

# CHAPTER 1

## Accounting in Action

**Study Objectives**

*After studying this chapter, you should be able to:*

- 1 Explain what accounting is.
- 2 Identify the users and uses of accounting.
- 3 Understand why ethics is a fundamental business concept.
- 4 Explain generally accepted accounting principles.
- 5 Explain the monetary unit assumption and the economic entity assumption.
- 6 State the accounting equation, and define its components.
- 7 Analyze the effects of business transactions on the accounting equation.
- 8 Understand the four financial statements and how they are prepared.

1-2

## Preview of CHAPTER 1

Accounting in Action				
What Is Accounting?	The Building Blocks of Accounting	The Basic Accounting Equation	Using the Accounting Equation	Financial Statements
<ul style="list-style-type: none"> <li>• Three activities</li> <li>• Who uses accounting data</li> </ul>	<ul style="list-style-type: none"> <li>• Ethics in financial reporting</li> <li>• Generally accepted accounting principles</li> <li>• Measurement principles</li> <li>• Assumptions</li> </ul>	<ul style="list-style-type: none"> <li>• Assets</li> <li>• Liabilities</li> <li>• Owner's equity</li> </ul>	<ul style="list-style-type: none"> <li>• Transaction analysis</li> <li>• Summary of transactions</li> </ul>	<ul style="list-style-type: none"> <li>• Income statement</li> <li>• Owner's equity statement</li> <li>• Balance sheet</li> <li>• Statement of cash flows</li> </ul>

1-3

## What is Accounting?

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**Purpose of accounting** is to:

1. **identify, record, and communicate** the economic events of an
2. organization to
3. interested users.

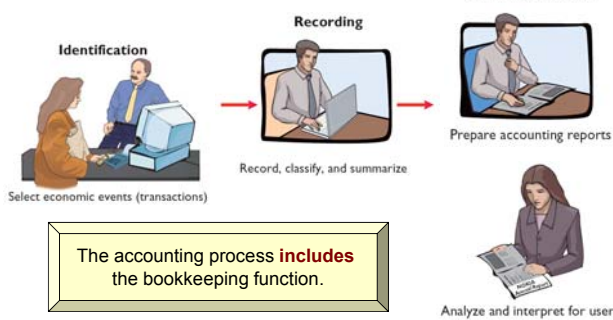
SO 1 Explain what accounting is.

1-4

## What is Accounting?

### Three Activities

Illustration 1-1  
Accounting process



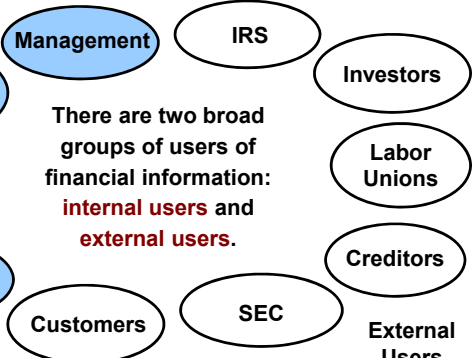
The accounting process **includes** the bookkeeping function.

1-5

SO 1 Explain what accounting is.

## Who Uses Accounting Data

### Internal Users



There are two broad groups of users of financial information: **internal users** and **external users**.

1-6

SO 2 Identify the users and uses of accounting.

## Who Uses Accounting Data

### Common Questions Asked

### User

- |   |   |                        |
|---|---|------------------------|
| 1. Can we afford to give our employees a pay raise?         | ➔ | <b>Human Resources</b> |
| 2. Did the company earn a satisfactory income?              | ➔ | <b>Investors</b>       |
| 3. Do we need to borrow in the near future?                 | ➔ | <b>Management</b>      |
| 4. Is cash sufficient to pay dividends to the stockholders? | ➔ | <b>Finance</b>         |
| 5. What price for our product will maximize net income?     | ➔ | <b>Marketing</b>       |
| 6. Will the company be able to pay its short-term debts?    | ➔ | <b>Creditors</b>       |

1-7

SO 2

## ACCOUNTING ACROSS THE ORGANIZATION

### The Scoop on Accounting

Accounting can serve as a useful recruiting tool even for the human resources department. Rhino Foods, located in Burlington, Vermont, is a manufacturer of specialty ice cream. Its corporate website includes the following:

"Wouldn't it be great to work where you were part of a team? Where your input and hard work made a difference? Where you weren't kept in the dark about what management was thinking? . . . Well—it's not a dream! It's the way we do business . . . Rhino Foods believes in family, honesty and open communication—we really care about and appreciate our employees—and it shows. Operating results are posted and monthly group meetings inform all employees about what's happening in the Company. Employees also share in the Company's profits, in addition to having an excellent comprehensive benefits package."

Source: [www.rhinofoods.com/workforus/workforus.html](http://www.rhinofoods.com/workforus/workforus.html).

? What are the benefits to the company and to the employees of making the financial statements available to all employees? (See page 46.)



1-8

## The Building Blocks of Accounting

### Ethics In Financial Reporting

Standards of conduct by which one's actions are judged as right or wrong, honest or dishonest, fair or not fair, are **Ethics**.

- ◆ Recent financial scandals include: **Enron, WorldCom, HealthSouth, AIG**, and others.
- ◆ Congress passed Sarbanes-Oxley Act of 2002.
- ◆ Effective financial reporting depends on sound ethical behavior.

1-9

SO 3 Understand why ethics is a fundamental business concept.

## Ethics in Financial Reporting

### Question

Ethics are the standards of conduct by which one's actions are judged as:

- right or wrong.
- honest or dishonest.
- fair or not fair.
- d.** all of these options.

1-10

SO 3 Understand why ethics is a fundamental business concept.

### ETHICS INSIGHT



#### The Numbers Behind Not-for-Profit Organizations

Accounting plays an important role for a wide range of business organizations worldwide. Just as the integrity of the numbers matters for business, it matters at least as much for not-for-profit organizations. Proper control and reporting help ensure that money is used the way donors intended. Donors are less inclined to give to an organization if they think the organization is subject to waste or theft. The accounting challenges of some large international not-for-profits rival those of the world's largest businesses. For example, after the Haitian earthquake, the Haitian-born musician Wyclef Jean was criticized for the poor accounting controls in a relief fund that he founded. Since then, he has hired a new accountant and improved the transparency regarding funds raised and spent.

? What benefits does a sound accounting system provide to a not-for-profit organization? (See page 46.)



1-11

## Generally Accepted Accounting Principles

Various users need financial information

### Financial Statements

- Balance Sheet
- Income Statement
- Statement of Owner's Equity
- Statement of Cash Flows
- Note Disclosure

The accounting profession has attempted to develop a set of standards that are generally accepted and universally practiced.

**Generally Accepted Accounting Principles (GAAP)**

1-12

SO 4 Explain generally accepted accounting principles.

## Generally Accepted Accounting Principles

**Generally Accepted Accounting Principles (GAAP)** - A set of rules and practices, having substantial authoritative support, that the accounting profession recognizes as a general guide for financial reporting purposes.

**Standard-setting bodies** determine these guidelines:

- ▶ Securities and Exchange Commission (**SEC**)
- ▶ Financial Accounting Standards Board (**FASB**)
- ▶ International Accounting Standards Board (**IASB**)

1-13

SO 4 Explain generally accepted accounting principles.

## Generally Accepted Accounting Principles

### Measurement Principles

**Cost Principle** – Or historical cost principle, dictates that companies record assets at their cost.

**Fair Value Principle** – Indicates that assets and liabilities should be reported at fair value (the price received to sell an asset or settle a liability).

1-14

SO 4 Explain generally accepted accounting principles.

### INTERNATIONAL INSIGHT



#### The Korean Discount

If you think that accounting standards don't matter, consider recent events in South Korea. For many years, international investors complained that the financial reports of South Korean companies were inadequate and inaccurate. Accounting practices there often resulted in huge differences between stated revenues and actual revenues. Because investors did not have faith in the accuracy of the numbers, they were unwilling to pay as much for the shares of these companies relative to shares of comparable companies in different countries. This difference in stock price was often referred to as the "Korean discount."

In response, Korean regulators decided that, beginning in 2011, companies will have to comply with international accounting standards. This change was motivated by a desire to "make the country's businesses more transparent" in order to build investor confidence and spur economic growth. Many other Asian countries, including China, India, Japan, and Hong Kong, have also decided either to adopt international standards or to create standards that are based on the international standards.

Source: Evan Ramstad, "End to 'Korea Discount'?" *Wall Street Journal* (March 16, 2007).



What is meant by the phrase "make the country's businesses more transparent"? Why would increasing transparency spur economic growth? (See page 46.)

1-15

## Generally Accepted Accounting Principles

### Assumptions

**Monetary Unit** – include in the accounting records only transaction data that can be expressed in terms of money.

**Economic Entity** – requires that activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities.

- ◆ Proprietorship.
- ◆ Partnership.
- ◆ Corporation.

Forms of Business Ownership

1-16

SO 5 Explain the monetary unit assumption and the economic entity assumption.

## Forms of Business Ownership

### Proprietorship

- ◆ Generally owned by one person.
- ◆ Often small service-type businesses
- ◆ Owner receives any profits, suffers any losses, and is personally liable for all debts.

### Partnership

- ◆ Owned by two or more persons.
- ◆ Often retail and service-type businesses
- ◆ Generally unlimited personal liability
- ◆ Partnership agreement

### Corporation

- ◆ Ownership divided into shares of stock
- ◆ Separate legal entity organized under state corporation law
- ◆ Limited liability

SO 5 Explain the monetary unit assumption and the economic entity assumption.

1-17

## Generally Accepted Accounting Principles

### Question

Combining the activities of Kellogg and General Mills would violate the

- a. cost principle.
- b. economic entity assumption.
- c. monetary unit assumption.
- d. ethics principle.

SO 5 Explain the monetary unit assumption and the economic entity assumption.

1-18

## Generally Accepted Accounting Principles

### Question

A business organized as a separate legal entity under state law having ownership divided into shares of stock is a

- a. proprietorship.
- b. partnership.
- c. corporation.
- d. sole proprietorship.

SO 5 Explain the monetary unit assumption and the economic entity assumption.

1-19

## The Basic Accounting Equation

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

Provides the **underlying framework** for recording and summarizing economic events.

Assets are claimed by either creditors or owners.

Claims of creditors must be paid before ownership claims.

SO 6 State the accounting equation, and define its components.

1-20

## The Basic Accounting Equation

### Assets

- ◆ Resources a business owns.
- ◆ Provide future services or benefits.
- ◆ Cash, Supplies, Equipment, etc.

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

1-21

SO 6 State the accounting equation, and define its components.

## The Basic Accounting Equation

### Liabilities

- ◆ Claims against assets (debts and obligations).
- ◆ Creditors - party to whom money is owed.
- ◆ Accounts payable, Notes payable, etc.

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

1-22

SO 6 State the accounting equation, and define its components.

## The Basic Accounting Equation

### Owner's Equity

- ◆ Ownership claim on total assets.
- ◆ Referred to as residual equity.
- ◆ Investment by owners and revenues (+)
- ◆ Drawings and expenses (-).

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

1-23

SO 6 State the accounting equation, and define its components.

## Owner's Equity

Illustration 1-6

Basic Equation:	Assets = Liabilities	+	Owner's Equity
Expanded Equation:	Assets = Liabilities	+	Owner's Capital – Owner's Drawings + Revenues – Expenses

**Revenues** result from business activities entered into for the purpose of earning income.

**Common sources of revenue** are: sales, fees, services, commissions, interest, dividends, royalties, and rent.

1-24

SO 6 State the accounting equation, and define its components.

## Owner's Equity

Illustration 1-6

Basic Equation:	Assets = Liabilities	+	Owner's Equity
Expanded Equation:	Assets = Liabilities	+	Owner's Capital – Owner's Drawings + Revenues – Expenses

**Expenses** are the cost of assets consumed or services used in the process of earning revenue.

**Common expenses** are: salaries expense, rent expense, utilities expense, tax expense, etc.

1-25

SO 6 State the accounting equation, and define its components.

## Using the Accounting Equation

**Transactions** are a business's economic events recorded by accountants.

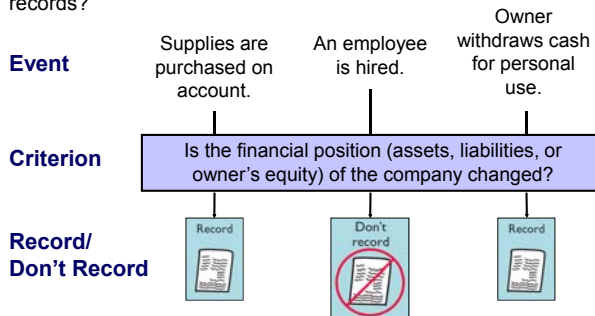
- ◆ May be external or internal.
- ◆ Not all activities represent transactions.
- ◆ Each transaction has a dual effect on the accounting equation.

1-26

SO 7 Analyze the effects of business transactions on the accounting equation.

## Using the Accounting Equation

**Illustration:** Are the following events recorded in the accounting records?



1-27

SO 7 Analyze the effects of business transactions on the accounting equation.

## Transaction Analysis

**Transaction (1):** Ray Neal decides to open a computer programming service which he names Softbyte. On September 1, 2012, Ray Neal invests \$15,000 cash in the business.

	Assets				=	Liabilities		+	Owner's Equity		
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	+	Owner's Drawings	+	Rev. – Exp.
(1)					=						
(2)					=						
(3)					=						
(4)					=						
(5)					=						
(6)					=						
(7)					=						
(8)					=						
(9)					=						
(10)					=						

1-28

SO 7

## Transaction Analysis

**Transaction (2):** Purchase of Equipment for Cash. Softbyte purchases computer equipment for \$7,000 cash.

	Assets				=	Liabilities		+	Owner's Equity			
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.	
(1)	+\$15,000						+\$15,000					
(2)												
(3)												
(4)												
(5)												
(6)												
(7)												
(8)												
(9)												
(10)												

1-29

SO 7

## Transaction Analysis

**Transaction (3):** Softbyte purchases for \$1,600 from Acme Supply Company computer paper and other supplies expected to last several months. The purchase is made on account.

	Assets				=	Liabilities		+	Owner's Equity			
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.	
(1)	+\$15,000						+\$15,000					
(2)	-7,000											
(3)				+\$7,000								
(4)												
(5)												
(6)												
(7)												
(8)												
(9)												
(10)												

1-30

SO 7

## Transaction Analysis

**Transaction (4):** Softbyte receives \$1,200 cash from customers for programming services it has provided.

	Assets				=	Liabilities		+	Owner's Equity			
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.	
(1)	+\$15,000						+\$15,000					
(2)	-7,000											
(3)				+\$7,000								
(4)			+\$1,600			+\$1,600						
(5)												
(6)												
(7)												
(8)												
(9)												
(10)												

1-31

SO 7

## Transaction Analysis

**Transaction (5):** Softbyte receives a bill for \$250 from the Daily News for advertising but postpones payment until a later date.

	Assets				=	Liabilities		+	Owner's Equity			
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.	
(1)	+\$15,000						+\$15,000					
(2)	-7,000											
(3)				+\$7,000								
(4)	+1,200		+\$1,600			+\$1,600					+\$1,200	
(5)												
(6)												
(7)												
(8)												
(9)												
(10)												

1-32

SO 7



## Transaction Analysis

**Transaction (6):** Softbyte provides \$3,500 of programming services for customers. The company receives cash of \$1,500 from customers, and it bills the balance of \$2,000 on account.

	Assets				=	Liabilities		+	Owner's Equity		
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.
(1)	+15,000						+15,000				
(2)	-7,000			+7,000							
(3)			+1,600			+1,600					
(4)	+1,200								+1,200		
(5)						+250					-250
(6)											
(7)											
(8)											
(9)											
(10)											

1-33

SO 7

## Transaction Analysis

**Transaction (7):** Softbyte pays the following expenses in cash for September: store rent \$600, salaries of employees \$900, and utilities \$200.

	Assets				=	Liabilities		+	Owner's Equity		
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.
(1)	+15,000						+15,000				
(2)	-7,000			+7,000							
(3)			+1,600			+1,600					
(4)	+1,200								+1,200		
(5)						+250					-250
(6)	+1,500	+2,000							+3,500		
(7)											
(8)											
(9)											
(10)											

1-34

SO 7

## Transaction Analysis

**Transaction (8):** Softbyte pays its \$250 Daily News bill in cash.

	Assets				=	Liabilities		+	Owner's Equity		
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.
(1)	+15,000						+15,000				
(2)	-7,000			+7,000							
(3)			+1,600			+1,600					
(4)	+1,200								+1,200		
(5)						+250					-250
(6)	+1,500	+2,000							+3,500		
(7)	-600										-600
	-900										-900
	-200										-200
(8)											
(9)											
(10)											

1-35

SO 7

## Transaction Analysis

**Transaction (9):** Softbyte receives \$600 in cash from customers who had been billed for services [in Transaction (6)].

	Assets				=	Liabilities		+	Owner's Equity		
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	-	Exp.
(1)	+15,000						+15,000				
(2)	-7,000			+7,000							
(3)			+1,600			+1,600					
(4)	+1,200								+1,200		
(5)						+250					-250
(6)	+1,500	+2,000							+3,500		
(7)	-600										-600
	-900										-900
	-200										-200
(8)	-250						-250				
(9)											
(10)											

1-36

SO 7

## Transaction Analysis

**Transaction (10):** Ray Neal withdraws \$1,300 in cash from the business for his personal use.

Illustration 1-8  
Tabular summary of  
Softbyte transactions

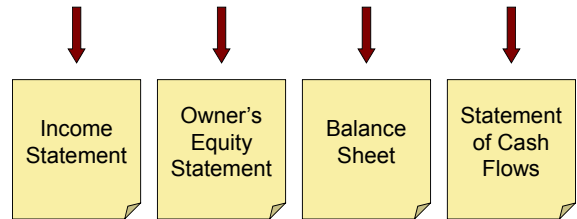
	Assets				=	Liabilities		Owner's Equity			
	Cash	Accounts Receivable	Supplies	Equipment		Accounts Payable	Owner's Capital	Owner's Drawings	Rev.	Exp.	
(1)	+\$15,000							+\$15,000			
(2)	-7,000										
(3)											
(4)	+1,200										
(5)											
(6)	+1,500	+\$2,000									
(7)	-600										
(8)	-900										
(9)	-200										
(10)	-250										
(11)	+600	-600									

1-37

SO 7

## Financial Statements

Companies prepare **four** financial statements :



1-38

SO 8 Understand the four financial statements and how they are prepared.

## Financial Statements

### Question

Net income will result during a time period when:

- assets exceed liabilities.
- assets exceed revenues.
- expenses exceed revenues.
- revenues exceed expenses.**

1-39

SO 8 Understand the four financial statements and how they are prepared.

## Financial Statements

Net income is needed to determine the ending balance in owner's equity.

Softbyte Income Statement For the Month Ended September 30, 2012	
Revenues	
Service revenue	\$ 4,700
Expenses	
Salaries and wages expense	\$900
Rent expense	600
Advertising expense	250
Utilities expense	200
Total expenses	<u>1,950</u>
Net income	<u>\$ 2,750</u>

Softbyte Owner's Equity Statement For the Month Ended September 30, 2012	
Owner's capital, September 1	\$ -0-
Add: Investments	\$15,000
Net income	<u>2,750</u>
	17,750
Less: Drawings	1,750
Owner's capital, September 30	<u>\$16,450</u>

Illustration 1-9  
Financial statements and  
their interrelationships

1-40

SO 8

## Financial Statements

The ending balance in owner's equity is needed in preparing the balance sheet

Softbyte Owner's Equity Statement For the Month Ended September 30, 2012		
Owner's capital, September 1		\$ -
Add: Investments	\$15,000	
Net income	2,750	17,750
		<u>17,750</u>
Less: Drawings		1,300
Owner's capital, September 30		<u>\$16,450</u>

Softbyte Balance Sheet September 30, 2012		
<b>Assets</b>		
Cash		\$ 8,050
Accounts receivable		1,400
Supplies		1,600
Equipment		7,000
Total assets		<u>\$18,050</u>
<b>Liabilities and Owner's Equity</b>		
<b>Liabilities</b>		
Accounts payable	\$ 1,600	
<b>Owner's equity</b>		
Owner's capital		<u>16,450</u>
Total liabilities and owner's equity		<u>\$18,050</u>

Illustration 1-9

1-41

SO 8

## Financial Statements

The balance sheet and income statement are needed to prepare statement of cash flows.

Softbyte Balance Sheet September 30, 2012		
<b>Assets</b>		
Cash		\$ 8,050
Accounts receivable		1,400
Supplies		1,600
Equipment		7,000
Total assets		<u>\$18,050</u>
<b>Liabilities and Owner's Equity</b>		
<b>Liabilities</b>		
Accounts payable	\$ 1,600	
<b>Owner's equity</b>		
Owner's capital		<u>16,450</u>
Total liabilities and owner's equity		<u>\$18,050</u>

Softbyte Statement of Cash Flows For the Month Ended September 30, 2012		
<b>Cash flows from operating activities</b>		
Cash receipts from revenues		\$ 3,300
Cash payments for expenses		(1,950)
Net cash provided by operating activities		1,350
<b>Cash flows from investing activities</b>		
Purchase of equipment		(7,000)
<b>Cash flows from financing activities</b>		
Investments by owner	\$15,000	
Drawings by owner	(1,300)	13,700
Net increase in cash		8,050
Cash at the beginning of the period		0
Cash at the end of the period		<u>\$ 8,050</u>

Illustration 1-9

1-42

SO 8

## Financial Statements

### Statement of Cash Flows

- ◆ Information for a specific period of time.
- ◆ Answers the following:
  1. Where did cash come from?
  2. What was cash used for?
  3. What was the change in the cash balance?

1-43

SO 8 Understand the four financial statements and how they are prepared.

## Financial Statements

### Question

Which of the following financial statements is prepared as of a specific date?

- a. Balance sheet.
- b. Income statement.
- c. Owner's equity statement.
- d. Statement of cash flows.

1-44

SO 8 Understand the four financial statements and how they are prepared.

## APPENDIX 1A

### Accounting Career Opportunities

#### Public Accounting

Careers in auditing, taxation, and management consulting serving the general public.

#### Private Accounting

Careers in industry working in cost accounting, budgeting, accounting information systems, and taxation.

#### Government

Careers with the IRS, the FBI, the SEC, and in public colleges and universities.

#### Forensic Accounting

Uses accounting, auditing, and investigative skills to conduct investigations into theft and fraud.

1-45

SO 9 Explain the career opportunities in accounting.

## IFRS A Look at IFRS



### Key Points

- ◆ International standards are referred to as International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board (IASB).
- ◆ Recent events in the global capital markets have underscored the importance of financial disclosure and transparency not only in the United States but in markets around the world. As a result, many are examining which accounting and financial disclosure rules should be followed. Much of the world has voted for the standards issued by the IASB. Over 115 countries require or permit use of IFRS.

1-46

## IFRS A Look at IFRS



### Key Points

- ◆ In some countries, the primary users of financial statements are private investors; in others, the primary users are tax authorities or central government planners. It appears that the United States and the international standard-setting environment are primarily driven by meeting the needs of investors and creditors.
- ◆ The internal control standards applicable to Sarbanes-Oxley (SOX) apply only to large public companies listed on U.S. exchanges. Debate about international companies (non-U.S.) adopting SOX-type standards centers on whether the benefits exceed the costs. The concern is that the higher costs of SOX compliance are making the U.S. securities markets less competitive.

1-47

## IFRS A Look at IFRS



### Key Points

- ◆ The textbook mentions a number of ethics violations, such as Enron, WorldCom, and AIG. These problems have also occurred internationally, for example, at Satyam Computer Services (India), Parmalat (Italy), and Royal Ahold (the Netherlands).
- ◆ IFRS tends to be simpler in its accounting and disclosure requirements; some people say more "principles-based." GAAP is more detailed; some people say it is more "rules-based." This difference in approach has resulted in a debate about the merits of "principles-based" versus "rules-based" standards.
- ◆ U.S. regulators have recently eliminated the need for foreign companies that trade shares in U.S. markets to reconcile their accounting with GAAP.

1-48

## IFRS A Look at IFRS



### Key Points

- ◆ The three most common forms of business organization, proprietorships, partnerships, and corporations, are also found in countries that use IFRS. Because the choice of business organization is influenced by factors such as legal environment, tax rates and regulations, and degree of entrepreneurship, the relative use of each form will vary across countries.
- ◆ The conceptual framework that underlies IFRS is very similar to that used to develop GAAP. The basic definitions provided in this textbook for the key elements of financial statements, that is, assets, liabilities, equity, revenues (referred to as income), and expenses, are simplified versions of the official definitions provided by the FASB.

1-49

## IFRS A Look at IFRS



### Key Points

- ◆ The more substantive definitions, using the IASB definitional structure, are as follows.
  - ▶ **Assets.** A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
  - ▶ **Liabilities.** A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Liabilities may be legally enforceable via a contract or law, but need not be, i.e., they can arise due to normal business practice or customs.

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## IFRS A Look at IFRS



### Key Points

- ◆ The more substantive definitions, using the IASB definitional structure, are as follows.
  - ▶ **Equity.** A residual interest in the assets of the entity after deducting all its liabilities.
  - ▶ **Income.** Increases in economic benefits that result in increases in equity (other than those related to contributions from shareholders). Income includes both revenues (resulting from ordinary activities) and gains.
  - ▶ **Expenses.** Decreases in economic benefits that result in decreases in equity (other than those related to distributions to shareholders). Expenses includes losses that are not the result of ordinary activities.

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## IFRS A Look at IFRS



### Looking to the Future

Both the IASB and the FASB are hard at work developing standards that will lead to the elimination of major differences in the way certain transactions are accounted for and reported. In fact, at one time the IASB stated that no new major standards would become effective until 2011. The major reason for this policy was to provide companies the time to translate and implement IFRS into practice, as much has happened in a very short period of time. Consider, for example, that as a result of a joint project on the conceptual framework, the definitions of the most fundamental elements (assets, liabilities, equity, revenues, and expenses) may actually change. However, whether the IASB adopts internal control provisions similar to those in SOX remains to be seen.

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## IFRS A Look at IFRS



### IFRS Self-Test Questions

Which of the following is not a reason why a single set of high-quality international accounting standards would be beneficial?

- a) Mergers and acquisition activity.
- b) Financial markets.
- c) Multinational corporations.
- d) GAAP is widely considered to be a superior reporting system.

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## IFRS A Look at IFRS



### IFRS Self-Test Questions

The Sarbanes-Oxley Act determines:

- a) international tax regulations.
- b) internal control standards as enforced by the IASB.
- c) internal control standards of U.S. publicly traded companies.
- d) U.S. tax regulations.

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## IFRS A Look at IFRS



### IFRS Self-Test Questions

IFRS is considered to be more:

- a) principles-based and less rules-based than GAAP.
- b) rules-based and less principles-based than GAAP.
- c) detailed than GAAP.
- d) None of the above.

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