Chapter 1

Introduction to Accounting and Business

Learning Objective 1 → Describe the nature of a business, the role of accounting, and ethics in business.

Nature of Business and Accounting

- A **business** is an organization in which basic resources (inputs), such as materials and labor, are assembled and processed to provide goods or services (outputs) to customers.

- The **objective** of most businesses is to earn a profit.
- **Profit** is the difference between the amounts received from customers for goods or services and the amounts paid for the inputs used to provide the goods or services.

Type of Business:

Service Business → Provide services rather than products to customers.

Merchandising Business → Sell products they purchase from other business to customers.

Manufacturing Business → Change basic input into products that are sold to customers.

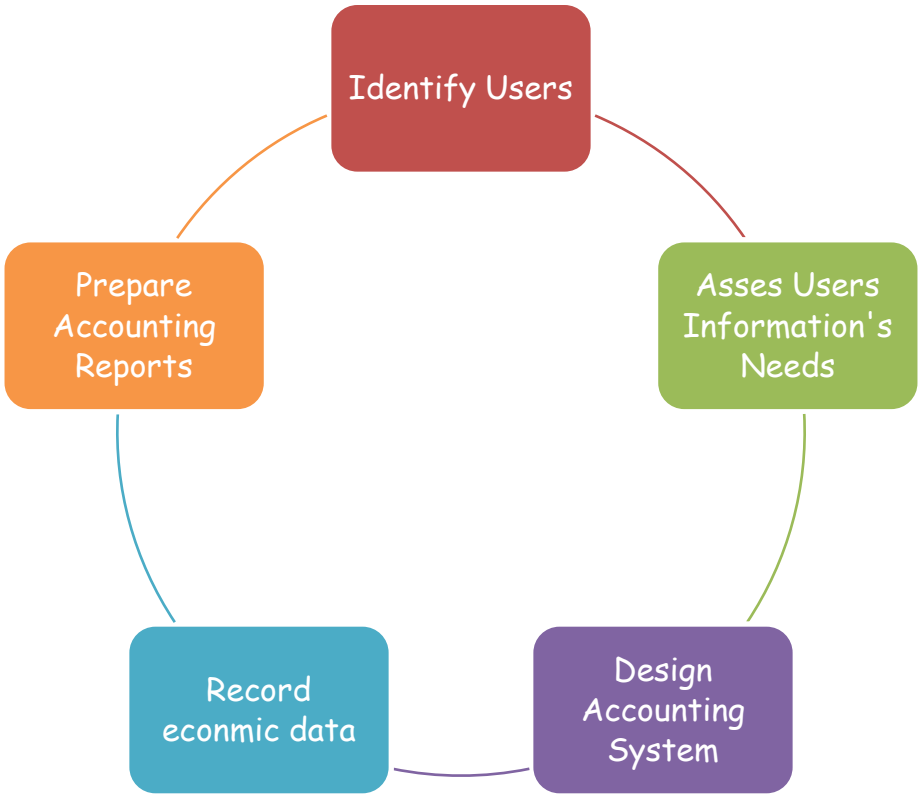
The Role of Accounting in Business

There is more than definition

Accounting is the art of recording, summarizing, classifying and reporting financial transactions and other events of an enterprise.

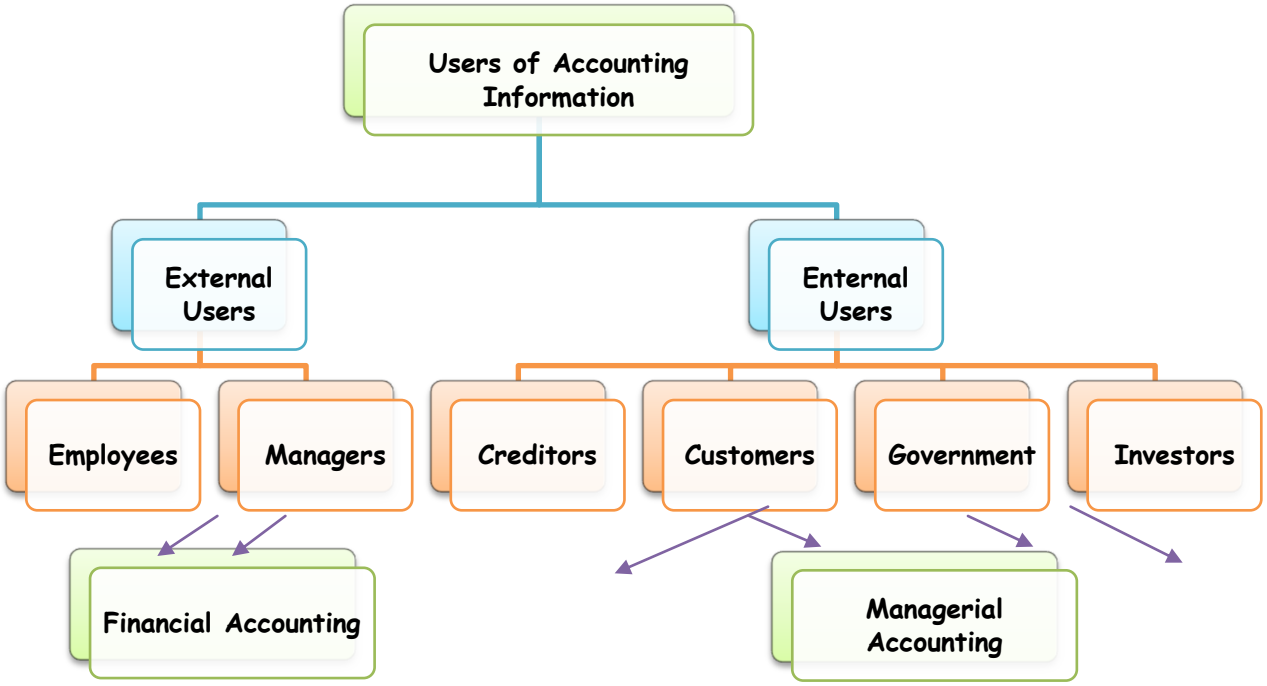
Accounting can be defined as an information system that provides reports to users about the economic activities and condition of a business.

The process by which accounting provides information to users :



Users of accounting can be divided into two groups:

- Internal Users
- External Users



Managerial Accounting → The area of accounting that provides internal users with information.

Financial Accounting → The area of accounting that provides external users with information.

- ➔ The objective of financial accounting is to provide relevant and timely information for the decision-making needs of users outside of the business.
- ➔ General-purpose financial statements are one type of financial accounting report that is distributed to external users.

Learning Objective 2 → Summarize the development of accounting principles and relate them to practice.

Generally Accepted Accounting Principles

- ➢ Financial accountants follow **generally accepted accounting principles (GAAP)** in preparing reports.

Form of Business Entity	
Proprietorship	Is owned by one individual (Small Businesses)
Partnership	Is owned by two or more individuals
Corporation	Is owned by shareholders or stockholders (Large Firms)

Some of Accounting Concepts GAAP

Business Entity Concept	• The activities of a business are recorded separately from the activities of its owners, creditors, or other.
The Cost Concept	• Amounts are initially recorded in the accounting records at their cost or purchase price.
The Objectivity Concept	• Requires that the amounts recorded in the accounting records be based on objective evidence.
The Unit Of Measure Concept	• Requires that economic data be recorded in dollars or riyals.
The Accounting Period Concept	• Requires that revenues and expenses be reported in the proper period.
The Revenue Recognition Concept	• Supporting the reporting of revenues when they are earned regardless of when cash is received.
The Matching Concept	• Supporting reporting revenues and related expenses in the same period.

Learning Objective 3 → State the accounting equation and define each element of the equation.

The Accounting Equation

- ➔ The resources owned by a business are its assets.
- ➔ The rights of creditors are the debts of the business and are called liabilities.
- ➔ The rights of the owners are called owner's equity.
- ➔ The equation Assets = Liabilities + Owner's Equity is called the accounting equation.

Assets = Liabilities + Owner's Equity

Assets = Liabilities + Capital – Drawings + Revenues - Expenses

Drawings + Expenses + Assets = Liabilities + Capital + Revenues

Debit Accounts

If ↑ Debit, and if ↓ Credit

Credit Accounts

If ↑ Credit, and if ↓ Debit

Elements of Accounting Equation

ASSETS → Resources owned by the business

Type off Assets

Fixed Assets → Land, Buildings, Furniture, Cars, Machinery and Equipment.

Current Assets → Cash, Marketable Securities, Accounts Receivable, Notes receivables, Merchandise Inventory, Supplies, Prepaid Expenses, and Accrued Revenues.

Intangible Assets → Goodwill, Copy Right, Patent, Trade Mark.

LIABILITIES → The rights of creditors

Type of Liabilities

Long-Term Liabilities → Bonds and Long-Term Loans.

Short-Term Liabilities → Accounts Payable, Notes Payable, Short-Term Loans, Accrued Expenses, and Unearned Revenues.

OWNER'S EQUITY → the rights of the owners

Capital and Net Income (Revenues – Expenses)

Learning Objective 4 → Describe and illustrate how business transactions can be recorded in terms of the resulting change in the elements of the accounting equation.

Business Transaction → is an economic event or condition that directly changes an entity's financial condition or its results of operations.

Account payable → is liability created by a purchase on account.

Account receivable → is a claim against a customer, which is an asset.

Expenses → Assets used in this process of earning revenue.

Revenue → the Amount of money that A business earned by selling goods or services to its customers.

Examples of revenue

- Fees earned → Revenue from providing services.
- Sales → Revenue from the sale of merchandise
- Rent revenue
- Interest revenue.

Some Notes before solving the transactions

- **Account payable = creditor = suppliers = purchase on account**
- **Account receivable = customer = client = billed on account**
- **Revenues in services business called Fees earned but in merchandising business called sales**
- **Revenues always credit account and the debit account can be cash, account receivables, or note receivables**
- **Expenses always debit account and the credit account is cash, account payable, or note payable**

On November 1, 2011, Chris Clark begins a business that will be known as Net Solution:

Transaction

A: On November 1, 2011, Chris Clark deposited $25,000 in a bank account in the name of Net Solutions.
(Assets ↑ (cash) = **Owner equity ↑** (capital)**)**

B: On November 5, 2011, Net Solutions paid $20,000 for the purchase of land as a future building site.
(Assets ↓ (cash) = **Assets ↑** (Land)**)**

C: On November 10, 2011, Net Solutions purchased supplies for $1,350 and agreed to pay the supplier in the near future.
(Assets ↑ (supplies) = **Liabilities ↑** (Account Payable)**)**

D: On November 18, 2011, Net Solutions received cash of $7,500 for providing services to customers.
(Assets ↑ (cash) = **Owner equity ↑** (Fees earned)**)**

E: On November 30, 2011, Net Solutions paid the following expenses: wages, $2,125; rent, $800; utilities, $450; and miscellaneous, $275.
(Assets ↓ (cash) = **Owner equity ↓** (Expenses)**)**

F: On November 30, 2011, Net Solutions paid creditors on account, $950.
(Assets ↓(cash) = **Liabilities ↓** (Account payable)**)**

G: On November 30, 2011, Chris Clark determined that the cost of supplies on hand at the end of the period was $550.
(Assets ↓ (supplies) = **Owner equity ↓** (supp. Exp.)**)**

H: On November 30, 2011, Chris Clark withdrew $2,000 from Net Solutions for personal use.
(Assets ↓ (cash) = **Owner equity ↓** (Drawing)**)**

Instructions: Indicate the effect of each transaction using the following tabular headings:

Transitions	Assets			=	Liabilities	+	Owner Equity							
	Cash	+Supplies	+Land	=	Accounts Payable	+	Chris Clark Capital	- Chris Clark Drawing	+Fees Earned	- Wages Exp.	- Rent Exp.	- Supplies Exp.	- Utilities Exp.	- Misc. Exp.
a.	+25,000			=		+	25,000							
b.	-20,000		+20,000	=		+								
c.		+1,350		=	+1,350	+								
d.	+7,500			=		+			+7,500					
e.	-3,650			=		+				-2,125	-800		-450	-275
f.	-950			=	-950	+								
g.		-800		=		+						-800		
h.	-2,000			=		+		-2,000						
	5,900	**+ 550**	**+ 20,000**	**=**	**400**	**+**	**25,000**	**– 2,000**	**+ 7,500**	**– 2,125**	**- 800**	**– 800**	**– 450**	**- 275**

26,450 26,450

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