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team for success

Financial
ACCOUNTING
IFRS EDITION **2e**

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Learning 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 accounting standards and the measurement 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.**

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">• Three activities• Who uses accounting data?	<ul style="list-style-type: none">• Ethics in financial reporting• Accounting standards• Measurement principles• Assumptions	<ul style="list-style-type: none">• Assets• Liabilities• Equity	<ul style="list-style-type: none">• Transaction analysis• Summary of transactions	<ul style="list-style-type: none">• Income statement• Retained earnings statement• Statement of financial position• Statement of cash flows

Financial Accounting
IFRS Second Edition
Weygandt • Kimmel • Kieso

What is Accounting?

Accounting consists of three basic activities - it

- ◆ identifies,
- ◆ records, and
- ◆ communicates

the economic events of an organization to interested users.

What is Accounting?

Three Activities

Illustration 1-1
The activities of the
accounting process

Identification



Identify economic events (transactions)

Recording



Record, classify, and summarize

Communication



Prepare accounting reports

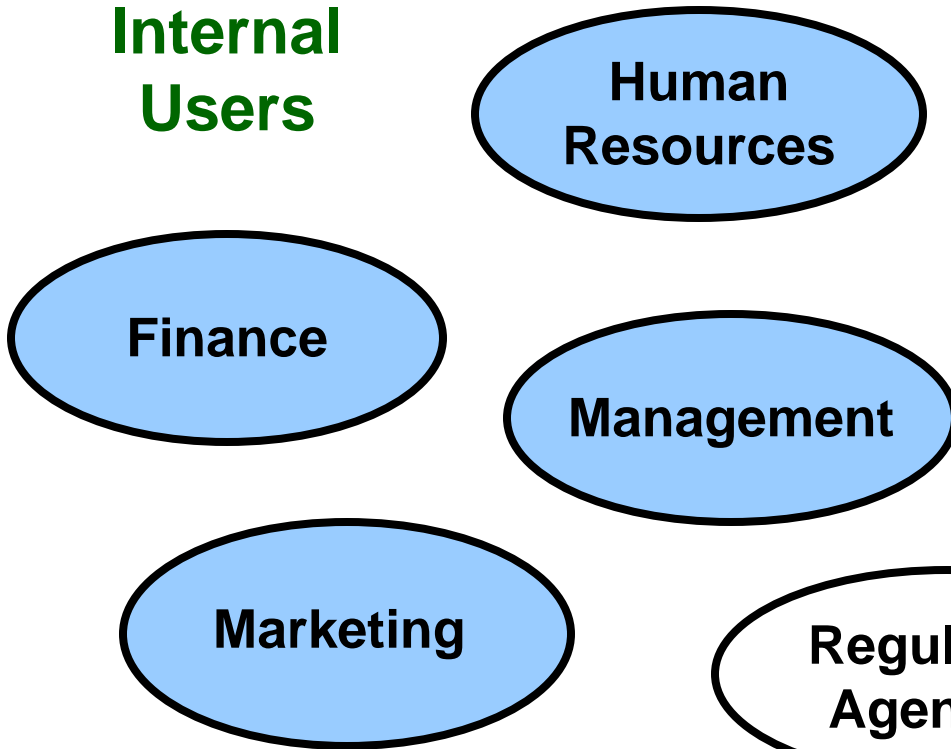


Analyze and interpret for users

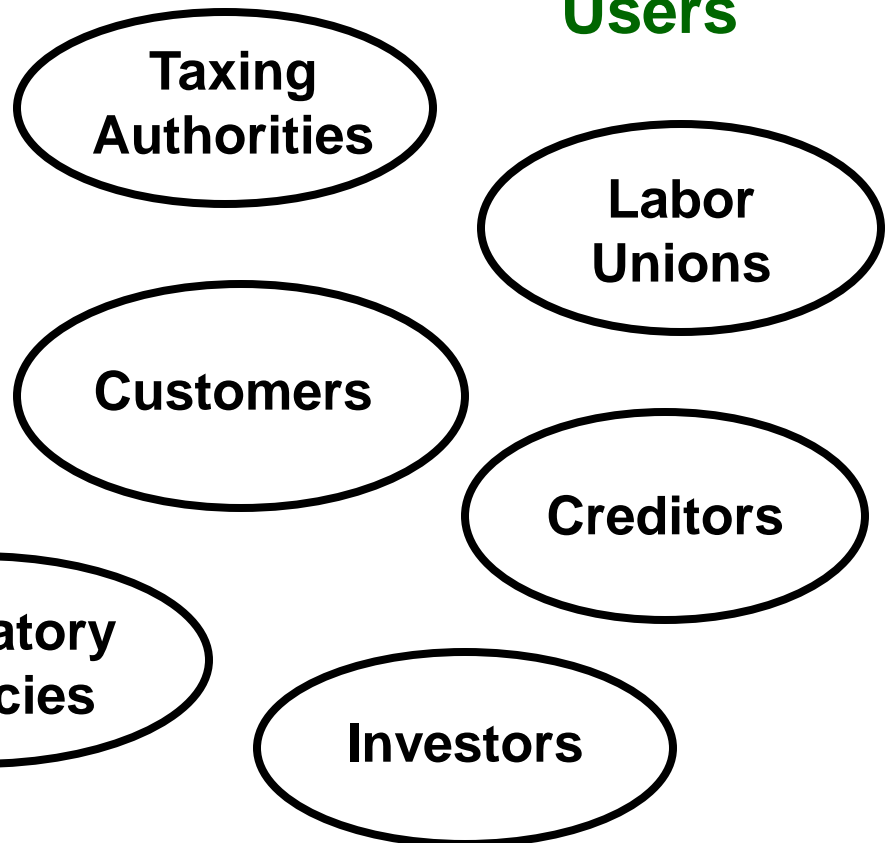
The accounting process includes
the **bookkeeping** function.

Who Uses Accounting Data

Internal Users









External Users



Who Uses Accounting Data

Common Questions Asked

User

- | | | |
|---|--|------------------------|
| 1. Can we afford to give our employees a pay raise? |  | Human Resources |
| 2. Did the company earn a satisfactory income? |  | Investors |
| 3. Should any product lines be eliminated? |  | Management |
| 4. Is cash sufficient to pay dividends to shareholders? |  | Finance |
| 5. What price for our product will maximize net income? |  | Marketing |
| 6. Will the company be able to pay its debts? |  | Creditors |

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** (USA), **Parmalat** (ITA), **Satyam Computer Services** (IND), **AIG** (USA), and others.
- ◆ Effective financial reporting depends on sound ethical behavior.

The Building Blocks of Accounting

Ethics In Financial Reporting



1. Recognize an ethical situation and the ethical issues involved.

Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.

2. Identify and analyze the principal elements in the situation.

Identify the *stakeholders*—persons or groups who may be harmed or benefited. Ask the question: What are the responsibilities and obligations of the parties involved?

Illustration 1-4

Steps in analyzing ethics cases and situations

3. Identify the alternatives, and weigh the impact of each alternative on various stakeholders.

Select the most ethical alternative, considering all the consequences. Sometimes there will be one right answer. Other situations involve more than one right solution; these situations require an evaluation of each and a selection of the best alternative.

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?



The Building Blocks of Accounting

Accounting Standards



International Accounting Standards Board (IASB)

<http://www.iasb.org/>

International Financial Reporting Standards (IFRS)



Financial Accounting Standards Board (FASB)

<http://www.fasb.org/>

Generally Accepted Accounting Principles (GAAP)

The Building Blocks of Accounting

Measurement Principles

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

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

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?

The Building Blocks of Accounting

Assumptions

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

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**

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
- ◆ Separate legal entity organized under corporation law
- ◆ Limited liability



DO IT!

Indicate whether each of the following statements presented below is **true** or **false**.

1. The three steps in the accounting process are identification, recording, and communication.
2. The two most common types of external users are investors and company officers.
3. Shareholders in a corporation enjoy limited legal liability as compared to partners in a partnership.

True

False

True



DO IT!

Indicate whether each of the following statements presented below is **true** or **false**.

4. The primary accounting standard-setting body outside the United States is the International Accounting Standards Board (IASB).

True

5. The cost principle dictates that companies record assets at their cost. In later periods, however, the fair value of the asset must be used if fair value is higher than its cost.

False

ACCOUNTING ACROSS THE ORGANIZATION



Spinning the Career Wheel

One question that students frequently ask is, “How will the study of accounting help me?” It should help you a great deal because a working knowledge of accounting is desirable for virtually *every field* of endeavor. Some examples of how accounting is used in other careers include:

General management: Imagine running **Volkswagen** (DEU), **Massachusetts General Hospital** (USA), a **Subway** (USA) franchise, or a **Fuji** (JPN) bike shop. All general managers need to understand where the enterprise’s cash comes from and where it goes in order to make wise business decisions.

Marketing: A marketing specialist at a company like **Hyundai Motor** (KOR) develops strategies to help the sales force be successful. But making a sale is meaningless unless it is a profitable sale. Marketing people must be sensitive to costs and benefits, which accounting helps them quantify and understand.

Finance: Do you want to be a banker for **Société Générale** (FRA) or an investment analyst for **Goldman Sachs** (USA)? These fields rely heavily on accounting. In all of them, you will regularly examine and analyze financial statements. In fact, it is difficult to get a good finance job without two or three courses in accounting.

Real estate: Are you interested in being a real estate broker for **Prudential Real Estate** (USA)? Because a third party—the bank—is almost always involved in financing a real estate transaction, brokers must understand the numbers involved: Can the buyer afford to make the payments to the bank? Does the cash flow from an industrial property justify the purchase price? What are the tax benefits of the purchase?



How might accounting help you?



The Basic Accounting Equation

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

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

Applies to all economic entities regardless of size.

The Basic Accounting Equation

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

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

Assets

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

The Basic Accounting Equation

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

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

Liabilities

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

The Basic Accounting Equation

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$$

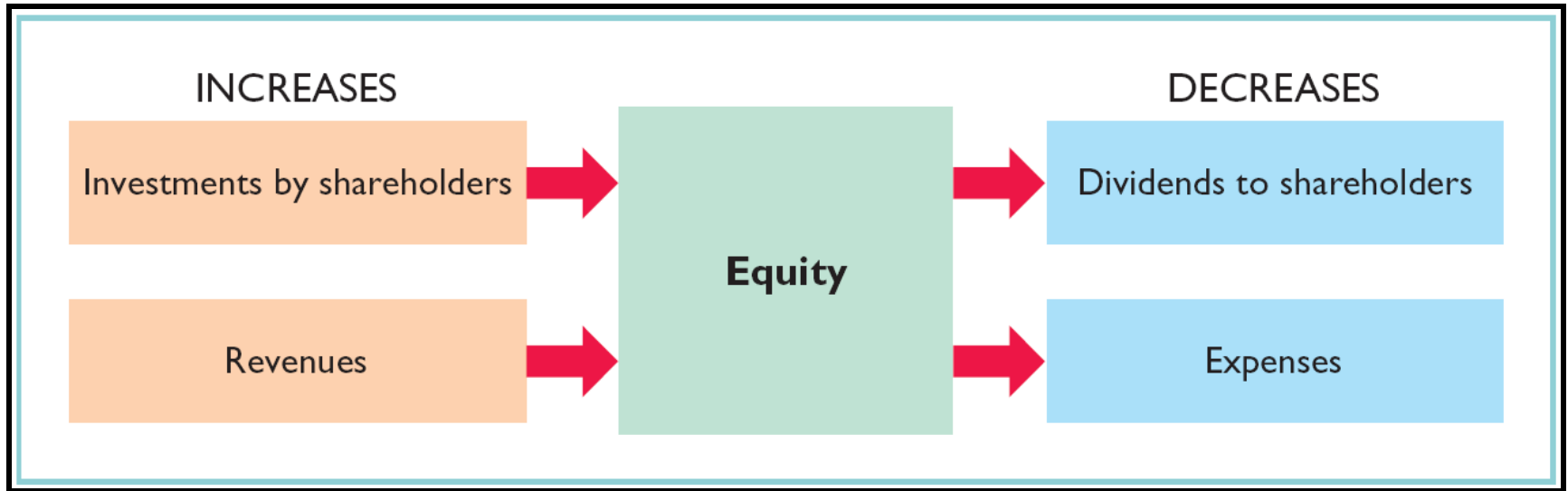
Provides the **underlying framework** for recording and summarizing economic events.

Equity

- ◆ Ownership claim on total assets.
- ◆ Referred to as residual equity.
- ◆ Share capital-ordinary and retained earnings.

The Basic Accounting Equation

Illustration 1-7

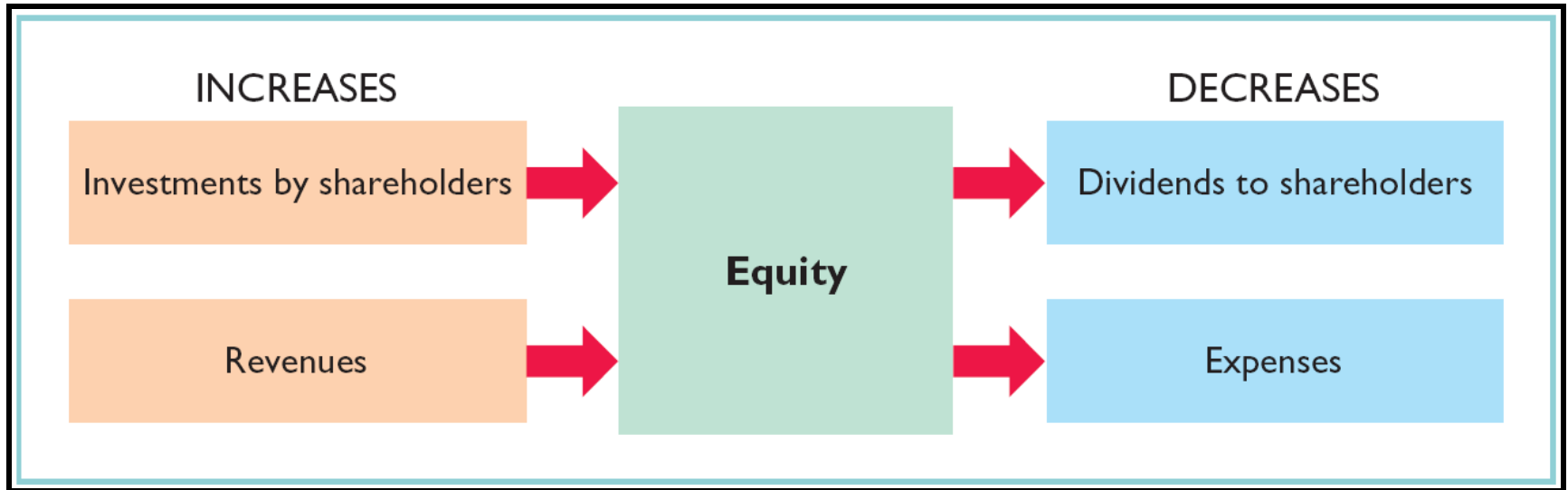


Revenues result from business activities entered into for the purpose of earning income.

Generally results from selling merchandise, performing services, renting property, and lending money.

The Basic Accounting Equation

Illustration 1-7

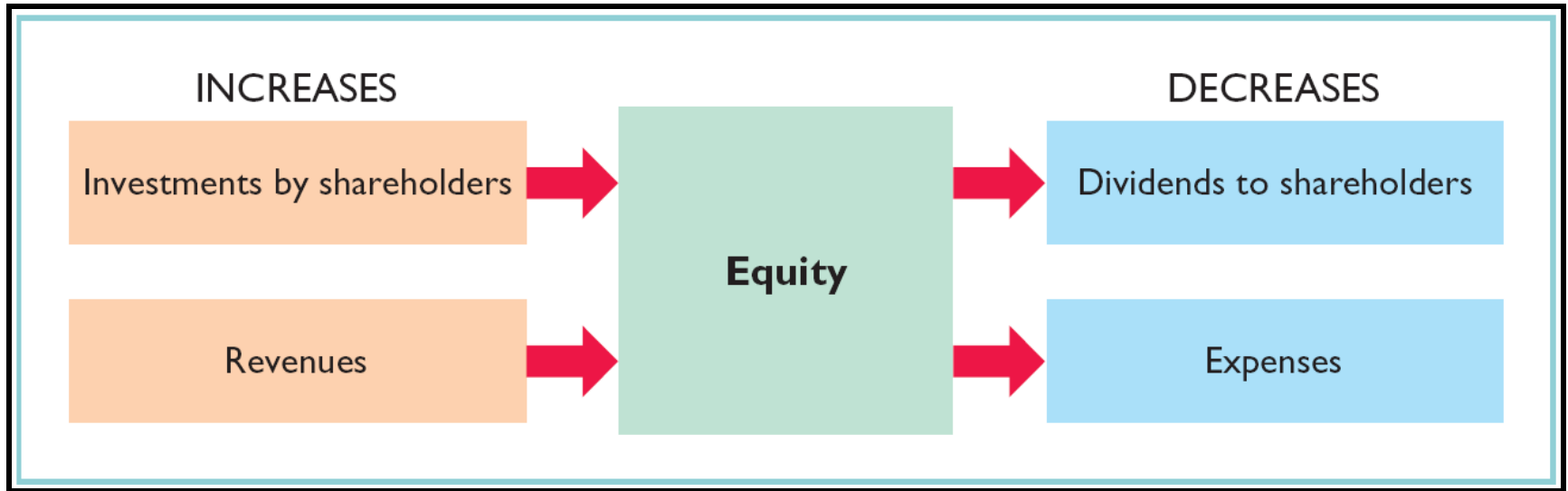


Expenses are the cost of assets consumed or services used in the process of earning revenue.

Common expenses are salaries expense, rent expense, interest expense, property tax expense, etc.

The Basic Accounting Equation

Illustration 1-7



Dividends are the distribution of cash or other assets to shareholders.

- ◆ Reduce retained earnings
- ◆ Not an expense



DO IT!

Classify the following items as issuance of shares, dividends, revenues, or expenses. Then indicate whether each item increases or decreases equity.

	<u>Classification</u>	<u>Effect on Equity</u>
1. Rent expense	<input type="text"/>	<input type="text"/>
2. Service revenue	<input type="text"/>	<input type="text"/>
3. Dividends	<input type="text"/>	<input type="text"/>
4. Salaries expense	<input type="text"/>	<input type="text"/>

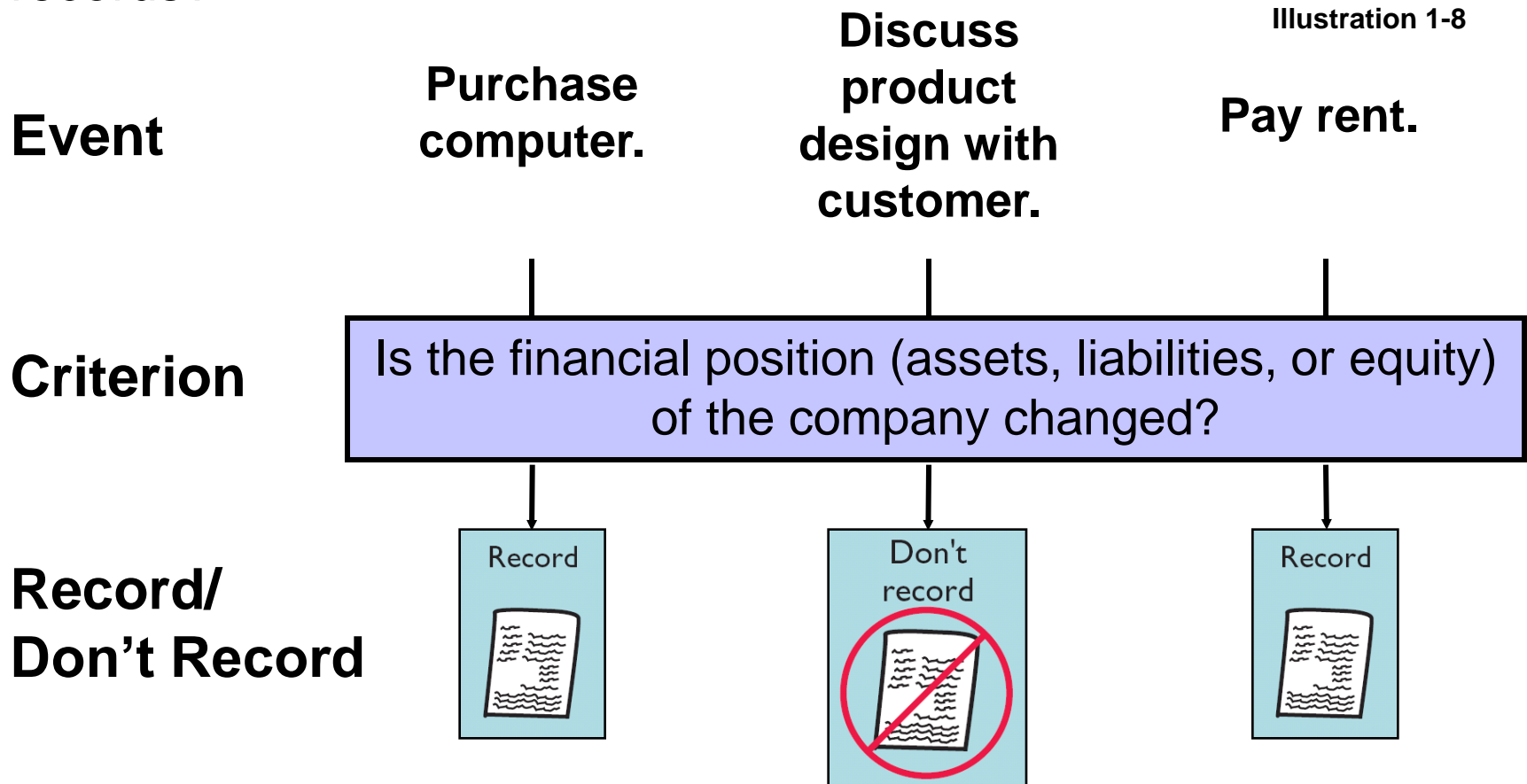
Using the Accounting Equation

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.

Using the Accounting Equation

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

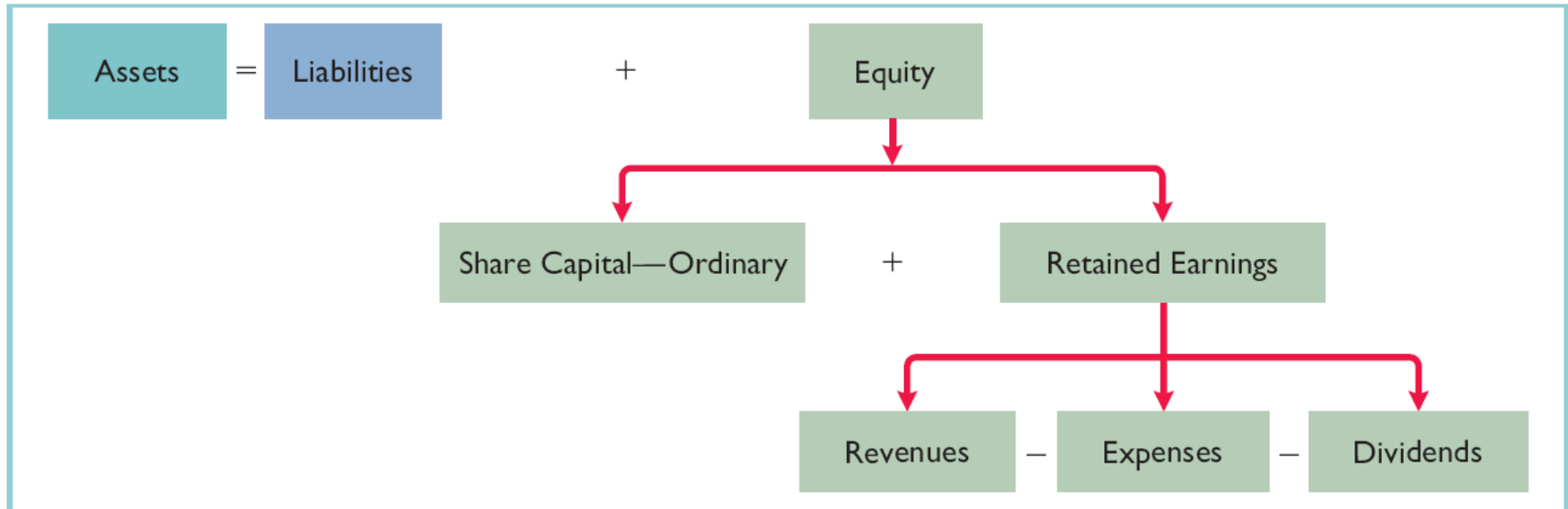


Using the Accounting Equation

Transaction Analysis

Illustration 1-9

Expanded accounting equation



Transaction Analysis

Transaction (1). Investment by Shareholders. Ray and Barbara Neal decides to open a computer programming service which he names Softbyte. On September 1, 2014, they invest €15,000 cash in exchange for €15,000 of ordinary shares.

Illustration 1-10

Transaction	Assets				=	Liabilities	+	Equity			
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	+ Retained Earnings	Rev.	- Exp.	- Div.
(1)					=						
(2)					=						
(3)					=						
(4)					=						
(5)					=						
(6)					=						
(7)					=						
(8)					=						
(9)					=						
(10)					=						

Transaction Analysis

Transaction (2). Purchase of Equipment for Cash. Softbyte purchases computer equipment for €7,000 cash.

Illustration 1-10

Trans- action	Assets				=	Liabilities	+	Equity			
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	Retained Earnings			
					=			Rev.	- Exp.	- Div.	
(1)	+€15,000				=		+ €15,000				Issued Shares
(2)					=						
(3)					=						
(4)					=						
(5)					=						
(6)					=						
(7)					=						
(8)					=						
(9)					=						
(10)					=						

Transaction Analysis

Transaction (3). Purchase of Supplies on Credit. Softbyte purchases for €1,600 from Acme Supply Company computer paper and other supplies expected to last several months. The purchase is on account.

Illustration 1-10

Transaction	Assets				=	Liabilities	+	Equity			
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	+ Retained Earnings	Rev.	- Exp.	- Div.
(1)	+€15,000				=		+ €15,000				
(2)	-7,000			+€7,000	=						
(3)					=						
(4)					=						
(5)					=						
(6)					=						
(7)					=						
(8)					=						
(9)					=						
(10)					=						

Issued Shares

Transaction Analysis

Transaction (4). Services Provided for Cash. Softbyte receives €1,200 cash from customers for programming services it has provided.

Illustration 1-10

Trans- action	Assets				=	Liabilities	+	Equity			
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	Retained Earnings			
								Rev.	- Exp.	- Div.	
(1)	+€15,000						+ €15,000				Issued Shares
(2)	-7,000			+€7,000							
(3)			+€1,600			+€1,600					
(4)											
(5)											
(6)											
(7)											
(8)											
(9)											
(10)											

Transaction Analysis

Transaction (5). Purchase of Advertising on Credit. Softbyte receives a bill for €250 from the Daily News for advertising but postpones payment until a later date.

Illustration 1-10

Transaction	Assets				=	Liabilities	+	Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	+ Retained Earnings	Rev.	- Exp.	- Div.	
(1)	+€15,000				=		+ €15,000					Issued Shares
(2)	-7,000			+€7,000	=							
(3)			+€1,600		=	+€1,600						
(4)	+1,200				=			+€1,200				Service Revenue
(5)					=							
(6)					=							
(7)					=							
(8)					=							
(9)					=							
(10)					=							

Transaction Analysis

Transaction (6). Services Provided for Cash and Credit. 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.

Illustration 1-10

Transaction	Assets				=	Liabilities	+	Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	+ Retained Earnings	Rev.	- Exp.		- Div.
(1)	+€15,000				=		+ €15,000					Issued Shares
(2)	-7,000			+€7,000	=							
(3)			+€1,600		=	+€1,600						
(4)	+1,200				=			+€1,200				Service Revenue
(5)					=	+250				-€250		Adver. Expense
(6)					=							
(7)					=							
(8)					=							
(9)					=							
(10)					=							

Transaction Analysis

Transaction (7). Payment of Expenses. Softbyte pays the following expenses in cash for September: store rent €600, salaries and wages of employees €900, and utilities €200.

Illustration 1-10

Transaction	Assets				=	Liabilities	+	Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	+ Retained Earnings	Rev.	- Exp.	- Div.	
(1)	+€15,000				=		+ €15,000					Issued Shares
(2)	-7,000			+€7,000	=							
(3)			+€1,600		=	+€1,600						
(4)	+1,200				=			+€1,200				Service Revenue
(5)					=	+250				-€250		Adver. Expense
(6)	+1,500	+€2,000			=			+3,500				Service Revenue
(7)					=							
(8)					=							
(9)					=							
(10)					=							

Transaction Analysis

Transaction (8). Payment of Accounts Payable. Softbyte pays its €250 Daily News bill in cash.

Illustration 1-10

Trans- action	Assets				=	Liabilities	+	Equity										
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Share Capital	+	Retained Earnings					
													Rev.	-	Exp.	-	Div.	
(1)	+€15,000										+ €15,000							Issued Shares
(2)	-7,000						+€7,000											
(3)					+€1,600				+€1,600									
(4)	+1,200												+€1,200					Service Revenue
(5)									+250						-€250			Adver. Expense
(6)	+1,500		+€2,000										+3,500					Service Revenue
(7)	-1,700														-600			Rent Expense
															-900			Sal./Wages Exp.
															-200			Utilities Expense
(8)																		
(9)																		
(10)																		

Transaction Analysis

Transaction (9). Receipt of Cash on Account. Softbyte receives €600 in cash from customers who had been billed for services [in Transaction (6)].

Illustration 1-10

Transaction	Assets				=	Liabilities	+	Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	+ Retained Earnings	Rev.	- Exp.	- Div.	
(1)	+€15,000				=		+ €15,000					Issued Shares
(2)	-7,000			+€7,000	=							
(3)			+€1,600		=	+€1,600						
(4)	+1,200				=			+€1,200				Service Revenue
(5)					=	+250				-€250		Adver. Expense
(6)	+1,500	+€2,000			=			+3,500				Service Revenue
(7)	-1,700				=					-600		Rent Expense
					=					-900		Sal./Wages Exp.
					=					-200		Utilities Expense
(8)	-250				=	-250						
(9)					=							
(10)					=							

Transaction Analysis

Transaction (10). Dividends. The corporation pays a dividend of €1,300 in cash.

Illustration 1-10

Trans- action	Assets				=	Liabilities	+	Equity				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+ Share Capital	+ Retained Earnings	Rev.	- Exp.	- Div.	
(1)	+€15,000				=		+ €15,000					Issued Shares
(2)	-7,000			+€7,000	=							
(3)			+€1,600		=	+€1,600						
(4)	+1,200				=			+€1,200				Service Revenue
(5)					=	+250				-€250		Adver. Expense
(6)	+1,500	+€2,000			=			+3,500				Service Revenue
(7)	-1,700				=					-600		Rent Expense
					=					-900		Sal./Wages Exp.
					=					-200		Utilities Expense
(8)	-250				=	-250						
(9)	+600	-600			=							
(10)					=							

Financial Statements

Companies prepare **four** financial statements :



Income
Statement



Retained
Earnings
Statement



Statement
of Financial
Position



Statement
of Cash
Flows

Financial Statements

Net income is needed to determine the ending balance in retained earnings.

Softbyte Inc. Income Statement For the Month Ended September 30, 2014		
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 Inc. Retained Earnings Statement For the Month Ended September 30, 2014		
Retained earnings, September 1		€ 0
Add: Net income		<u>2,750</u>
		2,750
Less: Dividends		<u>1,300</u>
Retained earnings, September 30		<u>€1,450</u>

Illustration 1-11
Financial statements and their interrelationships

1

Financial Statements

The ending balance in retained earnings is needed in preparing the balance sheet

Softbyte Inc.
Retained Earnings Statement
For the Month Ended September 30, 2014

Retained earnings, September 1	€	0	
Add: Net income		2,750	←
		<u>2,750</u>	
Less: Dividends		1,300	
Retained earnings, September 30		<u>€1,450</u>	

1

Illustration 1-11

Softbyte Inc.
Statement of Financial Position
September 30, 2014

<u>Assets</u>			
Equipment	€	7,000	
Supplies		1,600	
Accounts receivable		1,400	
Cash		8,050	
		<u>8,050</u>	
Total assets		<u>€18,050</u>	
<u>Equity and Liabilities</u>			
Equity			
Share capital—ordinary	€15,000		
Retained earnings	<u>1,450</u>	€16,450	←
Liabilities			
Accounts payable		1,600	
		<u>1,600</u>	
Total equity and liabilities		<u>€18,050</u>	

2

Financial Statements

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

Softbyte Inc. Statement of Financial Position September 30, 2014		
<u>Assets</u>		
Equipment		€ 7,000
Supplies		1,600
Accounts receivable		1,400
Cash		8,050
Total assets		<u>€18,050</u>
<u>Equity and Liabilities</u>		
Equity		
Share capital—ordinary	€15,000	
Retained earnings	<u>1,450</u>	€16,450
Liabilities		
Accounts payable		1,600
Total equity and liabilities		<u>€18,050</u>

Softbyte Inc. Statement of Cash Flows For the Month Ended September 30, 2014		
Cash flows from operating activities		
Cash receipts from revenues		€ 3,300
Cash payments for expenses		<u>(1,950)</u>
Net cash provided by operating activities		1,350
Cash flows from investing activities		
Purchase of equipment		(7,000)
Cash flows from financing activities		
Sale of ordinary shares	€15,000	
Payment of cash dividends	<u>(1,300)</u>	<u>13,700</u>
Net increase in cash		8,050
Cash at the beginning of the period		<u>0</u>
Cash at the end of the period		<u>€8,050</u>

2

Illustration 1-11

3

PEOPLE, PROFIT, AND PLANET

Beyond Financial Statements



Should we expand our financial statements beyond the income statement, retained earnings statement, balance sheet, and statement of cash flows? Some believe we should take into account ecological and social performance, in addition to financial results, in evaluating a company. The argument is that a company's responsibility lies with anyone who is influenced by its actions. In other words, a company should be interested in benefiting many different parties, instead of only maximizing stockholder's interests.

A socially responsible business does not exploit or endanger any group of individuals. It follows fair trade practices, provides safe environments for workers, and bears responsibility for environmental damage. Granted, measurement of these factors is difficult, and how to report this information is controversial. But, many interesting and useful efforts are underway. Throughout this textbook, we provide additional insights into how companies are attempting to meet the challenge of measuring and reporting their contributions to society as well as their financial results to stockholders.



Why might a company's stockholders be interested in its environmental and social performance?

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 tax authorities, law enforcement agencies, and corporate regulators.

Forensic Accounting

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

APPENDIX 1A ACCOUNTING CAREER OPPORTUNITIES

“Show Me the Money”

Salary estimates for jobs in public and corporate accounting

Illustration 1A-1

<u>Employer</u>	<u>Jr. Level (0–3 yrs.)</u>	<u>Sr. Level (4–6 yrs.)</u>
Public accounting (large firm)	\$48,750–\$69,250	\$66,750–\$86,000
Public accounting (small firm)	\$41,000–\$56,000	\$54,000–\$69,750
Corporate accounting (large company)	\$38,000–\$57,250	\$55,750–\$73,500
Corporate accounting (small company)	\$33,500–\$49,000	\$46,500–\$58,750

Upper-level management salaries in corporate accounting

Illustration 1A-2

<u>Position</u>	<u>Large Company</u>	<u>Small to Medium Company</u>
Chief financial officer	\$183,250–\$384,000	\$94,250–\$175,750
Corporate controller	\$122,000–\$180,000	\$80,500–\$134,750
Tax manager	\$ 92,250–\$130,250	\$74,250–\$100,250

Another Perspective

Key Points

- ◆ Most agree that there is a need for one set of international accounting standards. Here is why:
 - ▶ Multinational corporations. Today's companies view the entire world as their market.
 - ▶ Mergers and acquisitions. The mergers between Fiat/Chrysler and Vodafone/Mannesmann suggest that we will see even more such business combinations in the future.
 - ▶ Information technology. As communication barriers continue to topple through advances in technology, companies and individuals in different countries and markets are becoming more comfortable buying and selling goods and services from one another.
 - ▶ Financial markets. Financial markets are of international significance today.

Another Perspective

Key Points

- ◆ In 2002, the U.S. Congress issued the Sarbanes-Oxley Act (SOX), which mandated certain internal controls for large public companies listed on U.S. exchanges. There is a continuing debate as to whether non-U.S. companies should have to comply with this extra layer of regulation. 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.
- ◆ Financial frauds have occurred at companies such as Satyam Computer Services (IND), Parmalat (ITA), and Royal Ahold (NLD). They have also occurred at large U.S. companies such as Enron, WorldCom, and AIG.

Another Perspective

Key Points

- ◆ IFRS tends to be less detailed in its accounting and disclosure requirements than GAAP. This difference in approach has resulted in a debate about the merits of “principles-based” (IFRS) versus “rules-based” (GAAP) 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.
- ◆ GAAP is based on a conceptual framework that is similar to that used to develop IFRS.

Another Perspective

Key Points

- ◆ The three common forms of business organization that are presented in the chapter, proprietorships, partnerships, and corporations, are also found in the United States. 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.
- ◆ Transaction analysis is basically the same under IFRS and GAAP but, as you will see in later chapters, the different standards may impact how transactions are recorded.

Another Perspective

Key Points

- ◆ The basic definitions provided in this textbook for the key elements of financial statements are simplified versions of the official definitions provided by the IASB.
 - ▶ Assets Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
 - ▶ Liabilities Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

Another Perspective

Key Points

- ◆ The basic definitions provided in this textbook for the key elements of financial statements are simplified versions of the official definitions provided by the IASB.
 - ▶ **Equity** The residual interest in the assets of an entity that remains after deducting its liabilities.
 - ▶ **Revenues** Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.
 - ▶ **Expenses** Outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

Another Perspective

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. 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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