



Accounting as a Form of Communication

Chapter 1



What is Accounting?

Accounting is the process of identifying, measuring, and communicating economic information to various users.

Its purpose is to provide economic information about an organization that will be useful to those who need to make decisions regarding that entity.

For example, information provided by an accountant about an entity is useful to a banker in reaching a decision about whether to loan money to a business.

ACCOUNTING IS THE LANGUAGE USED TO DISCUSS BUSINESS PERFORMANCE.

BALANCE SHEET

BALANCE SHEET/ STATEMENT OF FINANCIAL POSITION

ASSET: Probable future economic benefit as a result of a past transaction, examples: Cash, accounts receivable

LIABILITY: Probable future economic sacrifice as a result of a past transaction, examples: accounts payable, accrued expenses

EQUITY: Residual interest of owners, examples retained earnings, common stock

$$A = L + E$$

OR

$$E = A - L$$



INCOME STATEMENT

REVENUE: Reported when it is earned

EXPENSE: Reported when the benefit is derived. Leads to the concept of **MATCHING**, which means we match the expense to the period in which the associated revenue is recorded.



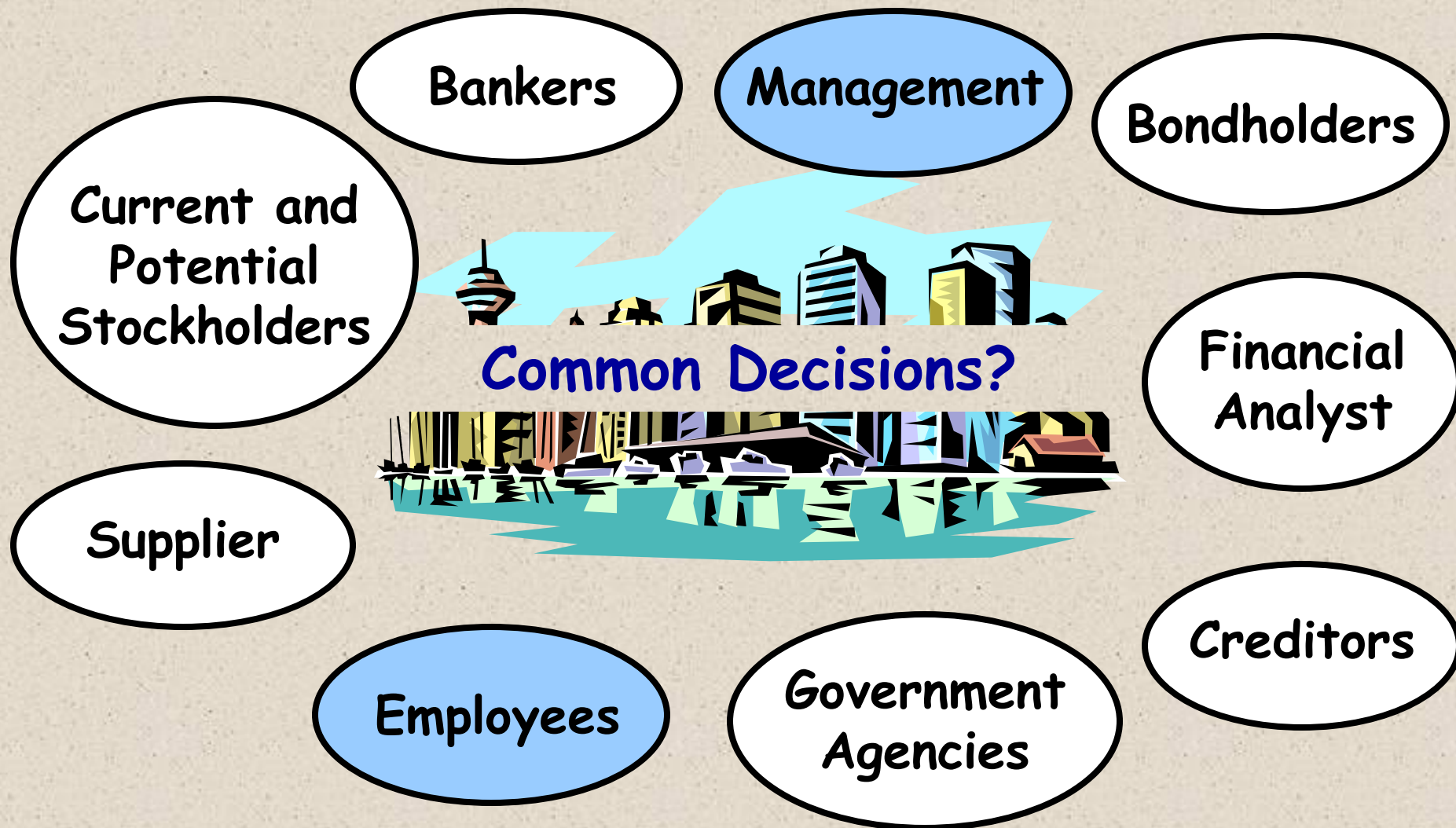
Why is Accounting Important?

Accounting is important for **markets**, **free enterprise**, and **competition** because it assists in providing information that leads to capital allocation.

The better the information, the more effective the process of capital allocation and then the healthier the economy.

**ACCOUNTING IS A CRITICAL COMPONENT OF THE
FUNCTIONING OF THE CAPITAL MARKETS!**

Users of Financial Information



Users of Financial Information

Needs Information About

User Group

- | | | |
|--|---|--|
| 1. The profitability of each division in the company | ➔ | Management |
| 2. The prospects for future dividend payments | ➔ | Stockholder |
| 3. The financial status of a company issuing securities to the public for the first time | ➔ | Securities and Exchange Commission (SEC) |
| 4. The prospects that the company will be able to pay its interest payments on time | ➔ | Banker |
| 5. The prospects that the company will be able to pay for its purchases on time | ➔ | Supplier |

Accounting Classes at UCSB

Principles of Accounting (Econ. 3AB)

Financial Statement Analysis (Econ. 118)

Auditing (Econ. 132)

Financial Accounting (Econ. 136ABC)

Managerial (cost) Accounting (Econ. 137AB)

Tax Accounting (Econ. 138AB)

Advanced Accounting (Econ. 139)

International Accounting (Econ. 182)

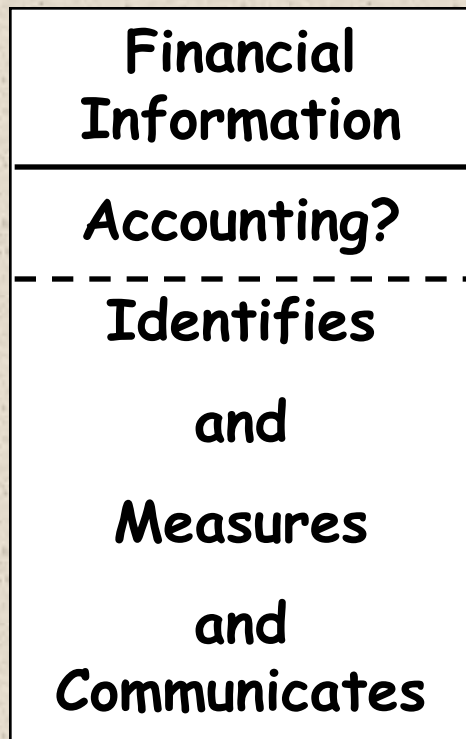
Accounting Information Systems (Econ. 185)

Law and Ethics (Econ. 189)

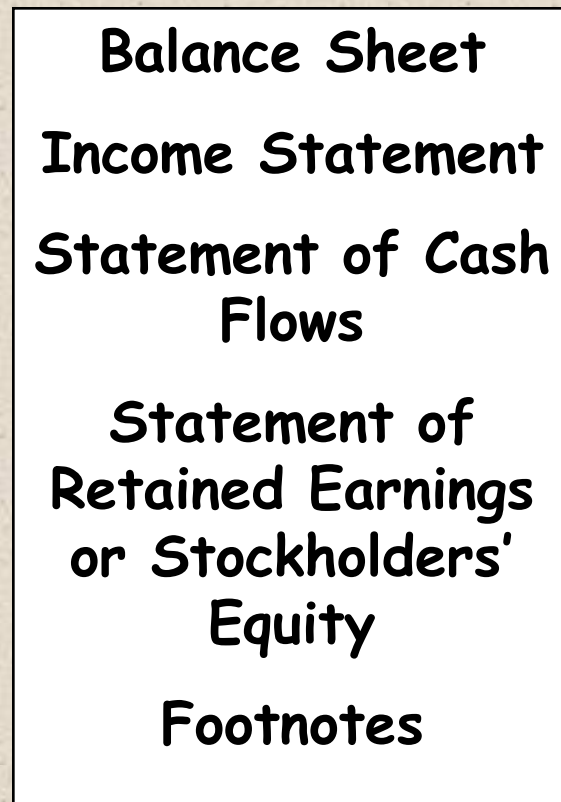
Which ones should I take?

Characteristics of Financial Accounting

Economic Entity

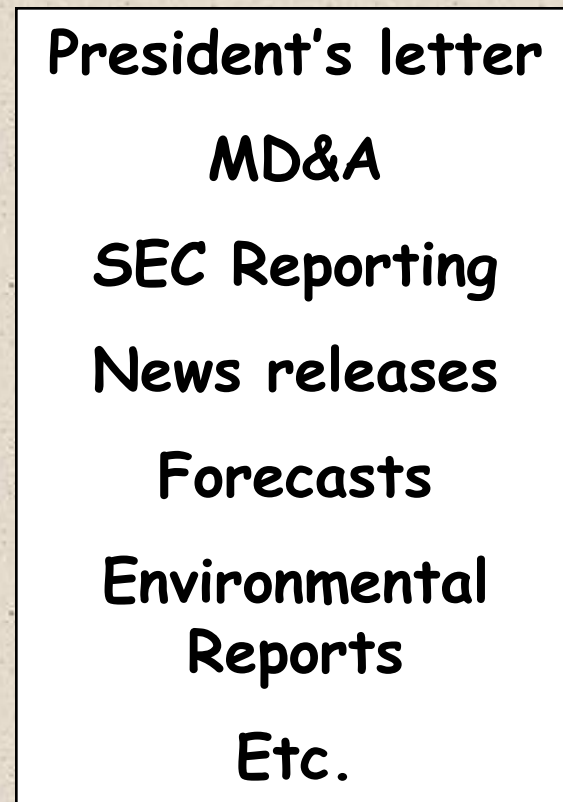


Financial Statements



GAAP

Additional Information



Not GAAP

LO 2 Explain the purpose of each of the financial statements.

Slide
1-9

<http://www.winnebagoind.com/>

ECON 3A UCSB-- ANDERSON



Objectives of Financial Reporting

True or False?

The purpose of accounting is to provide quantitative financial information about an economic entity to persons interested in the activities of that entity?

True



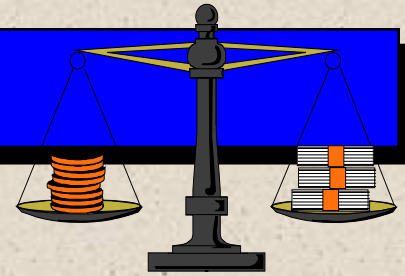
Objectives of Financial Reporting

True or False?

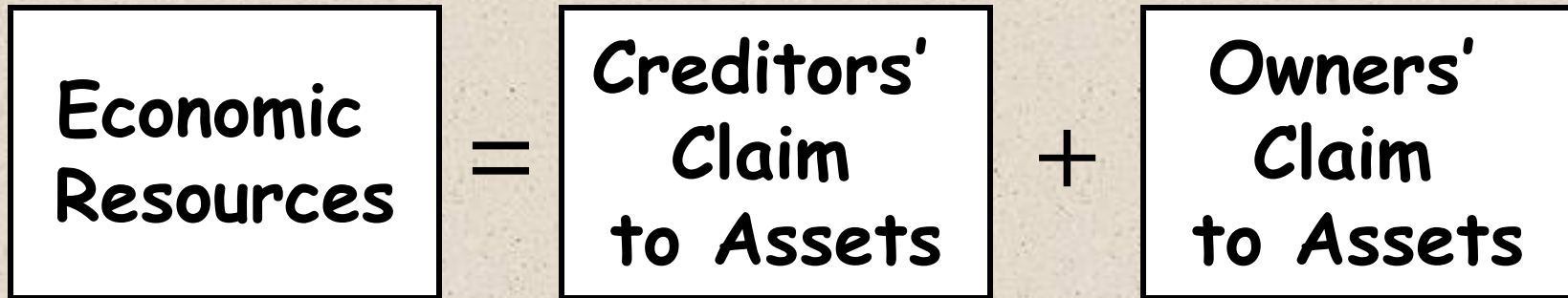
Financial accounting is the process that culminates in the preparation of financial reports that are relative to the business and that are used by parties both internal and external to the enterprise.

True

The Accounting Equation



Assets = Liabilities + Owners' Equity
(or Stockholders' Equity)



Accounts examples:

Cash

Accounts receivable

Inventory

Accounts payable

Notes payable

Common stock

Retained earnings

The accounting equation- ALGEBRA

If $A=L+E$, then:

$$E = A - L \quad \dots \quad \text{EQUITY} = \text{ASSETS} - \text{LIABILITIES}$$

**THEREFORE THE EQUITY IS WHAT IS
LEFTOVER FROM THE ASSETS AFTER
PAYING ALL LIABILITIES.**

MAY BE EASIER TO REMEMBER THIS WAY.

FOUR BASIC FINANCIAL STATEMENTS

→ **BALANCE SHEET:** Think of it as a statement of financial position:

- Summarizes the accounting equation, $A=L+E$;
- As of a certain date;
- Accrual basis;

— **INCOME STATEMENT:** How did we do:

- For a stated period;
- Accrual basis;

— **STATEMENT OF STOCKHOLDERS' EQUITY:** Rolls forward retained earnings and other EQUITY activity:

- For a stated period.

STATEMENT OF CASH FLOWS: Where did the cash come from and where did it go:

- Activities impacting cash; broken into activities...the “three buckets” (1) operating (2) investing (3) financing
- It's like a cash basis income statement

Communicate with Financial Statements

Balance Sheet

Assets: 2004

Total assets

Liabilities:

Equity:

Total liabilities & equity

Income Statement

Revenues: 2004

Expenses:

Net income (loss)

Statement of Retained Earnings

Beginning balance

Ending balance

The accountants job is NOT to decide what is best for the user of the financial statements, but to provide the user the information necessary to make informed decisions.

Is it a critical function?

- Cost of scandals: Enron, Worldcom, etc...**
- Implementation of the Sarbanes-Oxley Act of 2002.**
- Sound ethical behavior is absolutely critical.**

Conceptual Framework for Financial Reporting

ASSUMPTIONS

- ➔ Economic entity
- ➔ Going concern
- ➔ Monetary unit
- ➔ Periodicity

PRINCIPLES

- ➔ Historical cost
- Revenue recognition
- Matching
- Full disclosure

CONSTRAINTS

- Cost-benefit
- Materiality
- Industry practice
- Conservatism

QUALITATIVE CHARACTERISTICS

- Relevance
- Reliability
- Comparability
- Consistency

ELEMENTS

- Assets, Liabilities, and Equity
- Investments by owners
- Distribution to owners
- Comprehensive income
- Revenues and Expenses
- Gains and Losses

OBJECTIVES

1. Useful in investment and credit decisions
2. Useful in assessing future cash flows
3. About enterprise resources, claims to resources, and changes in them

MORE ABOUT THE STATEMENTS- INTERRELATIONSHIPS

WHEN?-- ACCRUAL ACCOUNTING:

That is the big question in accounting. Things happen, but you need to present it in a way which is meaningful to users of the financial statements.

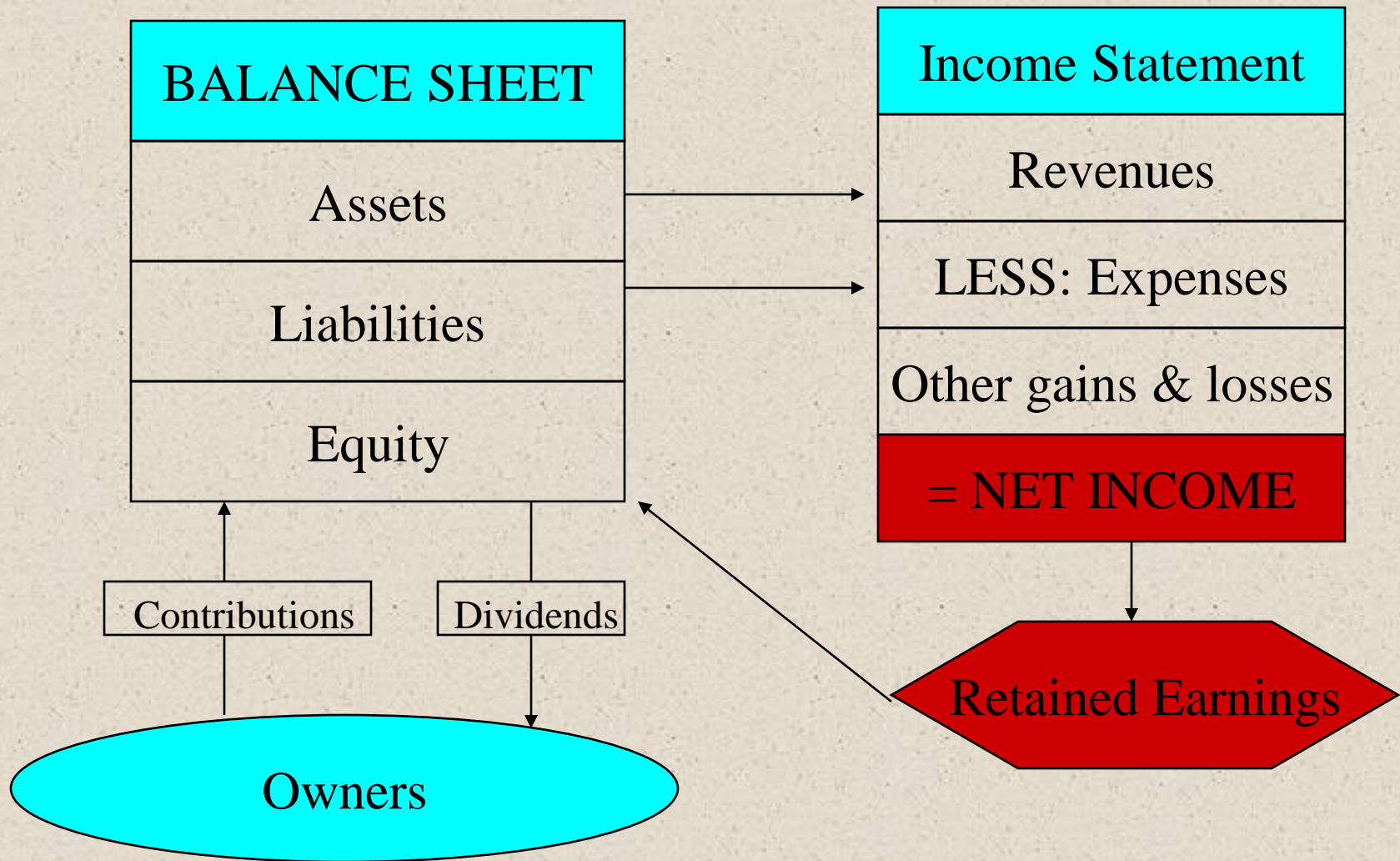
- Record revenue when earned;**
- Match expenses to period when revenue is recorded;**
 - Record expenses when “incurred” but DON’T use the webster’s definition of “incurred”- under GAAP, incurred means: “when the associated benefit has been realized”**

The balance sheet is a parking lot. Everything on the balance sheet eventually finds its way to the income and equity statements.

HOW MUCH?– HISTORICAL COST

- Assumes the Company is a “going concern”, otherwise consider utilizing “liquidation values”**

INTERRELATIONSHIP OF STATEMENTS- BASIC



Financial Statements Exercise

Various Accounts:

Accounts payable	\$ 5,000	Equipment	7,500
Accounts receivable	4,000	Rent expense	6,500
Capital stock	8,000	Retained earnings,	
Cash	13,000	beg. of year	8,500
Dividends paid	3,000	Salary expense	12,000
Landscaping revenues	25,000	Supplies on hand	500

Financial Statements

Balance Sheet

	<u>2004</u>
Assets:	
Accounts receivable	4,000
Cash	13,000
Equipment	7,500
Supplies	<u>500</u>
Total assets	<u><u>25,000</u></u>

Liabilities:	
Accounts payable	5,000
Equity:	
Capital stock	8,000
Retained earnings	<u>12,000</u>
Total liabilities & equity	<u><u>25,000</u></u>

Income Statement

	<u>2004</u>
Revenues:	
Landscape revenue	25,000
Expenses:	
Rent	6,500
Salary and wages	<u>12,000</u>
Net income	<u><u>6,500</u></u>

Statement of Retained Earnings

Retained earnings, beg.	8,500
+ Net income	6,500
- Dividends	<u>3,000</u>
Ending balance	<u><u>12,000</u></u>

Net income (loss)?

Balance Sheet

	<u>2004</u>
Assets:	
Accounts receivable	4,000
Cash	13,000
Equipment	7,500
Supplies	<u>500</u>
Total assets	<u><u>25,000</u></u>

Liabilities:	
Accounts payable	5,000
Equity:	
Capital stock	8,000
Retained earnings	<u>12,000</u>
Total liabilities & equity	<u><u>25,000</u></u>

Income Statement

	<u>2004</u>
Revenues:	
Landscape revenue	25,000
Expenses:	
Rent	6,500
Salary and wages	<u>12,000</u>
Net income	<u><u>6,500</u></u>

Statement of Retained Earnings

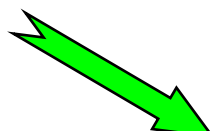
Retained earnings, beg.	8,500
+ Net income	6,500
- Dividends	<u>3,000</u>
Ending balance	<u><u>12,000</u></u>

What is Retained Earnings Balance?

Balance Sheet

	<u>2004</u>
Assets:	
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Equipment	7,500
Supplies	<u>500</u>
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Statement of Retained Earnings

Retained earnings, beg.	8,500
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- Dividends	<u>3,000</u>
Ending balance	<u><u>12,000</u></u>

How much are Total Assets?

Balance Sheet

	<u>2004</u>
Assets:	
Accounts receivable	4,000
Cash	13,000
Equipment	7,500
Supplies	500
	<hr/>
Total assets	25,000
	<hr/> <hr/>

Liabilities:	
Accounts payable	5,000
Equity:	
Capital stock	8,000
Retained earnings	12,000
	<hr/>
Total liabilities & equity	25,000
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Income Statement

	<u>2004</u>
Revenues:	
Landscape revenue	25,000
Expenses:	
Rent	6,500
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Net income	6,500
	<hr/> <hr/>

Statement of Retained Earnings

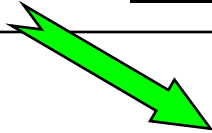
Retained earnings, beg.	8,500
+ Net income	6,500
- Dividends	3,000
	<hr/>
Ending balance	12,000
	<hr/> <hr/>

How much are Total Liabilities?

Balance Sheet

	<u>2004</u>
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Income Statement

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Salary and wages	<u>12,000</u>
Net income	<u><u>6,500</u></u>

Statement of Retained Earnings

Retained earnings, beg.	8,500
+ Net income	6,500
- Dividends	<u>3,000</u>
Ending balance	<u><u>12,000</u></u>

How much is Stockholders' Equity?

Balance Sheet

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Supplies	<u>500</u>
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Equity:	
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Expenses:	
Rent	6,500
Salary and wages	<u>12,000</u>
Net income	<u><u>6,500</u></u>

Statement of Retained Earnings

Retained earnings, beg.	8,500
Net income	6,500
Dividends	<u>3,000</u>
Ending balance	<u><u>12,000</u></u>

\$20,000

YOUR RENT AS AN EXAMPLE

RENT IS DUE ON THE?

1ST

HAVE YOU RECEIVED THE BENEFIT WHEN YOU PAY IT?

NO

USING THE DEFINITION OF AN EXPENSE, IS IT AN EXPENSE WHEN YOU PAY IT?

NO

DOES IT HAVE “FUTURE ECONOMIC BENEFIT” TO YOU WHEN YOU PAY IT?

YES

WHAT DO WE CALL SOMETHING THAT HAS FUTURE ECONOMIC BENEFIT?

ASSET!!!

RENT: HOW IT LOOKS, assume you start with \$4k in the bank

Balance Sheet

	<u>2004</u>
Assets:	
Cash	3,600
Prepaid rent	700
	<hr/>
Total assets	<u>4,000</u>

Liabilities:

Equity:

Retained earnings	<u>4,000</u>
Total liabilities & equity	<u>4,000</u>

Income Statement

	<u>2004</u>
Revenues:	
Expenses:	
	<hr/>
Net income	<u> </u>

Statement of Retained Earnings

Ending balance	<u>4,000</u>
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RENT CONTINUED

Balance Sheet

Assets:	<u>2004</u>
Cash	3,300
Prepaid rent	700
	<hr/>
Total assets	<u><u>3,600</u></u>

Liabilities:

Equity:

Retained earnings	<u>3,600</u>
Total liabilities & equity	<u><u>3,600</u></u>

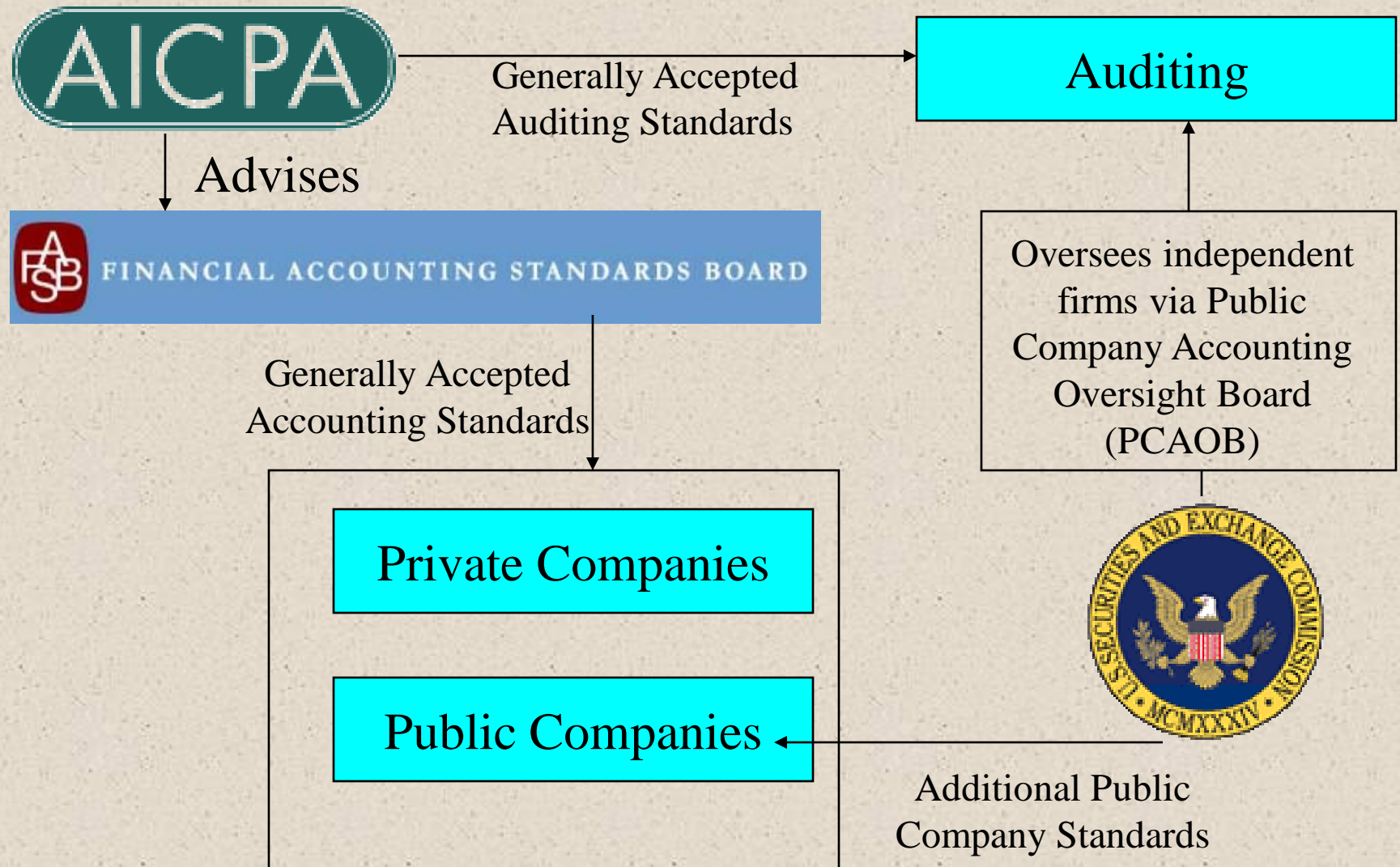
Income Statement

Revenues:	<u>2004</u>
Expenses:	
Rent expense	700
	<hr/>
Net loss	<u><u>(700)</u></u>

Statement of Retained Earnings

Net Loss	(700)
	<hr/>
Ending balance	<u><u>3,300</u></u>

HOW DOES GAAP COME TO BE?



Business Entities

***CPAs and
Accounting Firms***

***Financial
Community***

AICPA (AcSEC)

FASB

***Professional
Organizations***

Academics

Government

Investing Public

***Industry
Associations***

Statement of Financial Accounting Standards (SFAS)

Accounting Standard Setting

The primary mission of the U.S. Securities and Exchange Commission (SEC) is to protect investors and maintain the integrity of the securities markets.



Securities and Exchange Commission established in 1934

Securities Act of 1933 and 1934

- To restore integrity in capital markets

Accounting Standard Setting



Act of 1933:

- Requirement for Initial Public Offering

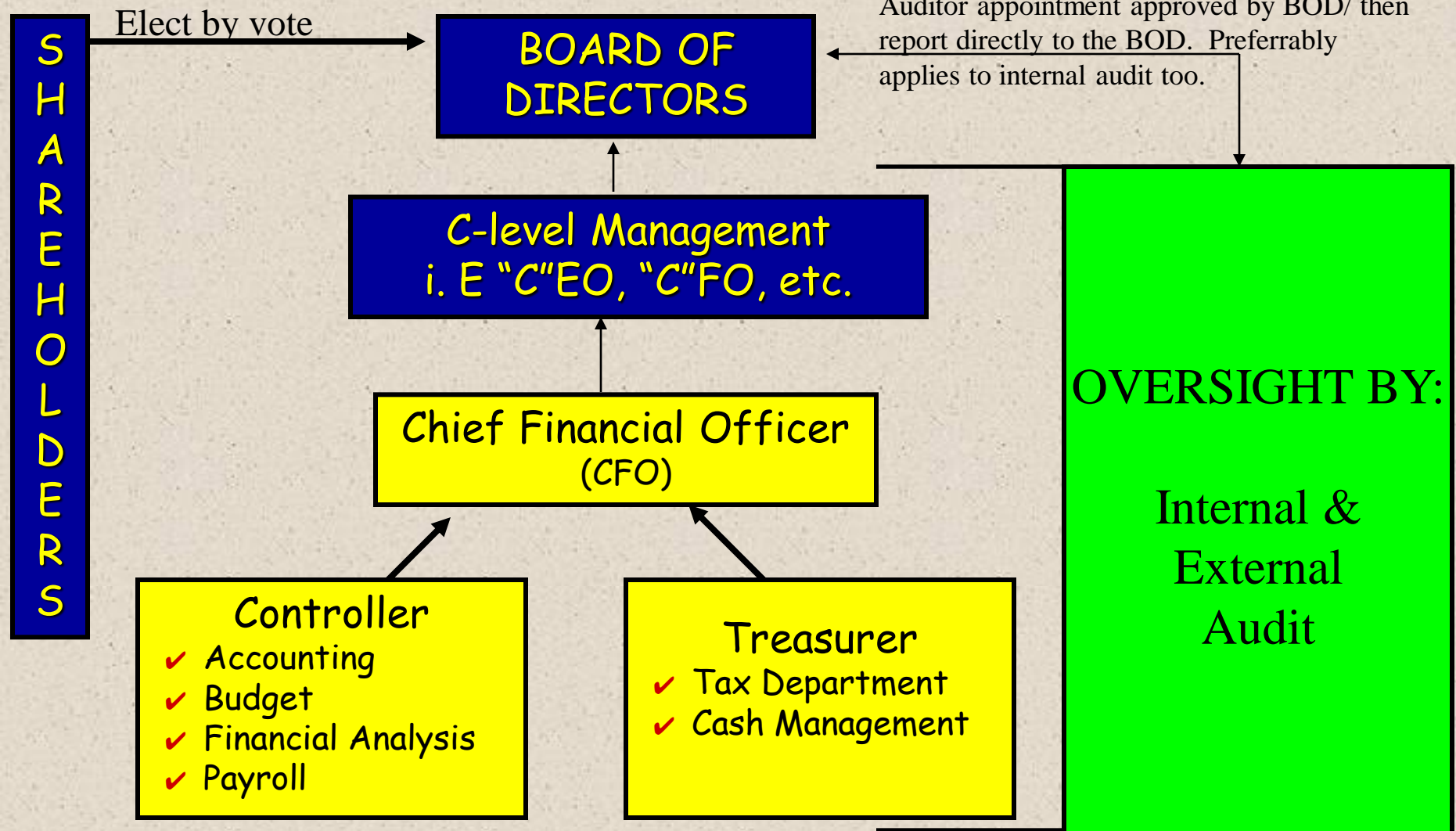
Act of 1934:

- Reporting requirements for public companies

SEC is the Enforcement Authority:

- Has legal authority to prescribe accounting Standards applicable to public companies.
- Delegated standard setting to AICPA, private sector organization (1939). Current standard setting body is the Financial Accounting Standards Board (FASB).

Employment in a Private Business



A Service Activity

Employment in a Public Business:


- Auditing Services
- Tax Services
- Management Consulting Services

Other Employment:

- Education
- Non-Profit Entities
- Governmental Entities



A Service Activity + An Analytical Discipline + An Information System



Report of Independent Auditors

To the Board of Directors and Shareholders
Winnebago Industries, Inc.

We have audited the accompanying consolidated balance sheets of Winnebago Industries, Inc. and subsidiaries (the Company) as of August 25, 2001 and August 26, 2000 and the related consolidated statements of income, cash flows and changes in stockholders' equity for each of the three years in the period ended August 25, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of August 25, 2001 and August 26, 2000, and the results of their operations and their cash flows for the three years in the period ended August 25, 2001 in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche
October 3, 2001



The Accounting Profession

1. The chief accounting officer for a company
2. The department responsible in a company for the review and appraisal of its accounting and administrative controls.
3. The officer responsible in an organization for the safeguarding and efficient use of a company's liquid assets.
4. The process of examining the financial statements and the underlying records of a company in order to render an opinion as to whether the statements are fairly presented.
5. The opinion rendered by a public accounting firm concerning the fairness of the presentation of the financial statements.

Controller

**Internal
Auditing**

Treasurer

Auditing

**Auditors'
Report
Exhibit 1-7**

FLOW TO FINANCIALS- FACTS

OPEN A BUSINESS SERVICES CENTER:				
NEED MONEY:				
Me & My partner contribute \$25,000 each				50,000
Borrow				200,000
RENT SPACE:				
Pay deposit				10,000
Pay first month rent- AT END OF THE MONTH				2,000
EQUIPMENT				
Buy a copy machine (36 month life)				36,000
SALES ACTIVITY				
Rent post office boxes per month- bill at end of the month				5,000
Photocopy use- all cash				1,250

STARTING POINT

Balance Sheet AS OF- START

Assets:

Liabilities:

Equity:

Income Statement

Revenues: N/A

Expenses:

Net income (loss)

1st MONTH

Balance Sheet

END OF MONTH

Assets:

Cash 50,000

Accounts receivable

Rent deposit

Equip't (copier)

Total Assets 50,000

Liabilities:

SBA Loan

Equity:

Contributions 50,000

Retained earnings

Liab & Equity 50,000

Income Statement

N/A

Revenues:

PO Box rent

Copy service

Expenses:

Space rent

Depreciation exp.

Net income (loss)

1st MONTH

Balance Sheet

END OF MONTH

Assets:

Cash 250,000

Accounts receivable

Rent deposit

Equip't (copier)

Total Assets 250,000

Liabilities:

SBA Loan 200,000

Equity:

Contributions 50,000

Retained earnings

Liab & Equity 250,000

Income Statement

N/A

Revenues:

PO Box rent

Copy service

Expenses:

Space rent

Depreciation exp.

Net income (loss)

1st MONTH

Balance Sheet

Assets: END OF MONTH

Cash 250,000

Accounts receivable

Rent deposit 10,000

Equip't (copier)

Total Assets 250,000

Liabilities:

SBA Loan 200,000

Equity:

Contributions 50,000

Retained earnings

Liab & Equity 250,000

Income Statement

N/A

Revenues:

PO Box rent

Copy service

Expenses:

Space rent

Depreciation exp.

Net income (loss)

1st MONTH

Balance Sheet

END OF MONTH

Assets:

Cash 288,000

Accounts receivable

Rent deposit 10,000

Equip't (copier)

Total Assets 288,000

Liabilities:

SBA Loan 200,000

Equity:

Contributions 50,000

Retained earnings (2,000)

Liab & Equity 288,000

Income Statement

N/A

Revenues:

PO Box rent

Copy service

Expenses:

Space rent 2,000

Depreciation exp.

Net income (loss) (2,000)

1st MONTH

Balance Sheet

END OF MONTH

Assets:

Cash 208,000

Accounts receivable

Rent deposit 10,000

Equip't (copier) 36,000

Total Assets 248,000

Liabilities:

SBA Loan 200,000

Equity:

Contributions 50,000

Retained earnings (2,000)

Liab & Equity 248,000

Income Statement

N/A

Revenues:

PO Box rent

Copy service

Expenses:

Space rent 2,000

Depreciation exp.

Net income (loss) (2,000)

1st MONTH

Balance Sheet

END OF MONTH

Assets:

Cash	202,000
Accounts receivable	5,000
Rent deposit	10,000
Equip't (copier)	36,000
Total Assets	<u><u>258,000</u></u>

Liabilities:

SBA Loan	200,000
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Equity:

Contributions	50,000
Retained earnings	(2,000)
Liab & Equity	<u><u>258,000</u></u>

Income Statement

N/A

Revenues:

PO Box rent	5,000
Copy service	

Expenses:

Space rent	2,000
Depreciation exp.	

Net income (loss) (2,000)

1st MONTH

Balance Sheet

END OF MONTH

Assets:

Cash	202,000
Accounts receivable	5,000
Rent deposit	10,000
Equip't (copier)	36,000
Total Assets	<u><u>253,000</u></u>

Liabilities:

SBA Loan	200,000
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Equity:

Contributions	50,000
Retained earnings	3,000

Liab & Equity	<u><u>253,000</u></u>
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Income Statement

N/A

Revenues:

PO Box rent	5,000
Copy service	1,250

Expenses:

Space rent	2,000
Depreciation exp.	

Net income (loss) 3,000

**“What we learn to do, we
learn by doing”**

AUTHOR OF THIS QUOTE?