

**BACHELOR**  
of **ECONOMICS**



**Thammasat University**  
**Faculty of Economics**  
**Bachelor of Economics (International Program)**

**AC201**  
**Fundamental Accounting**

Semester 1/2011

**Course Materials**

**Topic:**

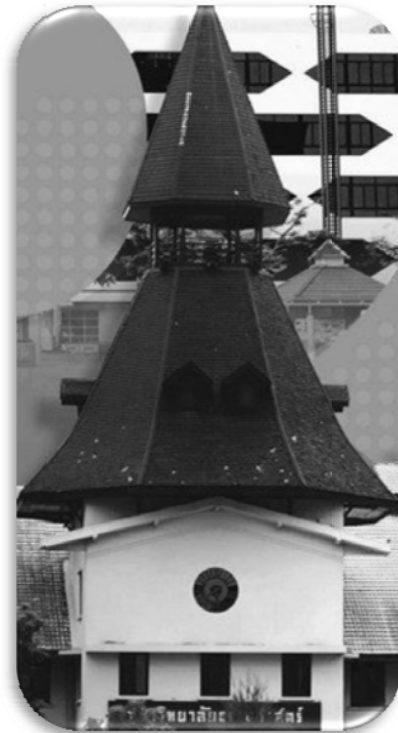
Chapter 01 Financial Statements and  
Business Decisions

**Session:**

Session #1

**Instructor:**

Ajarn Santana Singhasaneh





BACHELOR  
of ECONOMICS



**CHAPTER 1:  
FINANCIAL STATEMENTS  
AND BUSINESS DECISIONS**

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Thammasat Business School  
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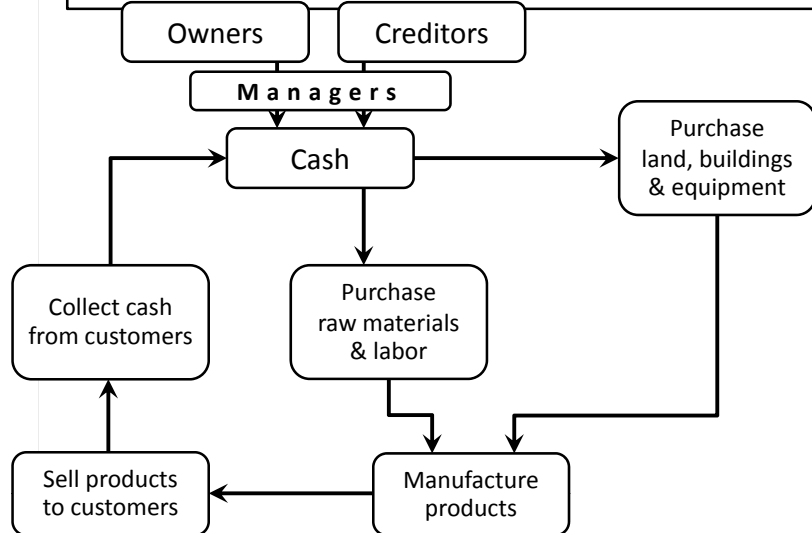


**Understanding the Business**

How does President Bakery run its business ?



**Understanding the Business**



**The Accounting System**





## The Accounting System



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## The Four Basic Financial Statements

1. **BALANCE SHEET** – reports the amount of assets, liabilities, and stockholders' equity of an accounting entity at a point in time.
2. **INCOME STATEMENT** – reports the revenues less the expenses of the accounting period.
3. **STATEMENT OF RETAINED EARNINGS** – reports the way that net income and distribution of dividends affected the financial position of the company during the accounting period.
4. **STATEMENT OF CASH FLOWS** – reports inflows and outflows of cash during the accounting period in the categories of operating, investing, and financing.

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## The Four Basic Financial Statements

Balance Sheet	
Cash	\$ 4,895
Other assets	22,366
<b>Total assets</b>	<b>\$ 27,261</b>
Liabilities	\$ 16,156
Contributed Capital	2,000
Retained earnings	9,105
<b>Total liabilities and equity</b>	<b>\$ 27,261</b>

Statement of Cash Flows	
Cash flows from operating activities	\$ 1,069
Cash flows from investing activities	-1,625
Cash flows from financing activities	400
Change in cash	\$ (156)
Beginning cash balance	5,051
<b>Ending cash balance</b>	<b>\$ 4,895</b>

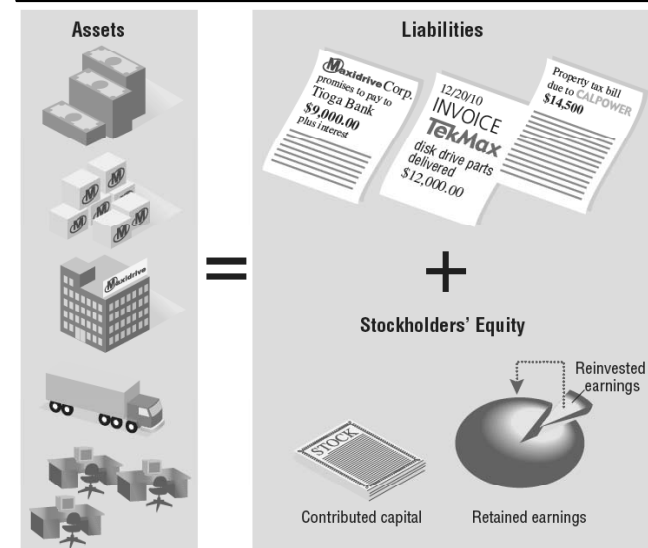
Income Statement	
Revenues	\$ 37,436
Expenses	34,136
<b>Net income</b>	<b>\$ 3,300</b>

Statement of Retained Earnings	
Beginning retained earnings	\$ 6,805
Net income	3,300
Dividends	(1,000)
<b>Ending retained earnings</b>	<b>\$ 9,105</b>

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## The Accounting Equation



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## The Balance Sheet

### Typical Account Titles

#### Assets

Cash  
 Short-Term Investment  
 Accounts Receivable  
 Notes Receivable  
 Inventory (to be sold)  
 Supplies  
 Prepaid Expenses  
 Long-Term Investments  
 Equipment  
 Buildings  
 Land  
 Intangibles

#### Liabilities

Accounts Payable  
 Accrued Expenses  
 Notes Payable  
 Taxes Payable  
 Unearned Revenue  
 Bonds Payable

#### Stockholders' Equity

Contributed Capital  
 Retained Earnings



## The Income Statement

### Typical Account Titles

#### Revenues

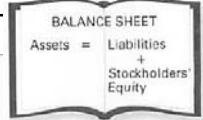
Sales Revenue  
 Fee Revenue  
 Interest Revenue  
 Rent Revenue

#### Expenses

Cost of Goods Sold  
 Wages Expense  
 Rent Expense  
 Interest Expense  
 Depreciation Expense  
 Advertising Expense  
 Insurance Expense  
 Repair Expense  
 Income Tax Expense



## Balance Sheet



**BODDINGTON LIMITED**  
**Balance Sheet**  
**At December 31, 2010**  
 (in thousands of dollars)

<b>Assets</b>	
Cash	\$ 4,895
Accounts receivable	5,714
Inventories	8,517
Plant and equipment	7,154
Land	981
<b>Total assets</b>	<b>\$27,261</b>
<b>Liabilities</b>	
Accounts payable	\$ 7,156
Notes payable	9,000
<b>Total liabilities</b>	<b>16,156</b>
<b>Stockholders' Equity</b>	
Contributed capital	2,000
Retained earnings	9,105
<b>Total stockholders' equity</b>	<b>11,105</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$27,261</b>



## Income Statement



**BODDINGTON LIMITED**  
**Income Statement**  
**For the Year Ended December 31, 2010**  
 (in thousands of dollars)

<b>Revenues</b>	
Sales revenue	\$37,436
<b>Total revenues</b>	<b>37,436</b>
<b>Expenses</b>	
Cost of goods sold expense	26,980
Selling, general, and administrative expense	3,624
Research and development expense	1,982
Interest expense	450
<b>Total expenses</b>	<b>33,036</b>
Pretax income	4,400
Income tax expense	1,100
<b>Net income</b>	<b>\$ 3,300</b>



## Statement of Retained Earnings

Beginning Retained Earning  
 Plus: Net Income  
 Less: Dividends  


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 Ending Retained Earnings



## Statement of Retained Earnings

Statement of Retained Earnings  
 Beginning RE  
 + Net Income  
 - Dividends  


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 Ending RE

**BODDINGTON LIMITED**  
**Statement of Retained Earnings**  
 For the Year Ended December 31, 2010  
 (in thousands of dollars)

Retained earnings, January 1, 2010	\$ 6,805
Net income for 2010	3,300
Dividends for 2010	<u>(1,000)</u>
Retained earnings, December 31, 2010	<u>\$ 9,105</u>



## Statement of Cash Flows

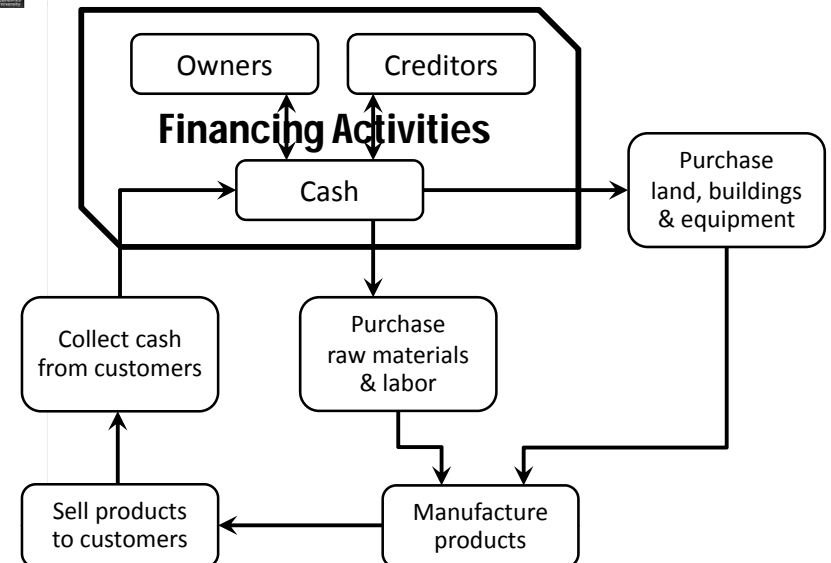
**BODDINGTON LIMITED**  
**Statement of Cash Flows**  
 For the Year Ended December 31, 2010  
 (in thousands of dollars)

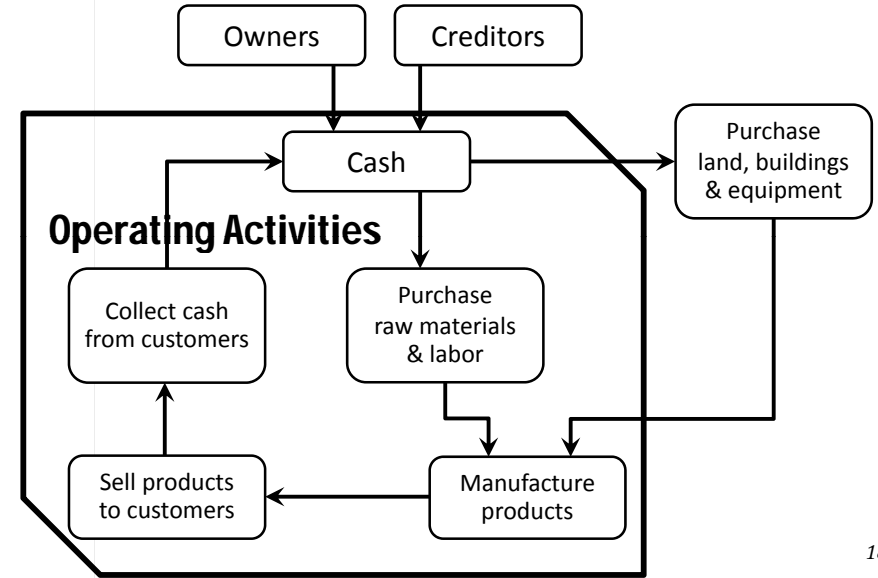
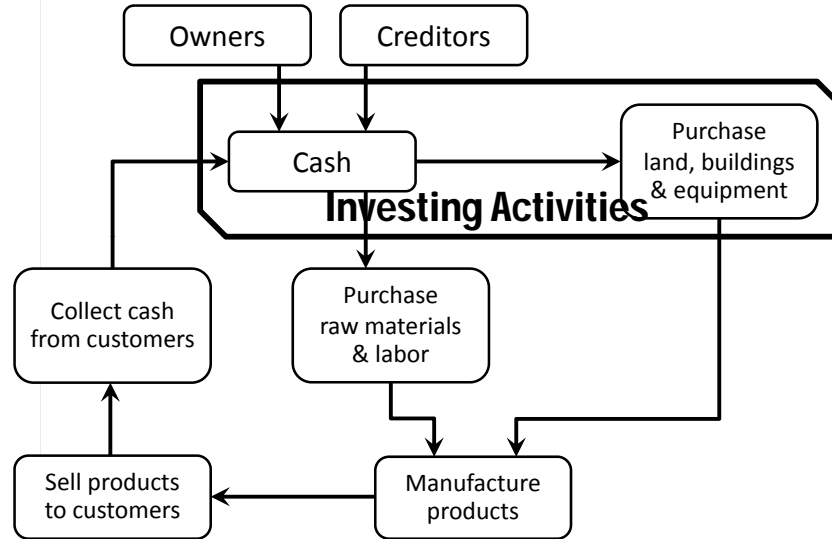
<b>Cash flows from operating activities</b>	
Cash collected from customers	\$ 33,563
Cash paid to suppliers and employees	(30,854)
Cash paid for interest	(450)
Cash paid for taxes	<u>(1,190)</u>
Net cash flow from operating activities	1,069
<b>Cash flows from investing activities</b>	
Cash paid to purchase manufacturing equipment	(1,625)
Net cash flow from investing activities	<u>(1,625)</u>
<b>Cash flows from financing activities</b>	
Cash received from bank loan	1,400
Cash paid for dividends	<u>(1,000)</u>
Net cash flow from financing activities	400
Net decrease in cash during the year	(156)
Cash at beginning of year	5,051
Cash at end of year	<u>\$ 4,895</u>

Statement of Cash Flows  
 +/- CFO  
 +/- CFI  
 +/- CFF  


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 Change in Cash





### Relationships Among the Statements

1. Net income from the income statement results in an increase in ending retained earnings on the statement of retained earnings.

Income Statement		Statement of Retained Earnings	
Revenues	\$ 37,436	Beginning retained earnings	\$ 6,805
Expenses	34,136	Net income	3,300
Net income	\$ 3,300	Dividends	(1,000)
		Ending retained earnings	\$ 9,105



### Relationships Among the Statements

2. Ending retained earnings from the statement of retained earnings is one of the two components of stockholders' equity on the balance sheet.

Balance Sheet		Statement of Retained Earnings	
Cash	\$ 4,895	Beginning retained earnings	\$ 6,805
Other assets	22,366	Net income	3,300
Total assets	\$ 27,261	Dividends	(1,000)
Liabilities	\$ 16,156	Ending retained earnings	\$ 9,105
Contributed Capital	2,000		
Retained earnings	9,105		
Total liabilities and equity	\$ 27,261		



## Relationships Among the Statements

3. The change in cash on the statement of cash flows is added to the beginning-of-year balance in cash to arrive at end-of-year cash on the balance sheet.

Balance Sheet		Statement of Cash Flows	
Cash	\$ 4,895	Cash flows from operating activities	\$ 1,069
Other assets	22,366	Cash flows from investing activities	(1,625)
Total assets	\$ 27,261	Cash flows from financing activities	400
Liabilities	\$ 16,156	Change in cash	\$ (156)
Contributed Capital	2,000	Beginning cash balance	5,051
Retained earnings	9,105	Ending cash balance	\$ 4,895
Total liabilities and equity	\$ 27,261		



## Relationships Among the Statements

Balance Sheet		Statement of Cash Flows		Income Statement		Statement of Retained Earnings	
Cash	\$ 4,895	Cash flows from operating activities	\$ 1,069	Revenues	\$ 37,436	Beginning retained earnings	\$ 6,805
Other assets	22,366	Cash flows from investing activities	-1,625	Expenses	34,136	Net income	3,300
Total assets	\$ 27,261	Cash flows from financing activities	400	Net income	\$ 3,300	Dividends	(1,000)
Liabilities	\$ 16,156	Change in cash	\$ (156)			Ending retained earnings	\$ 9,105
Contributed Capital	2,000	Beginning cash balance	5,051				
Retained earnings	9,105	Ending cash balance	\$ 4,895				
Total liabilities and equity	\$ 27,261						



## Notes

All financial statements should be accompanied by notes which provide the reader with supplemental information about the financial condition and results of operations of the company.



## Management Uses of Financial Statements



Marketing managers and credit managers use customers' financial statements to decide whether to extend credit.



Purchasing managers use suppliers' financial statements to decide whether suppliers have the resources to meet the demand for products.



Employees' union and human resource managers use the company's financial statements as a basis for contract negotiations over pay rates.



## Summary of the Financial Statements

Financial Statement	Purpose	Structure	Examples of Content
<b>Balance Sheet</b> (Statement of Financial Position)	Reports the financial position (economic resources and sources of financing) of an accounting entity at a point in time.		Cash, accounts receivable, plant and equipment, notes payable, contributed capital
<b>Income Statement</b> (Statement of Income, Statement of Earnings, Statement of Operations)	Reports the accountant's primary measure of economic performance during the accounting period.		Sales revenue, cost of goods sold, selling expense, interest expense
<b>Statement of Retained Earnings</b>	Reports the way that net income and the distribution of dividends have affected the financial position of the company during the accounting period.		Net income is taken from the income statement; Dividends are distributions to stockholders
<b>Statement of Cash Flows</b> (Cash Flow Statement)	Reports inflows (receipts) and outflows (payments) of cash during the accounting period in the categories operating, investing, and financing.		Cash collected from customers, cash paid to suppliers, cash paid to purchase equipment, cash borrowed from banks



## Responsibilities for the Accounting Communication Process

### The Rules

**Generally Accepted Accounting Principles (GAAP)**



## How are Generally Accepted Accounting Principles Determined?

Our accounting system has a long and distinguished history. An Italian monk named Luca Pacioli, published the first elements of double-entry bookkeeping in 1494.

Prior to 1933, the management teams of most companies were largely free to choose their own financial reporting practices.



## Generally Accepted Accounting Principles

Securities Act of 1933  
Securities and Exchange Act of 1934



The Securities and Exchange Commission (SEC) has been given broad powers to determine measurement rules for financial statements.





## Generally Accepted Accounting Principles

The SEC has worked closely with the accounting profession to work out the detailed rules that have become known as GAAP.



Currently, the Financial Accounting Standards Board (FASB) is recognized as the body to formulate GAAP.



## Generally Accepted Accounting Principles



Companies incur the cost of preparing the financial statements and bear the following economic consequences . . .

- Effects on the selling price of stock.
- Effects on the amount of bonuses received by managers and other employees.
- Loss of competitive information to other companies.



## International Perspective International Financial Reporting Standards

Since 2002, there has been substantial movement toward the adoption of **International Financial Reporting Standards (IFRS)** issued by the International Accounting Standards Board (IASB).

Examples of jurisdictions requiring the use of **IFRS** either currently or by 2012 include:

- European Union
- Australia and New Zealand
- Hong Kong, India, Malaysia, and South Korea
- Israel and Turkey
- Brazil and Chile
- Canada and Mexico



In the United States, the Securities and Exchange Commission now allows foreign companies whose stock is traded in the U.S. to use IFRS and is considering requiring the use of IFRS for U.S. domestic companies by 2014.



## Management Responsibility and the Demand for Auditing

To ensure the accuracy of the company's financial information, management:

- Maintains a system of controls.
- Hires outside independent auditors.
- Forms a committee of the board of directors to review these two safeguards.





## Independent Auditors

- Auditors express an opinion as to the fairness of the financial statements.
- Independent auditors have responsibilities that extend to the general public.
- The PCAOB issues detailed auditing standards that auditors must follow.



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## Independent Auditors

An audit involves . . .

- Examining the financial reports to ensure compliance with GAAP.
- Examining the underlying transactions incorporated into the financial statements.
- Expressing an opinion as to the fairness of presentation of financial information.



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## Ethics, Reputation, and Legal Liability

The **American Institute of Certified Public Accountants** requires that all members adhere to a professional code of ethics.

*Code of Ethics*

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## Ethics, Reputation, and Legal Liability

A CPA's reputation for honesty and competence is his/her most important asset.



Like physicians, CPAs have liability for malpractice.

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## Supplement A: Types of Business Entities

**Sole Proprietorship:** owned by a single individual.

**Partnership:** owned by two or more individuals.

**Corporation:** ownership represented by shares of stock.

### Advantages of a Corporation

- Limited liability
- Continuity of life
- Ease of transfer of ownership
- Opportunity to raise large amounts of money

### Disadvantage of a Corporation

- Double taxation

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## Supplement B: Employment in the Accounting Profession Today

### Professional Designations

CPA

CMA

CIA

### Career Opportunities

#### Public Accounting

- Audit and Assurance Services
- Management Consulting Services
- Tax Services

#### Employment by Organizations

- Internal accounting
- External reporting
- Tax planning
- Various other functions

#### Employment in the Public and Not-for-Profit Sector

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## End of Chapter 1



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