

FINANCIAL ACCOUNTING – CHAPTER 1

Summary: Cheat Sheet

ACCOUNTING USES

External users: Do not directly run the organization and have limited access to its accounting information. Examples are lenders, shareholders, boards of directors, external auditors, nonexecutive employees, labor unions, regulators, voters, donors, suppliers and customers.

Internal users: Directly manage organization operations. Examples are the CEO and other executives, research and development managers, purchasing managers, production managers, and other managerial-level employees.

Private accounting: Accounting employees working for businesses.

Public accounting: Offering audit, tax, and advisory services to others.

ETHICS AND ACCOUNTING

Fraud triangle: Three factors that push a person to commit fraud.

- **Opportunity:** Must be able to commit fraud with a low risk of getting caught.
- **Pressure or incentive:** Must feel pressure or have incentive to commit fraud.
- **Rationalization or attitude:** Justifies fraud or does not see its criminal nature.

Common business entities:

	Sole Proprietorship	Partnership
Number of owners	1 owner; easy to set up.	2 or more, called <i>partners</i> ; easy to set up.
Business taxation	No additional business income tax.	No additional business income tax.
Owner liability	Unlimited liability. Owner is personally liable for proprietorship debts.	Unlimited liability. Partners are jointly liable for partnership debts.
Legal entity	Not a separate legal entity.	Not a separate legal entity.
Business life	Business ends with owner death or choice.	Business ends with a partner death or choice.

	Corporation	Limited Liability Company (LLC)
Number of owners	1 or more, called <i>shareholders</i> ; can get many investors by selling <u>stock</u> or <u>shares</u> of corporate ownership.	1 or more, called <i>members</i>
Business taxation	Additional corporate income tax.	No additional business income tax.
Owner liability	Limited liability. Owners, called <u>shareholders</u> (or <u>stockholders</u>), are not liable for corporate acts and debts.	Limited liability. Owners, called <u>members</u> , are not personally liable for LLC debts.
Legal entity	A separate entity with the same rights and responsibilities as a person.	A separate entity with the same rights and responsibilities as a person.
Business life	Indefinite.	Indefinite.

SYSTEM OF ACCOUNTS

Assets: Resources a company owns or controls that are expected to yield future benefits.

Liabilities: Creditors' claims on assets. These are obligations to provide assets, products, or services to others.

Equity: Shareholders' claims on assets. It consists of:

- + **Common Stock** **Common Stock** reflects inflows of cash and other net assets from shareholders in exchange for stock.
- **Dividends** **Dividends** are outflows of cash and other assets to shareholders that reduce equity
- + **Revenues** **Revenues** increase equity (via net income) from sales of products and services to customers; examples are sales of products, consulting services provided, facilities rented to others, and commissions from services.
- **Expenses** **Expenses** decrease equity (via net income) from costs of providing products and services to customers; examples are costs of employee time, use of supplies, advertising, utilities, and insurance fees.

FINANCIAL STATEMENTS

Financial Statement	Layout	Purpose
Income Statement	<div style="border: 1px solid black; padding: 5px; width: fit-content;"> Revenues - <u>Expenses</u> Net income </div>	Describes a company's revenues and expenses and computes net income or loss over a period of time.
Statement of retained earnings	<div style="border: 1px solid black; padding: 5px; width: fit-content;"> Beg. Retained earnings + Net income - <u>Dividends</u> End. Retained earnings </div>	Explains changes in retained earnings from net income (or loss) and any dividends over a period of time.
Balance sheet	<div style="border: 1px solid black; padding: 5px; width: fit-content;"> Assets = Liabilities + Equity </div>	Describes a company's financial position (types and amounts of assets, liabilities, and equity) at a <i>point in time</i> .
Statement of cash flows	<div style="border: 1px solid black; padding: 5px; width: fit-content;"> +/- Operating C.F. +/- Investing C.F. +/- <u>Financing D.F.</u> Change in cash </div>	Identifies cash inflows (receipts) and cash outflows (payments) over a period of time.
