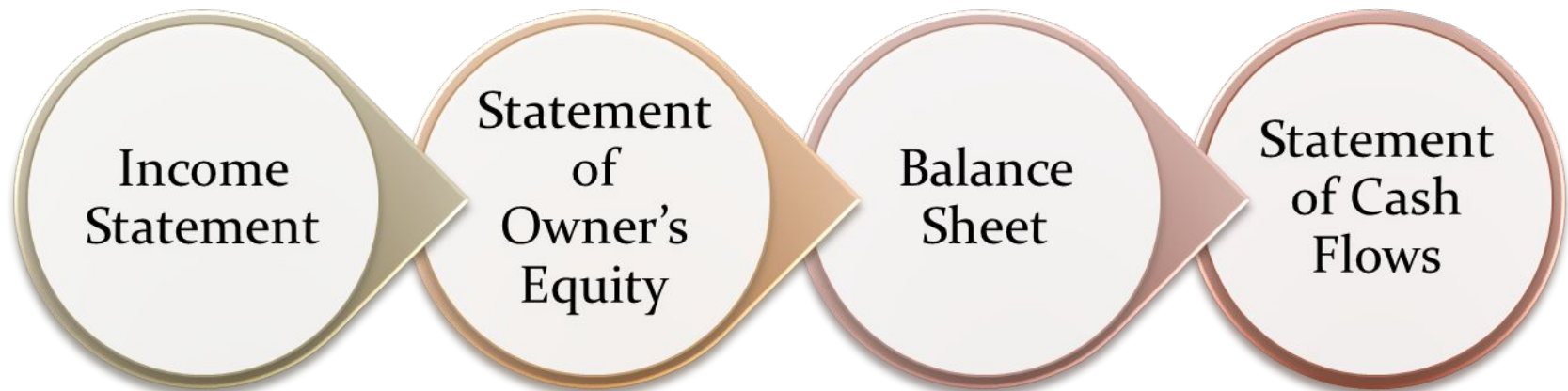
## Requirements

1. Use these data to write Hombran Doughnuts' accounting equation.
2. How much in resources does Hombran have to work with?
3. How much does Hombran owe creditors?
4. How much of the company's assets do the Hombran stockholders actually own?

# Learning Objective Four

Evaluate business operations

# The Financial Statements



# The Income Statement

- Also called the Statement of Operations/Earnings
- Reports two main categories
  - Revenues and gains
  - Expenses and losses
- Shows the “bottom line”
  - Net income or net loss for the period
- Net income is the most important item in the financial statements

# Alibaba's Income Statement

A1		B	C	D
Alibaba Group Holdings Limited Consolidated Income Statement		Year Ended March 31		
(Adapted, in millions of ¥ and US\$)		Mar. 31, 2015	Mar. 31, 2016	Mar. 31, 2016
1				
2				
3	<b>Revenue</b>	¥ 76,204	¥ 101,143	\$ 15,686
4	Cost of revenue	(23,834)	(34,355)	(5,328)
5	Product development expenses	(10,658)	(13,788)	(2,138)
6	Sales and marketing expenses	(8,513)	(11,307)	(1,753)
7	General and administrative expenses	(7,800)	(9,205)	(1,428)
8	Amortization of intangible assets	(2,089)	(2,931)	(455)
9	Impairment of goodwill	(175)	(455)	(71)
10	<b>Income from operations</b>	23,135	29,102	4,513
11	Other income	2,486	2,058	319
12	Interest and investment income	9,455	52,254	8,104
13	Interest expense	(2,750)	(1,946)	(301)
14	Share of results of equity investees	(1,590)	(1,730)	(269)
15	Income tax expenses	(6,416)	(8,449)	(1,310)
16	<b>Net income</b>	¥ 24,320	¥ 71,289	\$ 11,056
17				

# Statement of Retained Earnings

- Retained earnings is portion of net income company has kept
- Positive balance indicates revenues exceeded expenses
- Accumulated deficit indicates expenses have exceed revenues
- Net income (or net loss) flows from the Income Statement to the Statement of Retained Earnings



## Alibaba's Changes in Equity

A1				
	A	B	C	D
1	<b>Alibaba Group Holdings Limited Consolidated Statement of Changes in Equity</b>	<b>Financial Year Ended March 31</b>		
2	<b>(Adapted, in millions of ¥ and \$)</b>	<b>2015</b>	<b>2016</b>	<b>2016</b>
3	Balance as of 1 April preceeding year	¥ 30,417	¥ 158,071	\$ 25,393
4	Issuance of shares (Initial Public Offering)	61,536	-	-
5	Net income for the year	24,320	71,289	11,056
6	Other equity movements	41,798	20,529	2,305
7	Balance as of 31 March	¥ 158,071	¥ 249,889	\$ 38,754
8				

**ABC Corporation**  
**Statement of Retained Earnings**  
**For the year ending December 31, 2016**

Retained earnings, December 31, 2015	\$\$,\$\$\$
Plus: Net income	\$\$,\$\$\$
Less: Dividends	<u>\$\$,\$\$\$</u>
Retained earnings, December 31, 2016	<u>\$\$,\$\$\$</u>

# The Balance Sheet

- Also called the Statement of Financial Position
- Reports
  - Assets
  - Liabilities
  - Stockholders' equity

# Assets on the Balance Sheet

## Current

- Expected to be converted to cash, sold or consumed in the next year or within the business's operating cycle
  - Whichever is longer
- Include
  - Cash
  - Short-term investments
  - Accounts and notes receivable
  - Inventory
  - Prepaid expenses

## Long-term

- Will be held longer than one year
- Include
  - Property, plant and equipment
    - Land
    - Buildings
    - Computers
    - Equipment
  - Intangibles
  - Long-term investments

# Liabilities on the Balance Sheet

## Current

- Debts payable in the next year or within the business's operating cycle
- Include
  - Accounts payable
  - Income taxes payable
  - Accrued expenses

## Long-term

- Debts payable more than one year from balance sheet date
- Include
  - Long-term notes payable
  - Bonds payable

# Stockholders' Equity on the Balance Sheet

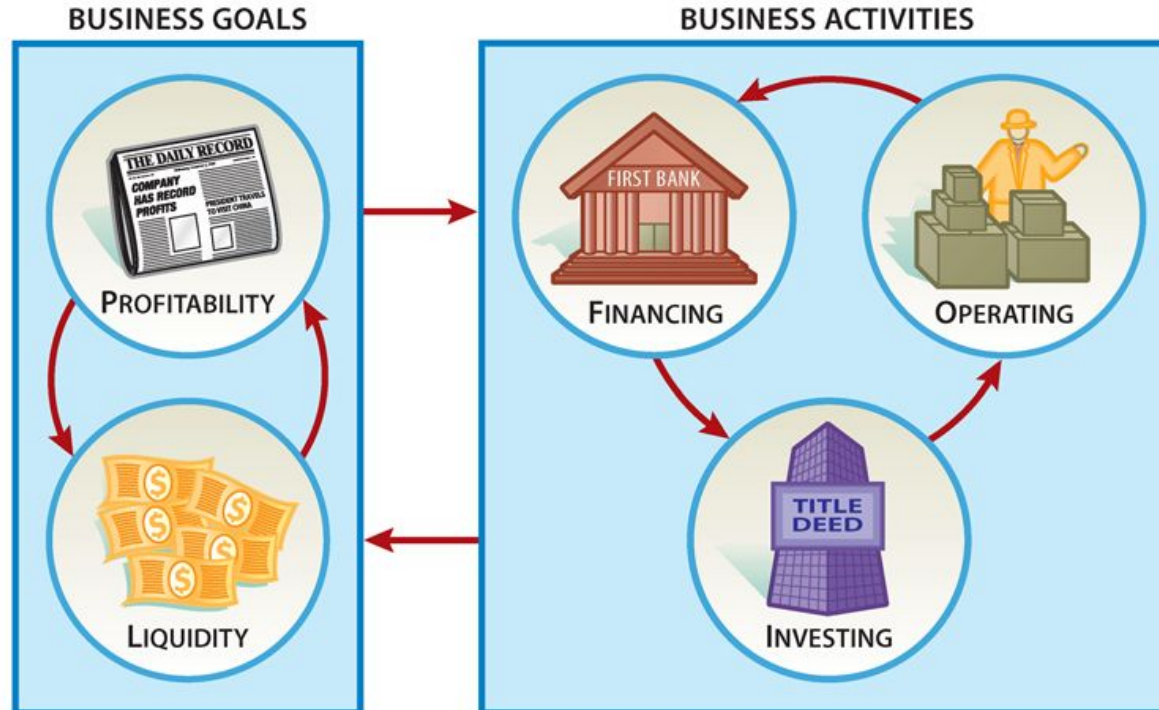
- Represents stockholders ownership of the business assets
- Consists of:
  - Common stock
  - Additional paid-in capital
  - Retained earnings

# The Balance Sheet

A1				
	A	B	C	D
1	<b>Alibaba Group Holdings Limited</b>	<b>As of March 31</b>		
	<b>Consolidated Balance Sheets</b>			
2	<b>(Adapted, in millions of ¥ and US\$)</b>	<b>2015</b>	<b>2016</b>	<b>2016</b>
3	<b>Assets:</b>			
4	Cash and cash equivalents	¥ 108,193	¥ 106,818	\$ 16,566
5	Short-term investments	17,806	8,878	1,377
6	Accounts receivable	1,067	1,209	188
7	Other current assets	15,043	17,165	2,661
8	<b>Total current assets</b>	<b>142,109</b>	<b>134,070</b>	<b>20,792</b>
9	Property, plant and equipment	12,244	16,505	2,560
10	Long-term investments	48,488	120,853	18,742
11	Intangible assets	48,508	87,015	13,495
12	Other non-current assets	4,085	6,007	932
13	<b>Total non-current assets</b>	<b>113,325</b>	<b>230,380</b>	<b>35,729</b>
14	<b>Total assets</b>	<b>255,434</b>	<b>364,450</b>	<b>56,521</b>
15	<b>Liabilities:</b>			
16	Accounts payable and accruals	19,834	27,334	4,240
17	Short-term bank borrowings	1,990	4,304	667
18	Income tax payable	2,733	2,790	433
19	Customer deposits and advances	15,115	17,611	2,731
20	<b>Total current liabilities</b>	<b>39,672</b>	<b>52,039</b>	<b>8,071</b>
21	Long-term bank borrowings	1,609	1,871	290
22	Other borrowings	48,994	51,596	8,002
23	Other non-current liabilities	7,088	9,055	1,404
24	<b>Total non-current liabilities</b>	<b>57,691</b>	<b>62,522</b>	<b>9,696</b>
25	<b>Total liabilities</b>	<b>97,363</b>	<b>114,561</b>	<b>17,767</b>
26	<b>Equity:</b>			
27	Share capital	117,143	132,207	20,504
28	Retained earnings	24,842	78,752	12,213
29	Other equity items	16,086	38,930	6,037
30	<b>Total equity</b>	<b>158,071</b>	<b>249,889</b>	<b>38,754</b>
31	<b>Total liabilities and equity</b>	<b>¥ 255,434</b>	<b>¥ 364,450</b>	<b>\$ 56,521</b>
32				

# The Statement of Cash Flows

- Measures cash receipts and cash payments
- Fourth required financial statement
- Categorizes into three types of activities:
  - Operating Investing Financing





# Cash Flow Categories

## Operating

- Cash receipts and payments from selling goods and services

## Investing

- Purchasing & selling long-term assets

## Financing

- Issuing stock and borrowing

# Alibaba's Statement of Cash Flows

A1				
	A	B	C	D
1	<b>Alibaba Group Holdings Limited Consolidated Statement of Cash Flows</b>	<b>Year Ended March 31</b>		
2	<b>(Adapted, in millions of ¥ and US\$)</b>	<b>2015</b>	<b>2016</b>	<b>2016</b>
3	Net income	¥ 24,320	¥ 71,289	\$ 11,056
4	Adjustments and changes in working capital	16,897	(14,453)	(2,241)
5	Net cash provided by operating activities	41,217	56,836	8,815
6	Net cash used by investing activities	(53,454)	(42,831)	(6,643)
7	Net cash provided/used by financing activities	87,497	(15,846)	(2,457)
8	Effect of exchange rate changes	(112)	466	72
9	Net cash flows for the period	75,148	(1,375)	(213)
10	Cash and cash equivalents at beginning of the year	33,045	108,193	16,779
11	Cash and cash equivalents at end of the year	¥ 108,193	¥ 106,818	\$ 16,566
12				

## Identify the financial statement where these decision makers can find the following information

(a) Common stock	(h) Revenue
(b) Income tax payable	(I) Cash spent to acquire a building
(c) Dividends	(j) Selling, general & administrative expenses
(d) Income tax expense	(k) Adjustments to reconcile net income to net cash from operations
(e) Ending balance of retained earnings	(l) Ending cash balance
(f) Total assets	(m) Current liabilities
(g) Long-term debt	(n) Net income

# Relationships among the Financial Statements (in Millions of ¥ / \$)

A1		A			B	C	D
1	<b>Alibaba Group Holdings Limited Consolidated Income Statement</b>	<b>Financial Year Ended March 31</b>					
2	<b>(Adapted, in millions of ¥ and US\$)</b>	<b>2015</b>	<b>2016</b>	<b>2016</b>			
3	Total income	¥ 88,145	¥ 155,455	\$ 24,109			
4	Total expenses	(63,825)	(84,166)	(13,053)			
5	<b>Net income</b>	¥ 24,320	¥ 71,289	\$ 11,056			
6							

A1		A			B	C	D
1	<b>Alibaba Group Holdings Limited Consolidated Statement of Changes in Equity</b>	<b>Financial Year Ended March 31</b>					
2	<b>(Adapted, in millions of ¥ and US\$)</b>	<b>2015</b>	<b>2016</b>	<b>2016</b>			
3	Balance as of 1 April preceeding year	¥ 30,417	¥ 158,071	\$ 25,193			
4	Issuance of shares (Initial Public Offering)	61,536	-	-			
5	Net income for the year	24,320	71,289	11,056			
6	Other equity movements	41,798	20,529	2,305			
7	Balance as of 31 March	¥ 158,071	¥ 249,889	\$ 38,754			
8							

# Relationships among the Financial Statements (in Millions of ¥ / \$)

A1				
	A	B	C	D
1	<b>Alibaba Group Holdings Limited Consolidated Statement of Changes in Equity</b>	<b>Financial Year Ended March 31</b>		
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3	Balance as of 1 April preceeding year	¥ 30,417	¥ 158,071	\$ 25,393
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8				
A1				
	A	B	C	D
1	<b>Alibaba Group Holdings Limited Consolidated Balance Sheets</b>	<b>As of March 31</b>		
2	<b>(Adapted, in millions of ¥ and US\$)</b>	<b>2015</b>	<b>2016</b>	<b>2016</b>
3	<b>Assets:</b>			
4	Cash and cash equivalents	¥ 108,193	¥ 106,818	\$ 16,566
5	All other assets	147,241	257,632	39,955
6	<b>Total assets</b>	<b>255,434</b>	<b>364,450</b>	<b>56,521</b>
7	Total liabilities	97,363	114,561	17,767
8	Total equity	158,071	249,889	38,754
9	Total liabilities and equity	¥ 255,434	¥ 364,450	\$ 56,521
10				

# Relationships between Financial Statements

<b>Income Statement</b> For the year ended December 31, 2010	
Revenues	\$\$\$,\$\$\$
Expenses	<u>(\$\$, \$\$\$)</u>
Net income	<u>\$\$, \$\$\$</u>

<b>Statement of Retained Earnings</b> For the year ended December 31, 2010	
Beginning retained earnings	\$\$\$, \$\$\$
Net income	\$\$, \$\$\$
Cash dividends	<u>(\$\$, \$\$\$)</u>
Ending retained earnings	<u>\$\$, \$\$\$</u>



**Statement of Retained Earnings  
For the year ended December 31, 2010**

Beginning retained earnings	\$\$\$\$,\$\$\$
Net income	\$\$,\$\$\$
Cash dividends	<u>(\$\$,\$\$\$)</u>
Ending retained earnings	<u>\$\$,\$\$\$</u>

**Balance Sheet  
December 31, 2010**

Assets	<u>\$\$\$\$,\$\$\$</u>
Liabilities	\$\$\$\$,\$\$\$
Stockholders' equity:	
Common stock	\$\$\$\$,\$\$\$
Retained earnings	\$\$\$\$,\$\$\$
Total liabilities and equity	<u>\$\$\$\$,\$\$\$</u>




**Balance Sheet  
December 31, 2010**

Assets	<u>\$\$\$,\$\$\$</u>
Liabilities	\$\$\$,\$\$\$
Stockholders' equity:	
Common stock	\$\$\$,\$\$\$
Retained earnings	\$\$\$,\$\$\$
Total liabilities and equity	<u>\$\$\$,\$\$\$</u>

**Statement of Cash Flows  
For the year ended December 31, 2010**

Cash flows from operating activities	\$\$\$,\$\$\$
Cash flows from investing activities	\$\$,\$\$\$
Cash flows from financing activities	<u>\$\$,\$\$\$</u>
Net cash flows	<u>\$\$,\$\$\$</u>
Cash balance, December 31, 2009	<u>\$\$,\$\$\$</u>
Cash balance, December 31, 2010	<u>\$\$,\$\$\$</u>

**Cash** from the Asset section of the Balance Sheet equals ending **Cash** on the Statement of Cash Flows





**Exhibit 1-3 | Comparison of Accounting Positions**

<b>Position</b>	<b>Job Description</b>	<b>Salary Range</b>
<b>Controllers</b>	Compile financial statements, interact with auditors, and oversee regulatory reporting.	\$89,000–\$216,000
<b>Financial analysts</b>	Review financial data and help to explain the story behind the numbers.	\$41,250–\$125,000
<b>Business systems analysts</b>	Use accounting knowledge to create computer systems.	\$44,250–\$107,250
<b>Tax accountants</b>	Help companies navigate tax laws.	\$44,000–\$190,750
<b>Auditors</b>	Perform reviews of companies to ensure compliance to rules and regulations.	\$44,500–\$184,750
<b>Cost accountants</b>	Typically work in a manufacturing business. Help analyze accounting data.	\$43,000–\$113,000
<b>Paraprofessional/ Bookkeeper</b>	Record financial transactions and help prepare financial records.	\$39,750–\$59,250