

Module 3: ACC 2100 Financial Statements and Standards Pack

Introduction

Financial accounting focuses on preparing financial information that can be used by investors, creditors, and other decision makers.

Accounting information must follow consistent rules so that financial statements are reliable and comparable across companies.

These rules are known as Generally Accepted Accounting Principles (GAAP).

The purpose of this module is to help students understand:

- the accounting conceptual framework
- the corporate accounting cycle
- the structure of financial statements
- how financial statements are connected

Understanding these relationships helps students analyze financial data and solve accounting problems more effectively.

The Accounting Conceptual Framework

The conceptual framework is a system of principles and ideas that guide the development of accounting standards.

It helps accountants determine how financial information should be measured and reported.

The conceptual framework ensures that financial information is:

- relevant
- reliable
- consistent
- comparable

These principles help maintain confidence in financial reporting.

Financial Statement Objectives

Financial statements are designed to provide useful information about a company's:

- financial position
- performance
- cash flows

Users of financial statements include:

- investors
- lenders
- management
- government agencies

These users rely on financial reports to make economic decisions.

The Corporate Accounting Cycle

The accounting cycle describes the process used to record and summarize business transactions.

The major steps in the accounting cycle include:

1. Identify and analyze transactions
2. Record transactions in the journal
3. Post transactions to the ledger
4. Prepare an unadjusted trial balance
5. Record adjusting entries
6. Prepare an adjusted trial balance
7. Prepare financial statements
8. Record closing entries
9. Prepare a post-closing trial balance

Each step builds on the previous step.

Classified Balance Sheet

A classified balance sheet separates assets and liabilities into categories based on time.

This helps users evaluate a company's short-term and long-term financial position.

Current Assets

Current assets are assets expected to be converted into cash within one year.

Examples include:

- Cash
- Accounts Receivable
- Inventory
- Prepaid Expenses

Non-Current Assets

Non-current assets are long-term assets used in business operations.

Examples include:

- Land
- Buildings
- Equipment
- Long-term investments

These assets typically provide benefits for more than one accounting period.

Current Liabilities

Current liabilities are obligations expected to be paid within one year.

Examples include:

- Accounts Payable
- Salaries Payable
- Notes Payable (short-term)
- Unearned Revenue

Long-Term Liabilities

Long-term liabilities are obligations that extend beyond one year.

Examples include:

- bonds payable
- long-term notes payable
- mortgage payable

Shareholders' Equity

In a corporation, the equity section includes:

- common stock
- additional paid-in capital
- retained earnings

These accounts represent the ownership interest of shareholders.

Income Statement

The income statement reports the company's financial performance over a specific period.

The basic formula is:

Net Income = Revenues - Expenses

Multi-Step Income Statement

A multi-step income statement separates operating activities from non-operating activities.

The major sections include:

1. Net Sales
2. Cost of Goods Sold
3. Gross Profit
4. Operating Expenses
5. Income from Operations

6. Other Revenues and Expenses

7. Net Income

Example Structure

Net Sales

- Cost of Goods Sold

= Gross Profit

Gross Profit

- Operating Expenses

= Income from Operations

Income from Operations

- Other Revenues
- Other Expenses

= Net Income

Statement of Retained Earnings

The statement of retained earnings explains changes in retained earnings during the accounting period.

The format is:

Beginning Retained Earnings

- Net Income
- Dividends

= Ending Retained Earnings

Retained earnings represents accumulated profits that remain in the business.

Statement of Cash Flows

The statement of cash flows explains changes in cash during the accounting period.

Cash flows are classified into three categories.

Operating Activities

Operating activities include transactions related to normal business operations.

Examples include:

- cash received from customers
- cash paid to suppliers
- wages paid to employees

Investing Activities

Investing activities involve the purchase or sale of long-term assets.

Examples include:

- purchase of equipment
- sale of land
- purchase of investments

Financing Activities

Financing activities involve transactions with owners and creditors.

Examples include:

- issuing stock
- issuing bonds
- paying dividends
- repaying loans

Relationship Between Financial Statements

Financial statements are connected to each other.

For example:

Net income from the income statement flows into the statement of retained earnings.

Ending retained earnings then appears in the equity section of the balance sheet.

The statement of cash flows explains how cash changed during the period.

Understanding these connections helps students analyze financial reports more effectively.

Common Student Errors

Students often struggle with:

- confusing assets and expenses
- misunderstanding the relationship between financial statements
- forgetting the order of financial statement preparation
- misclassifying assets and liabilities

To avoid errors:

- review account classifications carefully
- remember the accounting equation
- follow the accounting cycle step by step

Practice Problems

Problem 1

List three examples of current assets.

Problem 2

Which financial statement reports revenues and expenses?

Problem 3

Identify the three sections of the statement of cash flows.

Problem 4

Calculate ending retained earnings.

Beginning retained earnings: \$40,000

Net income: \$10,000

Dividends: \$3,000

Practice Problem Answers

Problem 1

Examples of current assets:

- Cash
- Accounts Receivable
- Inventory

Problem 2

The income statement reports revenues and expenses.

Problem 3

Sections of the statement of cash flows:

- Operating activities
- Investing activities
- Financing activities

Problem 4

Beginning Retained Earnings = 40,000

- Net Income = 10,000
- Dividends = 3,000

Ending Retained Earnings = 47,000