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Chapter 1

Introduction to Accounting 绪论



导读

本章从会计学最简单的概念、目的和类别等入手，由浅入深地介绍了会计要素、会计等式，并简单地介绍了财务报表。由于财务报表是本课程的重点和难点，因此本章对财务报表的介绍只是为学习者今后的学习做一个知识上和心理上的准备和铺垫，使学习者对此有一个先期印象。

通过本章的学习，应重点掌握：1. 会计要素的分类和含义，包括资产、负债、所有者权益、收入、费用、净收入等六项。2. 会计等式，即 $\text{资产} = \text{负债} + \text{所有者权益}$ 。会计等式是会计学的核心内容，是账务处理的最基本的平衡式。它反映出六大会计要素之间存在的一种恒等关系，反映了财务报表，尤其是资产负债表各类账户之间的平衡关系。无论经济业务发生怎样的变化，会计等式始终成立。3. 使用会计等式记录各种经济业务，通过实践来理解、掌握会计等式。4. 正确解读基本财务报表的编列、数据采集和运算，理解净收入对损益表和资产负债表之间的钩稽关系。

本章的学习难点：1. 正确理解收入和费用。收入只有使资本增加时才构成收入，费用只有使资本减少时才构成费用。2. 用会计等式记账时收入和费用在所有者权益项下的处理方式。3. 会计要素在基本财务报表上的表达。



Learning Objectives

After reading this chapter, you should be able to:

- ① learn the definition, purpose, role and branches of accounting;
- ② understand the underlying assumptions of financial accounting;
- ③ learn the accounting elements and accounting equation;
- ④ learn how to record transactions in the accounting equation;
- ⑤ learn two primary financial statements—income statement and balance sheet;
- ⑥ understand the qualitative characteristics of financial statements;
- ⑦ know about the standards for the preparation of financial statements.



Introductory Case

Rosa Scarlett opened a bar. She deposited \$14,000 into a bank account opened specially for her business—Scarlett’s Bar. She bought equipment, supplies, inventories, etc. sustained debt and paid expenses. After the first month’s operation, she summarized her transactions occurred. The total sales revenue was \$15,000, and the expenses paid was \$4,745. However, she was wondering about the issues as follows:

- How come that her net income reaches \$10,255?
- What are the total assets of her bar at the end of the month?
- How much debt did she sustain during the month?
- How does her accountant present all the financial information?

What Is Accounting 会计的内涵

Accounting is the language of business and, unless one has some understanding of it, business, investments, taxes and money management will be like a foreign language too difficult to understand. This section introduces the definition, purpose, branches, and underlying assumptions of accounting.

1.1 Accounting

Accounting is an information system that classifies, records, measures, summarizes, interprets and reports the economic activities of a business with monetary unit as its main criterion. Under this definition three important points call for our attention: (1) accounting involves such activities as classifying, recording, measuring, summarizing, interpreting, reporting and describing; (2) the object of accounting is economic activities of a business; (3) monetary unit is the criterion. Therefore, accounting is a systematic process of measuring the economic activities of a business to provide information about the financial position of a business. It is also a language that provides useful information for business decision-making.

1.2 Purpose of Accounting

The purpose of accounting is to provide useful information to those who make economic decisions which often determine the success of a business. While an economic decision involves making the best allocation of resources available, among various alternatives the decision maker has to consider a lot of factors. Take investment for example. The investment

choice alone will depend on many factors, such as the specific alternatives available, current needs, long-term plans, other resources available, and the potential risks and rewards associated with the investment opportunity.

1.3 Role of Accounting

Accounting plays a vital role in providing information needed to make knowledgeable economic decisions. The information supplied is in the form of quantitative data, primarily financial in nature, and relates to specific economic entities. An economic entity may be an individual, a business enterprise, or a nonprofit organization. Every entity, regardless of its size or purpose, must have a way to keep track of its economic activities and to measure how well it does in accomplishing its goals. Without accounting information, many important economic decisions would be made blindly. For example, investors would have no way to distinguish between a profitable company and one that is on the verge of failure; bankers could not evaluate the risks of potential loans; managers would have no basis for controlling costs, setting prices, or investing the company's resources.

Exercises

- 1.1 Accounting is the _____ of business.
- 1.2 Accounting is an information system that classifies, records, measures, summarizes, interprets and reports the economic activities of a business with _____ as its main criterion.
- 1.3 The purpose of accounting is to provide useful information to those who make _____ which often determine the success of a business.
- 1.4 Accounting plays a vital role in providing information needed to make _____ economic decisions.
- 1.5 The information supplied is in the form of quantitative data, primarily _____ in nature.



Q & A

Q: Is the accounting department important in an entity?

A: Absolutely yes. We are in an information era and the accounting department is one of the most important departments dealing with information. Financial information from all departments is recorded and summarized by the accounting department. And the information from the accounting department is useful for decision-making in all levels of departments. For example, the accounting department records the money received and

goods sold with the information from the selling department. It also records the money paid and goods purchased with the information from the purchasing department. The investment department and the financing department will use the information recorded by the accounting department to invest or attract money. The production department and the human resource department also need information about products and labor costs recorded. In fact, all the departments are related to the accounting department with financial and non-financial information.

1.4 Accounting Branches 会计学的类别

When a business applies for a loan from the bank, the bank needs to know the financial position and performance of the business through financial statements. What involves here is called **financial accounting**. Financial accounting is the area of accounting aimed at serving external users. Its primary objective is to provide external reports called financial statements to help users analyze a business' activities. When a business is thinking of how much to spend on advertising and whether to launch another product, **managerial accounting** is involved. Managerial accounting provides information to the decision makers of a business, or internal users. Managerial accounting reports much of the information in financial accounting. But it also reports information not reported to the outsiders of the business. If a business buys equipment or goods for production, the business has to calculate the materials and labor spent on the production. That's when **cost accounting** comes in. Cost accounting is a process of accumulating the information managers need about costs. It helps managers identify, measure, and control costs. A business is required to calculate tax liabilities annually and complete tax forms. This is regarded as tax compliance and tax planning which belongs to the area of **tax accounting**. Tax accounting covers the computation of taxes on what the law defines as income of a business. It helps taxpayers prepare their tax returns and plan future transactions to minimize taxes. When once again the business is using the financial statements to apply for a loan, the bank may require them to be audited. In this case, **auditing** (审计) is referred to. Auditing is a check of a business' accounting systems and records using various tests. It increases the credibility of the financial statements.

Exercises

- 1.6 When a business applies for a loan from the bank, the bank needs to know the financial position and performance of the business through _____.
- 1.7 The primary objective of financial accounting is to provide _____ called financial statements to help users analyze a business' activities.
- 1.8 Managerial accounting provides information to the decision makers of a business, or _____.

- 1.9 Cost accounting is involved in the calculation of materials and labor spend on production. It helps managers _____, _____, and _____ costs.
- 1.10 Tax accounting covers the computation of taxes on what the law defines as income of a business. It helps taxpayers prepare their tax returns and plan future transactions to _____ taxes.
- 1.11 Auditing is a check of a business' accounting systems and records using various tests. It increases the _____ of the financial statements.



Q & A

Q: Do you agree that an accountant is a bookkeeper?

A: In fact, an accountant today is more than just a bookkeeper. Since accounting software takes most of the manual job, accountants have more time to help the management make economic decisions, for instance, conduct ratio analysis, fulfill performance measurement and work out tax planning.

Q: Kate doesn't like numbers. So she thinks it will be better for her to become an auditor instead of an accountant. Is she right at this point?

A: No. When an auditor performs an audit, he or she must know how to prepare financial statements as well as auditing standards, because financial accounting is the underlying knowledge for auditing.

1.5 Underlying Assumptions 基本假设

As for financial accounting, there are two underlying assumptions—**accrual basis** and **going concern**. These assumptions don't exist actually. They are assumed and used for the convenience of bookkeeping. We must understand them because they are what we take for granted except for contrary conditions.

1.5.1 Accrual basis

The effects of transactions and other events are recognized when they occur (Not as cash or its equivalent is received or paid), and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. That is, revenue is recognized when earned, regardless of when cash is actually collected; and expense is matched to the revenue, regardless of when cash is paid out.

For example, if a business spends \$50,000 on decorating the premises and holds that there is no need of any modification in 5 years, only one-fifths of the \$50,000, that is \$10,000, is regarded as expense for the current year. The remaining \$40,000 is not related to the current year's expenses.

Contrary to accrual basis, **cash basis** is *not* an underlying assumption. Revenue is recorded when cash, checks or credit card deposits are received from customers; and expenses are deducted from revenues when they are paid, regardless of the period they relate to. That's to say, on cash basis, every cent a business gets and pays out in a fiscal year will be recorded as the current year's revenues and expenses, without considering which year they are actually related to.

1.5.2 Going concern

The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the business entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations.

Continued with the example that a business spends \$50,000 on decorating the premises and will not decorate again within 5 years. In this case, the business views the \$50,000 as the expense for 5 years because the business is assumed to last for 5 or more than 5 years. This assumption is referred to as going concern. Otherwise, if the business has any intention to sell the premises, expenses as well as net income will be calculated in another way instead of using a 5-year period to apportion the \$50,000.

Liquidation basis is contrary to going concern which is *not* an underlying assumption. Individual assets and liabilities are adjusted to estimate net-realizable values which may result in either a net write-up or write-down of net assets/equity. In the above example, if the business intends to sell the entire enterprise, the value of assets equals to what is left after selling them.

Exercises

- 1.12 Under accrual basis of accounting, revenue is recognized when earned, regardless of when cash is actually _____; and expense is matched to the revenue, regardless of when cash is _____.
- 1.13 Which of the followings are the two underlying assumptions for financial accounting?
A. Cash basis B. Going concern C. Accrual basis D. Liquidation basis
- 1.14 On cash basis of accounting, revenue is recorded when you receive _____, checks or credit card deposits from your customers; and expenses are deducted from revenues when they are _____, regardless of _____.
- 1.15 Going concern means that the business entity has neither the _____ nor the _____ to liquidate or curtail materially the scale of its operations.
- 1.16 On liquidation basis, individual assets and liabilities are adjusted to estimated _____ values which may result in either a net write-up or write-down of net assets/equity.



Q & A

Q: In what situation should accrual basis and cash basis be used?

A: For profit-oriented entities, accrual basis is usually used. For non-profit entities, cash basis is commonly used.

Q: When is the going concern assumption not suitable?

A: When a company goes bankrupt owing to operation failure, or merges for special purpose, the company needs to prepare the financial statement at liquidation basis. At this time, the going concern assumption is not suitable.

Accounting Elements 会计要素

Accounting elements include assets, liabilities, equity, revenues, expenses, and net income. The first three are the basic accounting elements that describe the amounts of resources and claims to resources at a specific time and that make up the basic accounting equation. The last three accounting elements, that is, revenues, expenses, and net income describe events that affect a business' gains and losses during a period of time and make up the expanded accounting equation. Definitions of these accounting elements are as follows:

2.1 Assets 资产

Assets are resources controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity. Assets can be classified into **current assets** and **non-current assets**.

Assets that satisfy any of the following criteria can be classified as current assets:

- (a) It is expected to be realized, or is intended for sale or consumption in the entity's normal operating cycle;
- (b) It is held primarily for the purpose of trading;
- (c) It is expected to be realized within twelve months after the balance sheet date; or
- (d) It is cash or a cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the balance sheet date.

Assets that do not meet the definition of current assets shall be classified as non-current assets.

It is important to distinguish between current assets and non-current assets. The point is that they are presented in different sections in the balance sheet and used for different purposes in financial analysis.

2.2 Liabilities 負債

Liabilities are present obligations of the entity arising from past events, the settlement of which are expected to result in outflows of resources from the entity. Like assets, liabilities are usually classified as **current liabilities** (流动负债) and **non-current liabilities**.

Liabilities that satisfy any of the following criteria shall be classified as current liabilities:

- (a) It is expected to be settled in the entity's normal operating cycle;
- (b) It is held primarily for the purpose of being traded;
- (c) It is due to be settled within twelve months after the balance sheet date; or
- (d) The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date.

Liabilities that do not meet the definition of current liabilities shall be classified as non-current liabilities.

2.3 Equity 权益

Equity is the residual interest in the assets of the entity after deducting all its liabilities. It represents the net assets available after all obligations have been satisfied. Obviously, if there are no liabilities, the total assets are exactly equal to equity.

When a business is owned by one person, the equity is shown as “capital” or “owner's equity.” When it is owned by stockholders, it is shown as “shareholders' equity” or “stockholders' equity.” Equity is affected by the results of a company's operations. If a business is profitable, equity is increased; if a business suffers a loss, equity is decreased.

2.4 Revenues 收入

Revenues refer to increases in the resources of a business from the sale of goods or services. The increases are derived primarily from the normal operations of the business. For manufacturing and merchandizing businesses, revenues derive from the sale of merchandise. For a service business, revenues generate from the fees it charges for the services it provides. Revenues can also be earned from other activities, for example, from charging interest or collecting rent. Note that a cash receipt qualifies as revenue only when it helps increase equity. Thus, cash borrowed from a bank is not revenue but simply a liability.

2.5 Expenses 费用

Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Like revenues, expenses represent flows of resources during a period of time, but expenses are outflows whereas revenues are inflows. In amount, the expenses are equal to the

value of goods or services used up in gaining revenues. Please note that a cash payment can be regarded as an expense only if it decreases equity. Thus, purchasing supplies, which is an exchange of one asset for another, is not an expense. Please also note that dividend payments and drawings are not expenses since they are not related to revenue-producing operations of a business.

2.6 Net Income¹ 净收入

Net income is the residual amount that remains after expenses have been deducted from revenues. If revenues exceed expenses, there is net income and the amount is a positive figure; if expenses exceed revenues, there is a net loss and the amount is a negative figure.

It is important to note the difference between revenues and net income. Both concepts represent an increase in the net assets of a firm. However, revenues represent total resource increases; expenses are subtracted from revenues to derive net income or net loss. Thus, whereas revenue is a “gross” concept, net income (or net loss) is a “net” concept.

Exercises

- 1.17 Accounting elements include assets, liabilities, equity, _____, _____, and net income.
- 1.18 Assets are resources controlled by an entity as a result of _____ events and from which _____ economic benefits are expected to _____ the entity. liabilities are _____ obligations of the entity arising from _____ events, the settlement of which are expected to result in _____ of resources from the entity.
- 1.19 Cars produced by a motor manufacturer for sale are the _____ assets of the motor manufacturer.
Cars bought by a super market for daily use are the _____ assets of the super market.
An old machine supposed to be sold right after the balance sheet day is a _____ asset.
A machine bought for new production line is a _____ asset.
- 1.20 A company bought \$40,000 goods and promised to pay within three months. This is a _____ liability.
A company obtained a loan of \$400,000 from a bank and promised to pay two years later. This is a _____ liability.

1. net income 是目前较为通用的一个会计术语，但是在国际会计准则中则采用 profit 一词。

- 1.21 Equity is the _____ in the assets of the entity after deducting all its _____.
Net income is the residual amount that remains after _____ have been deducted from revenues.
- 1.22 When a business is owned by one person, the equity is shown as “_____” or “_____.”
- 1.23 Revenues refer to increases in the resources of a business from the _____ of goods or services.
- 1.24 The money gained by selling an old equipment of a food manufacturer _____ revenue.
The money received as additional investment from investors _____ revenue.
The money gained by selling a new medicine for a medicine manufacturer _____ revenue.
- 1.25 An expense is a _____ in economic benefits during the accounting period in the form of _____ or depletions of assets or incurrences of liabilities that result in _____ in equity, other than those relating to distributions to equity participants.
- 1.26 The money a company pays for electricity fee _____ expense.
The money a company pays for renting a building _____ expense.
The money a company pays for constructing a building _____ expense.
- 1.27 If revenues exceed expenses, there is _____ and the amount is a positive figure; if expenses exceed revenues, there is a _____ and the amount is a negative figure.



Q & A

Q: Are the accounting elements the same in different entities?

A: As for the size of entities, there are small, middle and large entities. As for the type of entities, there are service, commercial and manufacturing entities. As for the organization of entities, there are **sole proprietorship**, **partnership**, and **corporation**. The basic accounting elements are the same, but slight difference might exist when we talk about a specific account. So you may attempt to compare the accounts used in different entities during the following chapters. That will be helpful for your learning.

Case 1.1

Sachet Hardware is registered as a proprietorship. On July 1, when this firm began its operation, the accountant summarized the financial events in investment occurred and the transactions estimated for the first monthly operation as follows. Please classify these events and transactions into different accounting elements.

Investment occurred:

Cash	\$40,000
Inventory	\$20,000
Equipment	\$16,000
Accounts payable (debt owed on Equipment)	\$6,000

Transactions estimated:

Short-term borrowings	\$10,000
Sales revenue	\$50,000
Salaries expense	\$5,000
Cost of goods sold	\$10,000
Finance costs	\$1,000
Administrative expense	\$2,000

Accounting Equation 会计等式

The accounting equation is very important in learning and practicing accounting. Because the equation shows the basic relationship between the accounting elements, it helps understand the changes in accounts when transactions or events occur.

3.1 Accounting Equation

Accounting equation shows the balancing condition of assets on one side (the left side) and liabilities plus owners' equity on the other side (the right side). In the following the basic accounting equation is given:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

This equation tells us that assets of an entity must equal to the total of its liabilities and owners' equity. This equation explains who supply the assets of the entity. Suppose a business, Scarlett's Bar, owns assets of \$31,755 and liabilities of \$7,500. According to the accounting equation, the owner's equity must be \$24,255 (\$31,755 = \$7,500 + \$24,255).

Since the accounting equation is in equality, it can be presented in another way:

$$\text{Owners' Equity} = \text{Assets} - \text{Liabilities}$$

At this point, we bring revenues and expenses into the picture. Since revenues help increase equity and expenses decrease equity, the accounting equation may be expanded to include revenues and expenses as shown below:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

$$\text{+Revenues} - \text{Expenses}$$

Thus the expanded accounting equation is:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity} + (\text{Revenues} - \text{Expenses})$$

3.2 Recording Transactions in the Accounting Equation

Any business event that alters the amount of assets, liabilities or owners' equity or that affects the accounting equation is called a transaction. To record transactions using the accounting equation, we assume that during the month of January, 2007, Scarlett's Bar had the following transactions:

Jan. 4 Scarlett started her business and deposited \$14,000 into a bank account opened specially for her business Scarlett's Bar.

6 Bought equipment like refrigerators, tables and chairs, etc. for \$8,500.

7 Bought supplies such as tableware for \$2,000.

8 Bought beverages etc. for \$7,500 on account.

20 Borrowed \$5,000 from the bank for a duration of 3 months.

21 Paid \$5,000 owed on inventory.

28 Paid electricity and water bills for the month \$245.

31 Total monthly cash sales \$15,000.

31 Paid chefs salary for the month \$4,500.

Now let's see how the accountant makes a meaningful record of the series of transactions, reconciling step by step with the accounting equation.

Transaction 4 Scarlett started her business and deposited \$14,000 into a bank account. There are two accounts that are affected: the asset Cash is increased, and the Capital of the firm is increased by the same amount. (Capital C is used in "Cash and" "Capital" to mean the titles of accounts.)

Assets	=	Liabilities	+	Owners' Equity
Cash				Scarlett, Capital
4 + \$14,000	=		+	+\$14,000

Transaction 6 Bought such equipment as refrigerators, tables and chairs, etc. for \$8,500. Here Scarlett is substituting one asset (cash) for another asset (equipment). She is receiving (+) the asset Equipment and paying out (−) the asset Cash. Note that the capital of \$14,000 remains unchanged.

	Assets	=	Liabilities	+	Owners' Equity
	Cash + Equipment	=			Scarlett, Capital
	\$14,000				\$14,000
6	-\$8,500 +\$8,500				
	\$5,500 \$8,500				\$14,000

Transaction 7 Bought supplies such as tableware for \$2,000. In this case Scarlett again substitutes one asset Cash for another asset Supplies (Tableware is current assets which is grouped under the title Supplies. She receives Supplies (+) and pays out Cash (-).

	Assets	=	Liabilities	+	Owners' Equity
	Cash + Supplies + Equipment	=			Scarlett, Capital
	\$5,500 \$8,500				\$14,000
7	-\$2,000 +\$2,000				
	\$3,500 \$2,000 \$8,500				\$14,000

Transaction 8 Bought beverages etc. for \$7,500 on account. In this transaction, both sides of the accounting equation are affected: increase on the left side Assets (+) and increase on the right side Liabilities (+) by the same amount. So the accounting equation is still in balance. For Scarlett's Bar such goods as beverages, pastry, refreshment, etc. are grouped under the title Inventories. She therefore is receiving the asset Inventories but is not paying for it with the asset Cash. Instead, she will owe the money. Thus she creates the liability Accounts Payable because she owes that much.

	Assets	=	Liabilities	+	Owners' Equity
	Cash + Supplies + Inventories + Equipment	=	Accounts Payable	+	Scarlett, Capital
	\$3,500 \$2,000 \$8,500				\$14,000
8	+\$7,500		+\$7,500		
	\$3,500 \$2,000 \$7,500 \$8,500		\$7,500		\$14,000

Transaction 20 Borrowed \$5,000 from the bank for a duration of 3 months. Like creating Accounts Payable to purchase an asset, both sides of the accounting equation increase by the same amount, but the balancing condition is not impaired. In this case Scarlett is receiving Cash (+) and creating a current liability—Short-term Borrowings (+).

	Assets	=	Liabilities	+	Owners' Equity
	Cash+Supplies+Inventories+Equipment	=	Short-term Borrowings + Accounts Payable	+	Scarlett, Capital
	\$3,500 \$2,000 \$7,500 \$8,500				\$7,500 +\$14,000
20	+\$5,000		+\$5,000		
	\$8,500 \$2,000 \$7,500 \$8,500		\$5,000		\$7,500 \$14,000

Transaction 21 Paid \$5,000 owed on inventory. This transaction reduces Scarlett's asset Cash since she is paying out money by \$5,000 (-). She also reduces her liability Accounts Payable, by \$5,000 (-). Now she owes that much less.

	Assets				=	Liabilities		+	Owners' Equity
	Cash+Supplies+Inventories+Equipment				=	Short-term Borrowings + Accounts Payable		+	Scarlett, Capital
	\$8,500	\$2,000	\$7,500	\$8,500		\$5,000	\$7,500		\$14,000
21	- \$5,000						- \$5,000		
	<u>\$3,500</u>	<u>\$2,000</u>	<u>\$7,500</u>	<u>\$8,500</u>		<u>\$5,000</u>	<u>\$2,500</u>		<u>\$14,000</u>

Transaction 28 Paid electricity and water bills for the month \$245. Electricity and water bills constitute Utilities Expense. This transaction means a deduction from Cash. Incurrence of expense means a deduction of Capital.

	Assets				=	Liabilities		+	Owners' Equity
	Cash + Supplies +Inventories + Equipment				=	Short-term Borrowings+Accounts Payable		+	Scarlett, Capital
	\$3,500	\$2,000	\$7,500	\$8,500		\$5,000	\$2,500		\$14,000
28	- \$245								- \$245 Utilites Ex.
	<u>\$3,255</u>	<u>\$2,000</u>	<u>\$7,500</u>	<u>\$8,500</u>		<u>\$5,000</u>	<u>\$2,500</u>		<u>\$13,755</u>

Transaction 31 Total monthly cash sales \$15,000. In this transaction Scarlett is receiving cash. So Cash is increased (+), and her Capital is also increased by the same amount (+). It is important to note that she labels Sales Revenue under Capital to indicate revenue received from major operation of her business.

	Assets				=	Liabilities		+	Owners' Equity
	Cash + Supplies+Inventories+Equipment				=	Short-term Borrowings+Accounts Payable		+	Scarlett, Capital
	\$3,255	\$2,000	\$7,500	\$8,500		\$5,000	\$2,500		\$13,755
31	+ \$15,000								+ \$15,000 Sales Rev.
	<u>\$18,255</u>	<u>\$2,000</u>	<u>\$7,500</u>	<u>\$8,500</u>		<u>\$5,000</u>	<u>\$2,500</u>		<u>\$28,755</u>

Transaction 31 Paid chefs salary for the month \$4,500. In this transaction, another expense, Salaries Expense, is created. Also, both Cash and Capital are reduced by \$4,500 (-).

	Assets				=	Liabilities		+	Owners' Equity
	Cash+Supplies+Inventories+Equipment				=	Short-term Borrowings+Accounts Payable		+	Scarlett, Capital
	\$18,255	\$2,000	\$7,500	\$8,500		\$5,000	\$2,500		\$28,755
31	- \$4,500								- \$4,500 Salaries Ex.
	<u>\$13,755</u>	<u>\$2,000</u>	<u>\$7,500</u>	<u>\$8,500</u>		<u>\$5,000</u>	<u>\$2,500</u>		<u>\$24,255</u>

At this point, the figures of the basic accounting equation are:

Assets	=	Liabilities	+	Owners' Equity
\$31,755	=	\$7,500	+	\$24,255

3.3 Summary of Transactions

	Assets	=	Liabilities	+	Owners' Equity
	Cash + Supplies+Inventories+Equipment	=	Short-term Borrowings+Accounts Payable	+	Scarlett, Capital
4	+\$14,000				+\$14,000
Bal.	\$14,000	=			\$14,000
6	-\$8,500		+ \$8,500		
Bal.	\$5,500	+	\$8,500	=	\$14,000
7	-\$2,000 +\$2,000				
Bal.	\$3,500 + \$2,000	+	\$8,500	=	\$14,000
8			+\$7,500		+\$7,500
Bal.	\$3,500 + \$2,000 + \$7,500	+	\$8,500	=	\$7,500 + \$14,000
20	+\$5,000		+\$5,000		
Bal.	\$8,500 + \$2,000 + \$7,500 + \$8,500	=	\$5,000	+	\$7,500 + \$14,000
21	-\$5,000				-\$5,000
Bal.	\$3,500 + \$2,000 + \$7,500 + \$8,500	=	\$5,000	+	\$2,500 + \$14,000
28	-\$245				-\$245 Utilities Ex.
Bal.	\$3,255 + \$2,000 + \$7,500 + \$8,500	=	\$5,000	+	\$2,500 + \$13,755
31	+\$15,000				+\$15,000 Sales Rev.
Bal.	\$18,255 + \$2,000 + \$7,500 + \$8,500	=	\$5,000	+	\$2,500 + \$28,755
31	-\$4,500				-\$4,500 Sala Ex.
Bal.	\$13,755 + \$2,000 + \$7,500 + \$8,500	=	\$5,000	+	\$2,500 + \$24,255
	<div style="display: flex; justify-content: space-around; width: 100%;"> </div>	=	<div style="display: flex; justify-content: space-around; width: 100%;"> </div>	+	
	\$31,755		\$7,500		+ \$24,255

Exercises

- 1.28 Accounting equation shows the _____ of assets on one side (the left side) and liabilities plus owners' equity on the other side (the right side).
- 1.29 Assume that a business owned assets of \$100,000, owed creditors \$20,000, and owed the owner \$80,000. The accounting equation would be _____. If \$5,000 was used to pay for the debt, the accounting equation would then be _____.
- 1.30 Given any two known elements, the third can be easily computed. Determine the missing amount in each of the accounting equations below.

	Assets	=	Liabilities	+	Capital
a	\$74,500	=	\$32,430	+	?
b	\$25,001	=	?	+	\$16,000
c	?	=	\$445,000	+	\$960,000

1.31 Determine the effect of the following transactions on capital.

- Bought machinery on account.
- Paid the above account.
- Received fees for services rendered.
- Bought supplies for cash.

1.32 Decide the effect of the transactions on the elements of the accounting equation, using I= increases; D = decreases; NE = no effect.

- Invested cash in a business.
- Purchased equipment on account.
- Purchased supplies for cash.
- Borrowed \$5,000 from bank.
- Received sales revenues.

Assets = Liabilities + Capital

- _____
- _____
- _____
- _____
- _____

1.33 Conrad invests in his new firm \$87,000 in cash; \$30,980 worth of supplies and equipment; machinery valued at \$23,500; and an unpaid bill of \$6,000 for the machinery. What is the capital of the firm?

1.34 Financial information of Doherty Wood Products for December is presented as follows:

- Started business, investing \$55,000 cash and \$75,000 equipment.
- Bought additional equipment for \$11,000 on account.
- Purchased supplies, \$2,000, for cash.
- Paid \$7,000 on account.
- Received sales revenue for \$8,800.
- Paid salaries, \$3,000.
- Paid general expenses, \$1,700.
- Paid balance owed on equipment.
- Determined supplies used, \$500.

Record each transaction in the accounting equation below:

	Assets			=	Liabilities	+	Owners' Equity
	Cash	+ Supplies	+ Equipment	=	Accounts Payable	+	Doherty, Capital
(1)	_____	_____	_____	=	_____	+	_____
(2)	_____	_____	_____	=	_____	+	_____
Bal.	_____	_____	_____	=	_____	+	_____
(3)	_____	_____	_____	=	_____	+	_____
Bal.	_____	_____	_____	=	_____	+	_____
(4)	_____	_____	_____	=	_____	+	_____
Bal.	_____	_____	_____	=	_____	+	_____
(5)	_____	_____	_____	=	_____	+	_____
Bal.	_____	_____	_____	=	_____	+	_____
(6)	_____	_____	_____	=	_____	+	_____
Bal.	_____	_____	_____	=	_____	+	_____
(7)	_____	_____	_____	=	_____	+	_____
Bal.	_____	_____	_____	=	_____	+	_____
(8)	_____	_____	_____	=	_____	+	_____
Bal.	_____	_____	_____	=	_____	+	_____
(9)	_____	_____	_____	=	_____	+	_____
Bal.	=====	=====	=====	=	=====	+	=====

1.35 Summary of transactions of Lauder Laundry is presented as follows. Please describe each transaction in simple English.

	Assets			=	Liabilities	+	Owners' Equity
	Cash	+ Supplies	+ Machinery	=	Accounts Payable	+	Lauder, Capital
(1)	\$8,000	+ \$5,000	+ \$15,000	=		+	\$28,000
(2)	-3,000	+ 3,000		=		+	
(3)	-2,000	+	+ 4,000	=	+2,000	+	
(4)	+4,500			=		+	4,500 Laundry Income
(5)	-1,200			=		+	-1,200 Wages Ex.
(6)		-1,800		=		+	-1,800 Supplies Ex.
(7)	-2,000			=	-2,000	+	
(8)	-1,000			=		+	-1,000 Rent Ex.
	<u>\$3,300</u>	+ <u>\$6,200</u>	+ <u>\$19,000</u>	=	<u>_____</u>	+	<u>\$28,500</u>

Introduction to Financial Statements

财务报表简介

The accounting equation provides the balancing condition of assets against liabilities and capital. However, this is insufficient because (1) information on the type and amount of individual asset, each liability, and capital is not provided in detail, and (2) information on the type and amount of revenues and expenses for the period is incomplete. These problems can be solved through financial statements. Financial statements are all the summary statements of the business operations and financial position. There are four major financial statements: income statement, balance sheet, statement of changes of owners' equity, and statement of cash flows. Financial statements are the focal point and final goal of our studies. In order to pave way for the study of financial statements, we are now making a brief introduction to the income statement and the balance sheet.

4.1 Income Statement 利润表

The income statement provides detailed information on the type and amount of revenues, expenses, and net income for the period. It summarizes and lists revenues, expenses and net income (profit) or loss of a business. Revenues may arise from selling goods or providing services or investing. Expenses are the costs involved in operating the business. The net income or loss is the difference between revenues and expenses. Using the information in **3.3 Summary of Transactions**, the primary income statement is prepared. See Exhibit 1-1.

Exhibit 1-1

Scarlett's Bar		
Income Statement		
For the Month of January, 2007		
Sales Revenue		\$15,000
Expenses		
Salaries Expenses	\$4,500	
Utilities Expenses	<u>245</u>	
Total Operating Expenses		<u>4,745</u>
Net Income		<u><u>\$10,255</u></u>

4.2 Balance Sheet 资产负债表

The balance sheet provides information on the type and amount of individual asset, each liability, and capital at a specific point in time, usually the end of the period. The balance sheet lists the assets, liabilities, and owners' equity of a business. The balance sheet is prepared according to the accounting equation: $\text{Assets} = \text{Liabilities} + \text{Owners' equity}$. Exhibit 1-2 shows a balance sheet, using the information in **3.3 Summary of Transactions**.

Exhibit 1-2

Scarlett's Bar
Balance Sheet
January 31, 2007

ASSETS

Cash		\$13,755
Supplies		2,000
Inventories		7,500
Equipment		8,500
Total Assets		<u>\$31,755</u>

LIABILITIES AND CAPITAL

Liabilities

Short-term Borrowings	\$5,000	
Accounts Payable	<u>2,500</u>	
Total Liabilities		7,500

Capital

Scarlett, Capital, Jan. 4	14,000	
Net income for the period	<u>10,255</u>	
Less: Drawings		
Increase in Capital	<u>10,255</u>	
Scarlett, Capital, Jan. 31		<u>24,255</u>
Total Liabilities and Capital		<u>\$31,755</u>

Note that the net income of \$10,255 from the income statement is shown as the amount of "Increase in Capital" in the balance sheet. The net income is thus the connecting link between the income statement and the balance sheet.

Exercises

- 1.36 Financial statements provide information on (1) the _____ of asset, each liability, and capital, and (2) the type and amount of _____ for the period.
- 1.37 The income statement summarizes and lists _____, _____ and _____ of a business for the period.
The balance sheet lists the _____, _____, and _____ of a business. It is prepared according to the _____.
- 1.38 Revenues arise from selling _____ or providing _____ or investing.
Expenses are the _____ involved in operating the business.
The _____ is the difference between revenues and expenses.
- 1.39 The following is an income statement with some of the information missing. Please calculate and fill in the missing information.

Income Statement
Sandrea Company
Month of October, 2008

Sales Income		(b)
Operating Expenses		
Wages Expense	\$15,000	
Rent Expense	(a)	
Utilities Expense	3,500	
Total Operating Expenses		30,750
Net Income		\$45,000

- 1.40 Information for Dashimor Company is given below. Based on the information, please (1) prepare a balance sheet; (2) determine cash at the end of the December; (3) determine the capital at the end of December 2008.
- | | | |
|---|--|---------|
| Cash, December 1 | | \$6,000 |
| Supplies | | 400 |
| Equipment | | 8,000 |
| Accounts Payable | | 5,000 |
| Capital, December 1 | | 9,400 |
| Net Income in the form of Cash for the period | | 1,000 |

4.3 Objective of Financial Statements 财务报表的目标

The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of management's stewardship of the resources entrusted to it.

4.4 Qualitative Characteristics of Financial Statements 财务报表的质量特征

Qualitative characteristics of financial statements are the attributes that make the information useful to users. There are four principal qualitative characteristics: understandability, relevance, reliability and comparability.

Understandability means that the information provided in the financial statements is readily understandable by users. Sometimes, information about complex matters may be too difficult for certain users to understand. However, these kinds of information must be included in the financial statements when they are relevant to the economic decision-making needs of users.

Relevance means that the information provided in the financial statements could influence the economic decisions of users by helping them evaluate past, present or future events, or correcting their past evaluations. Relevant information could be used to predict the ability of the entity to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the entity would be structured or the outcome of planned operations.

Reliability means that the information is free from errors and bias and can be relied on by users. At times, information may be relevant but so unreliable in nature. So to be useful, information must also be reliable.

Comparability means that the measurement and display of the financial events and transactions must be carried out in a consistent way throughout the business entity and over time, and in a consistent way for different entities, so that users could compare the financial statements of an entity and of different entities.

4.5 Standards for the Preparation of Financial Statements

编制财务报表的准则

In the past, different countries have different standards for the preparation of financial statements. Nowadays international convergence of accounting standards is taking the trend. The International Accounting Standards Board (IASB) is the leader of this progress.

IASB is committed to developing a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements.

In pursuit of this objective, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world. Up to 1 January 2009, there are 8 International Financial Reporting Standards (IFRSs) and 29 International Accounting standards (IASs).

Exercises

- 1.41 The objective of financial statements is to provide information about the _____, _____ and _____ of an entity.
- 1.42 Reliability means that the information is free from _____ and _____ and can be relied on by users.
- 1.43 The measurement and display of the financial events and transactions must be carried out in a _____ way.



Q & A

Q: Why don't we disclose as much information as possible in the financial statements?

A: First, more information will bring more benefits as well as more costs. The balance between benefit and cost is a pervasive constraint. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Secondly, the costs do not necessarily fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is provided. Thirdly, if financial statements are presented to the public, more information than required may reveal sensitive information to their competitors.

Q: Helen is reading *IFRSs 2008*. Unfortunately, before she finishes reading the 2008 volume, *IFRSs 2009* which includes changes to the 2008 volume is published. What should she do?

A: We have to admit that it is not an easy job to study accounting. One reason is that the accounting standards are changing frequently to reflect the changing economic environment. So as a professional accountant, you have to catch up the latest standards; otherwise mistakes will happen in your work. But if you have already grasped the idea of accounting, it will be easy for you to understand the changes. All in all continuing education is important for accountants.

Q: Must all the financial statements be prepared according to IFRSs?

A: It depends. Generally the national stock exchange requires that financial statements are prepared according to national accounting standards. The fact is that more and more

countries reform their national accounting standards toward the IFRSs. Some countries even use IFRSs as their national accounting standards. And more and more stock exchanges accept financial statements prepared according to IFRSs. As for the question above, maybe we should ask how much difference left between your national accounting standards and IFRSs.

Case 1.2

Continued with Case 1.1, Sachet Hardware's estimated transactions changed considerably during the course of its operations in the month of July. The actual financial information is summarized and provided as follows.

Cash	\$40,600
Inventory	\$27,000
Van	\$15,000
Equipment	\$16,000
Short-term borrowings	\$6,000
Sales revenue	\$49,000
Salaries expense	\$5,500
Cost of goods sold	\$18,100
Finance costs	\$800
Administrative expense	\$2,000

Then come the questions: (1) Is there a net income or a net loss for Sachet Hardware? (2) What is Sachet's capital? Suppose you are the accountant. How do you answer these questions?

Summary

Accounting is an information system that classifies, records, measures, summarizes, interprets and reports the economic activities of a business with monetary unit as its main criterion. The purpose of accounting is to provide useful information to those who make economic decisions. So, accounting plays a vital role in making informed economic decisions.

Continuing with the definition of accounting, this chapter also covers the accounting branches which include financial accounting, managerial accounting, cost accounting, tax accounting and auditing. Besides, two underlying assumptions are introduced. They are the assumptions of accrual basis and going concern. Accrual basis of accounting is very important in the recognition and measurement of transactions.

Accounting elements include assets, liabilities, equity, revenues, expenses, and net

income. The first three are the basic accounting elements that describe resources and claims to resources at a specific time and that make up the basic accounting equation. The last three accounting elements, that is, revenues, expenses, and net income describe events that affect a business' gains and losses during a period of time and that make up the expanded accounting equation. Learners should know the definition of the accounting elements. They should also know the classifications of the accounting elements.

The accounting equation is $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$. This is the basic accounting equation while the expanded accounting equation is $\text{Assets} = \text{Liabilities} + \text{Owners' Equity} + \text{Revenues} - \text{Expenses}$.

Any business event that alters the amount of assets, liabilities or owners' equity or that affects the accounting equation is called a transaction. Through examples in this chapter, how transactions affect the accounting equation and how they are recorded in the accounting equation are illustrated.

After all the transactions are recorded in the accounting equation, a primary income statement and balance sheet are prepared accordingly. Learners should know how the accounts and accounting elements are arranged and how the amounts are obtained in the two primary financial statements. The purpose of providing the financial statements in this chapter is to help learners get a general feel of the financial statements.

Review Questions

1. How is accounting compared to a foreign language?
2. What is accounting?
3. What role does accounting play?
4. Define the elements of accounting.
5. In what case is owners' equity referred to as capital?
6. What is the difference between revenue and net income?
7. What is the accounting equation? What is the expanded accounting equation?
8. What information do the income statement and balance sheet provide, respectively?
9. According to what is the balance sheet prepared?
10. What are the principal qualitative characteristics of financial statements?

Helpful Resources

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7. <http://www.cninfo.com.cn> (巨潮资讯网, 中国证监会指定信息披露网站)
8. <http://www.e521.com> (中华财会网)
9. <http://www.cpa-view.com> (中国会计视野)