

Course Learning Outcomes for Unit I

Upon completion of this unit, students should be able to:

1. Examine the accounting cycle.
 - 1.1. Identify the accounting equation.
 - 1.2. Explain the foundation of accounting principles and assumptions.
2. Identify business transactions.
 - 2.1. Identify accounting transactions.
 - 2.2. Record accounting transactions.

Course/Unit Learning Outcomes	Learning Activity
1.1, 1.2, 2.1, 2.2	Unit Lesson Chapter 1, pp. 1-1 to 1-26 Video: <i>Business Transactions and Accounting Equation</i> Video: <i>The Accounting Equation</i> Video: <i>The Accounting Equation and Analyzing Business Transactions</i> Unit I Case Study

Required Unit Resources

Chapter 1: Accounting in Action, pp. 1-1 to 1-26

In order to access the following resources, click the links below.

A transcript and closed captioning are available once you access the videos.

Finance Train. (2013, February 12). [Business transactions and accounting equation \[Video\]](https://c24.page/rz3ayp9fb6j5jstpfmgxxmegu8).
https://c24.page/rz3ayp9fb6j5jstpfmgxxmegu8

SuperfastCPA. (2011, September 25). [The accounting equation \[Video\]](https://c24.page/yaepbvbf2ee7qxpjtf885kk2z8).
https://c24.page/yaepbvbf2ee7qxpjtf885kk2z8

TLC Tutoring. (2017, May 7). [The accounting equation and analyzing business transactions \[Video\]](https://c24.page/jx58sn8mgfjd52xmdf8fjrc4q).
https://c24.page/jx58sn8mgfjd52xmdf8fjrc4q

Unit Lesson

Accounting in Action

Accounting is often referred to as the language of business. The process of accounting for business transactions forms a narrative of the activities of a business by recording business transactions. Periodically, accountants prepare reports, both in summary and detail, showing the results of the business transactions according to principles and standards set by governmental and authoritative bodies. These reports, otherwise known as financial statements, communicate the status of the business by stating what assets the business owns, what the business owes to others, what others owe the business, the revenue of the business, and the business's expenses. Interested stakeholders, such as banks, investors, and even competitors, can review

standard financial statements in order to have confidence that the dollar amounts reported are the result of standardized accounting processes.

The financial information produced by accountants is needed by two groups of users: internal users and external users. Internal users are the executives, managers, and other decision makers, and the external users include customers, potential creditors (banks or suppliers), shareholders, and potential investors. As a result, there are two broad fields of accounting: managerial and financial. Managerial accountants analyze the accounting data and prepare internal reports focused on specific aspects of the business. Some examples of managerial reports include an accounts payable aging report, a budget versus actual expense report for a department, or a year-to-year comparison of sales by month.

Financial accountants compile the data and prepare standardized financial statements for external users. Financial statements are summary amounts for a specific period (i.e., monthly, quarterly, or annually), whereas the income statement shows all revenue and expenses related to the operations and administration of the company. The balance sheet shows the amount that the business has invested in equipment, buildings, and land, as well as accumulated earnings throughout the life of the company (owner's equity or retained earnings) and all amounts owed to other entities, such as accounts payable, mortgages payable, and lines of credit held by the bank. The owner's equity statement reports all owner activity in the period. Components shown in this financial statement include owner capital, owner drawings, and net income or loss for the period being reported.

Numerous careers are available in all fields of accounting. The career that is most often discussed is in public or financial accounting. The public accountant typically will pursue the Certified Public Accountant (CPA) certification and obtain a license through the state board of accountancy. To be certified as a CPA, one must pass the Uniform CPA Examination, which consists of four sections. The managerial accounting career has various career paths in the private industry. A managerial accountant may pursue the Certified Managerial Accounting (CMA) certification. To be certified as a CMA, one must pass the CMA Exam, which consists of two parts and covers 11 competencies. Another career field for the managerial accountant is the pursuit of the Certified Public Finance Officer (CPFO) title or the position of a Certified Governmental Accountant (CGA). Similar to the CPA and CMA, one must pass the exam consisting of five sections. Other careers in accounting include forensic accounting, cost accounting, and healthcare administration.

The process of accounting is based on accounting principles, concepts, and standards. These standards are developed by boards, which are made up of well-experienced and certified accountants. The most common board is the Financial Accounting Standards Board or the FASB (pronounced fahzbee). This body develops accounting standards for private sector businesses. Financial accountants must comply with the accounting standards set by the FASB. The next most common board is the Governmental Accounting Standards Board or the GASB (pronounced gahzbee). These accounting standards are based on the standards set by the FASB. GASB accounting standards focus on the specific accounting needs of state and local governments. CPFOs and CGAs must comply with the accounting standards set by the FASB. The third board is the Federal Accounting Standards Advisory Board (FASAB). This board develops accounting standards and addresses the specific needs of federal governmental agencies. Finally, the International Accounting Standards Board (IASB) produces the International Financial Reporting Standards (IFRS). The FASB and IASB have been working to reduce the differences between U.S. standards and international standards. Eventually, there will be one standard used globally.



Accountants must identify business transactions (otherwise known as economic events), record the transactions, and then communicate the results. All of these tasks are based on generally accepted accounting principles (GAAP). GAAP include principles such as those mentioned above, assumptions, and concepts. Each transaction is analyzed using these principles of accounting. This ensures that all business is communicated in a standardized fashion. Many accounting principles are considered to be common sense. The measurement principles of relevance and faithful representation are two such principles. Might this financial information potentially affect decision-making efforts? This is the measurement principle of relevance. Do the dollar amounts, descriptions, and comments reflect the actual transaction (i.e., are they truthful)? This is the measurement principle of faithful representation.

The historical cost principle has been the subject of debate throughout the last 50 years. This principle states that businesses must record assets at their original cost. There are a fraction of accountants who argue that assets should be reported at fair value rather than historical cost. The fair value principle applies to reporting investment securities; other assets continue to be reported at historical cost.

The form of business in which the company conducts business affects the accounting process. A sole proprietorship is owned by one person. The owner is personally liable for all debts of the business and enjoys the profits or suffers the losses. There is no distinction between the business and the owner.

Partnerships are formed when two or more people go into business together. There are various partnership designations, such as limited liability partnership (LLP). A limited liability partnership creates some separation from the business liabilities for the partners.

A *corporation* is a legal entity with total separation from the owners or shareholders. The key to understanding the distinction between a partnership and a corporation is that shareholders may transfer ownership at any time, whereas a partner must be careful to properly exit the partnership and require that specific transactions take place.

All accounting processes are founded on the accounting equation. Assets (i.e., the cash and equipment, buildings, and land) that the business owns equals the sum of liabilities (i.e., the amounts owed to other businesses) plus the owner's equity (i.e., the value of the business after liabilities are subtracted). This equation is shown as $Assets = Liabilities + Owner's Equity$, which is illustrated in the image below.

BASIC EQUATION

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

Each of these components consists of multiple accounts. Most notably, the owner's equity is made up of four sub-components: Owner's Capital – Owner's Drawings + Revenues – Expenses, which is illustrated in the image below.

EXPANDED EQUATION

$$\text{Assets} = \text{Liabilities} + \text{Owner's Capital} - \text{Owner's Drawings} + \text{Revenues} - \text{Expenses}$$

The first step of the accounting cycle is to analyze business transactions. Each transaction will affect at least two accounts in the accounting equation. The effect on each account (increase or decrease) will determine how the transaction is recorded. When one is finished recording a transaction, the left side of the accounting equation must equal the right side of the accounting equation (Weygandt et al., 2018).

Conclusion

After completing this unit, you will have a basic understanding of the accounting equation and what each component of the equation consists of. You will be acquainted with each of the financial statements, the purpose of the financial statements, and their usefulness to internal and external users. The unit assessment consists of questions and problems related to these concepts. If you need additional practice working these problems, please review the end-of-chapter exercises, which can be found in the Learning Activities (Nongraded) section of this unit.

Reference

Weygandt, J. J., Kimmel, P. D., & Kieso, D. E. (2018). *Accounting principles* (13th ed.) [VitalSource Bookshelf version]. <https://online.vitalsource.com/#/books/978119411017>

Learning Activities (Nongraded)

Nongraded Learning Activities are provided to aid students in their course of study. You do not have to submit them. If you have questions, contact your instructor for further guidance and information.

This is an opportunity for you to express your thoughts about the material you are studying by writing about it. Conceptual thinking is a great way to study because it gives you a chance to process what you have learned, and it increases your ability to remember it.

In order to practice what you have learned, please attempt the exercises below, which can be found in your textbook.

- DO IT! 1 | Basic Concepts, p. 1-6
- DO IT! 2 | Building Blocks of Accounting, p. 1-10
- DO IT! 3 | Owner's Equity Effects, p. 1-13

- DO IT! 4 | Tabular Analysis, p. 1-19
- DO IT! 5 | Financial Statement Items, p. 1-23

You are also encouraged to complete the following end-of-chapter exercises and problems, which can be found in your textbook.

- Practice Multiple Choice Questions and Solutions, pp. 1-28 to 1-29
- Practice Brief Exercises, pp. 1-29 to 1-32
- Practice Problem, pp. 1-32 to 1-33

If you have any questions or do not understand a concept, contact your professor for clarification. Completing these practice exercises and problems will give you practice, which will be helpful as you complete the assignment for this unit.