



PNU University

English for The Students of Accounting 1

**Moghadam,A.K.
Gholamikian, A.R. Salim,F.**

Contents

CHAPTER 1. Uses of Accounting Information.....	1
Accounting As An Information System.....	1
Decision Makers: The Users of Accounting Information.....	5
Accounting Measurement	6
Forms of Business Organization	7
REVIEW OF LEARNING OBJECTIVES	9
REVIEW OF CONCEPTS AND TERMINOLOGY	10
QUESTIONS.....	11
SHORT EXERCISES	12
CHAPTER 2. Communication through Financial Statements.....	15
Financial Position and the Accounting equation.....	15
The Basic Financial Statements	18
Generally Accepted accounting Principles	20
GAAP, Financial Statements and Auditing	21
Professional Ethics and Accounting Profession.....	22
REVIEW OF LEARNING OBJECTIVES	23
REVIEW OF CONCEPTS AND TERMINOLOGY.....	24
QUESTIONS.....	27
SHORT EXERCISES	27
CHAPTER 3. Measuring Business Transactions.....	29
Measurement Issues	29
Accounts and the Charts of Accounts	33
The Double-Entry System: The Basic Method of Accounting	37
Recording and Posting Transactions	42

REVIEW OF LEARNING OBJECTIVES	45
REVIEW OF CONCEPTS AND TERMINOLOGY	47
QUESTIONS	48
SHORT EXERCISES	51
CHAPTER 4. Measuring Business Income	53
The Majoring of Business Income	53
ACCRUAL ACCOUNTING	59
The Adjustment Process	61
Using the Adjusted Trial Balance to Prepared Financial Statements	67
Cash Flows, Accrual Accounting, and Management Objectives	68
A Note about Journal Entries	70
REVIEW OF LEARNING OBJECTIVES	70
REVIEW OF CONCEPTS AND TERMINOLOGY	72
QUESTIONS	74
SHORT EXERCISES	76
CHAPTER 5. Financial Reporting and Analysis	79
Objectives of Financial Information	80
Qualitative Characteristics of Accounting Information	81
Conventions that help in the Interpretation of Financial Information	84
Management's Responsibility for Ethical Reporting	89
Classified Balance Sheet	90
Forms of the Income Statements	98
Using Classified Financial Statements	100
REVIEW OF LEARNING OBJECTIVES	107
REVIEW OF CONCEPTS AND TERMINOLOGY	109
QUESTIONS	113
SHORT EXERCISES	114
CHAPTER 6. Short-Term Liquid Assets	119
Management Issues Related to Short-Term Liquid Assets	119
Cash and Cash Equivalents	123
Short-Term Investments	124
Accounts Receivable	130
REVIEW OF LEARNING OBJECTIVES	139
REVIEW OF CONCEPTS AND TERMINOLOGY	141
QUESTIONS	143

SHORT EXERCISES	144
CHAPTER 7. Inventories	147
Management Issues Associated with Accounting for Inventories	148
Pricing Inventory under Periodic Inventory System	153
Pricing Inventory Under the Perpetual Inventory System	159
Comparison and Impact of Inventory Decisions and Misstatements	162
Valuing Inventory at the Lower of Cost or Market (LMC)	167
REVIEW OF LEARNING OBJECTIVES	168
REVIEW OF CONCEPTS AND TERMINOLOGY	170
QUESTIONS	172
SHORT EXERCISES	174
CHAPTER 8. Long-Term Assets	177
Management Issues Related to Accounting for Long-Term Assets	178
Acquisition Cost of Property, Plants and Equipment	183
Accounting for Depreciation	187
Disposal of Depreciable Assets	192
Accounting For Natural Resources	196
Accounting for Intangible Assets	198
REVIEW OF LEARNING OBJECTIVES	199
REVIEW OF CONCEPTS AND TERMINOLOGY	201
QUESTIONS	203
SHORT EXERCISES	206
Chapter 9. Current and Long Term Liabilities	209
Management Issues Related to Accounting for Current Liabilities	209
Common Categories of Current Liabilities	212
Contingent Liabilities	224
REASONS FOR ISSUING LONG - TERM DEBT	225
THE NATURE OF BONDS	227
ACCOUNTING FOR BONDS PAYABLE	229
REVIEW OF LEARNING OBJECTIVES	233
REVIEW OF CONCEPTS AND TERMINOLOGY	235
QUESTIONS	237
SHORT EXERCISES	238

CHAPTER 10. Contributed Capital and Retained Earnings	241
The Corporation	241
Organization cost	247
Components of stockholders equity	249
Dividends	252
Identify the characteristics of preferred stock	253
Treasury Stock	255
Retained Earnings	256
Stock Dividends	258
Restrictions on Retained Earnings	259
REVIEW OF LEARNING OBJECTIVES	260
REVIEW OF CONCEPTS AND TERMINOLOGY	263
QUESTIONS.....	266
SHORT EXERCISES	267
GLOSSARY	269

To The Student

How to Study Accounting Successfully

Whether you are majoring in accounting or in another business discipline, your introductory course is one of the most important classes you will take, because it is fundamental to the business curriculum and to your success in the business world beyond college. What are your goals in studying accounting? Being clear about your goals can contribute to your success in this course.

Success in this class also depends on your desire to learn and your willingness to work hard. And it depends on your understanding of how the text complements the way your instructor teaches and the way you learn. A familiarity with how this text is structured will help you to study more efficiently make better use of classroom time, and improve your performance on examinations and other assignments.

To be successful in the business world after you graduate, you will need broad set of skills, which may be summarized as follows:

Technical/Analytical Skills

A major objective of your accounting course is to give you a firm grasp of the essential business and accounting terminology and techniques that you will need to succeed in a business environment. With this foundation, you then can begin to develop the higher-level perception skills that will help you to acquire further knowledge on your own.

An even more crucial objective of this course is to help you develop analytical skills that will allow you to evaluate data. Well-developed analytical and decision-making skills are among the professional skills most highly valued by employers, and will serve you well throughout your academic and professional careers.

Communication Skills

Another skill highly prized by employers is the ability to express oneself in a manner that is understood correctly by others. This can include writing skills, speaking skills, and presentation skills. Communication skills are developed through particular tasks and assignments and are improved through constructive criticism. Reading skills and listening skills support the direct communication skills.

Interpersonal Skills

Effective interaction between two people requires a solid foundation of interpersonal skills. The success of such interaction depends on empathy, or the ability to identify with and understand the problems, concerns, and motives of others. Leadership, supervision, and interviewing skills also facilitate a professional's interaction with others.

Personal/Self Skills

Personal/Self Skills form the foundation for growth in the use of all other skills. To succeed, a professional must take initiative, possess self-confidence, show independence, and be ethical in all areas of life. Personal/Self Skills can be enhanced significantly by the formal learning process and by peers and mentors who provide models upon which you can build. Accounting is just one course in your entire curriculum, but it can play an important role in your development of the above skills. Your instructor is interested in helping you gain both a knowledge of accounting and the more general skills you will need to succeed in the business world. The following sections describe how you can get the most out of this course.

The Teaching/Learning Cycle

Both teaching and learning have natural and mutually compatible cycle. This teaching/learning cycle, shown in Figure 1.

The Teaching Cycle:

The inner circle in Figure 1 shows the steps an instructor takes in teaching a chapter. Your teacher assigns material, presents the subject in lecture, explains by going over assignments and answering questions, reviews the subject prior to an exam, and tests your knowledge and understanding using examinations and other means of evaluation.

The Learning Cycle:

The outside circle in Figure 1 shows the steps you should take in studying a chapter. You should preview the material, read the chapter, apply your understanding by working the assignments, review the chapter, and recall and demonstrate your knowledge and understanding of the material on examinations and other assessments.

Why Students succeed:

Students succeed in their accounting course when they coordinate their personal learning cycle with their instructor's cycle. Students who do a good job of previewing their assignments, reading the chapters before the instructor is ready to present them, preparing homework assignments before they are discussed in class, and reviewing carefully will ultimately achieve their potential on exams. Those who get out of phase with their instructor, for whatever reason, will do poorly or fail. To ensure that your learning cycle is synchronized with your instructor's teaching cycle, check your study habits against these suggestions.

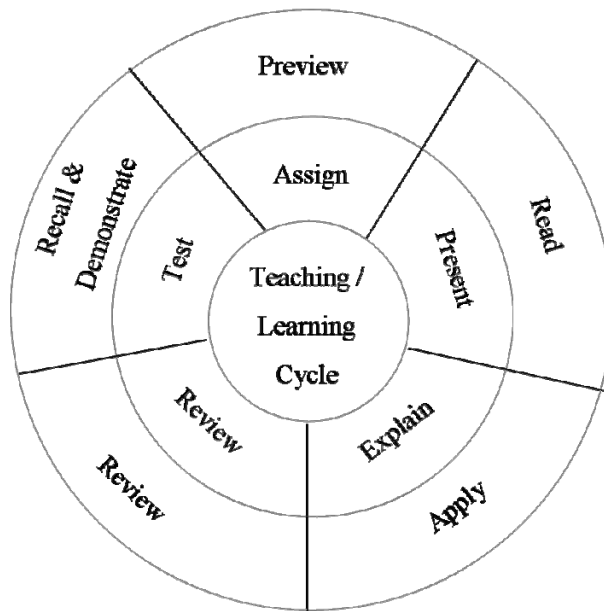


Figure 1. The Teaching/Learning Cycle

Moghadam, A.K.

Gholami Kian, A.R.

Salim, F.

CHAPTER 1

Uses of Accounting Information

Learning Objectives:

1. Define accounting as an information system
2. Identify business goals and activities
3. Describe the role of accounting in making informed decisions
4. Distinguish between accounting from bookkeeping
5. Identify the three broad categories users of accounting information
6. Explain the importance of business transactions, money measure, and separate entity to accounting measurement.
7. Identify the three basic forms of business organization

In this chapter we determine to explore the nature and environment of accounting, with special emphasis on the users and uses of accounting information. It introduces the concept of accounting measurement, business transactions, money measure, and separate entity. This chapter concludes with identifying the three basic forms of business organization.

Accounting As An Information System

Today's accounting focuses on the ultimate needs of decision makers who use accounting information, whether those decision makers are inside or outside the business. *Accounting* "is not an end in itself" but is *an*

information system that measures, processes, and communicates financial information about an identifiable economic entity. An economic entity is a unit that exists independently - for example a business, a hospital or a government body.

In fact, accounting provides a vital service by supplying the information that decision makers need to make "reasoned choices among alternative uses of scarce resources in the conduct of business and activities". As shown in Figure 1-1, accounting is a link between business activities and decision makers. First, accounting measures business activities by recording data about them for future use. Second, the data are stored until needed and then processed to become useful information. Third, the information is communicated, through reports, to decision makers. We might say that data about business activities are the input to the accounting system and that useful information for decision makers is the output.

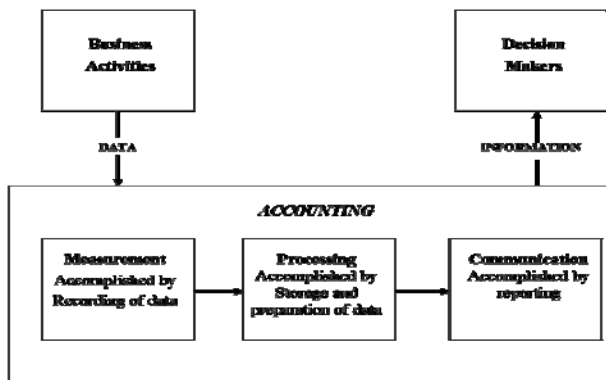


Figure 1.1. Accounting as an Information system

Business Goals and Activities

A business is an economic unit that aims to sell goods and services to customers at prices that will provide an adequate return to its owners. All businesses have goals and engage in similar activities, as shown in

Figure1-2. Each must take in enough money from customers to pay all the costs of doing business, with enough left over as profit for the owners to want to stay in the business. This need to earn enough income to attract and hold investment capital is the goal of profitability. In addition, businesses must meet the goal of liquidity. Liquidity means having enough funds on hand to pay debts when they are due. All businesses pursue their goals by engaging in similar activities. First, each business must engage in financing activities to obtain adequate funds, or capital, to begin and to continue operating. Financing activities include obtaining capital from owners and creditors, such as banks and suppliers. They also include repaying creditors and paying a return to the owners. Second, each business must engage in *investing activities* to spend the capital it receives in ways that are productive and will help to achieve its objectives. Investing activities include buying land, buildings, equipment, and other long-lived resources needed in the operation of the business, and selling these resources when they are no longer needed. Third, each business must engage in *operating activities*. In addition to the selling of goods and services to customers, operating activities include such actions as employing managers and workers, buying and producing goods and services, and paying taxes to the government.

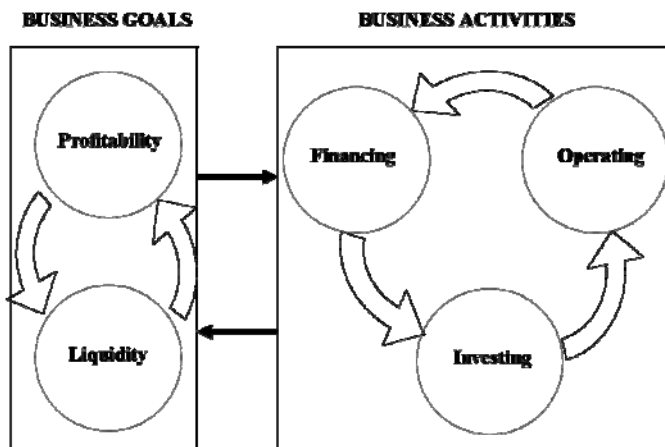


Figure 1.2. Business Goals and Activities

Financial and Management Accounting

Accounting's role of assisting decision makers by measuring, processing, and communicating information is usually divided into the categories of management accounting and financial accounting. *Management accounting* provides internal decision makers who are charged with achieving the goals of profitability and liquidity with information about financing, investing, and operating activities. Managers and employees who conduct the activities of the business need information that tells them how they have done in the past and what they can expect in the future. *Financial accounting* generates reports and communicates them to external decision makers so that they can evaluate how well the business has achieved its goals. These reports are called *financial statements*. Financial statements report directly on the goals of profitability and liquidity and are used extensively both inside and outside a business to evaluate the business's success.

Processing Accounting Information

To avoid misunderstandings, it is important to distinguish accounting itself from the ways in which accounting information is processed by bookkeeping, the computer, and management information systems. *Bookkeeping* is the mechanical and repetitive process of recording financial transactions and keeping financial records. The *computer* is an electronic tool that is used to collect, organize, and communicate vast amounts of information with great speed. It may appear that the computer is doing the accountant's job; in fact, it is only a tool that is instructed to do routine bookkeeping and to perform complex calculations. A *management information system (MIS)* consists of the interconnected subsystems that provide the information needed to run a business. The accounting information system is the most important subsystem because it plays the key

role of managing the flow of economic data to all parts of a business and to interested parties outside the business.

Decision Makers: The Users of Accounting Information

The people who use accounting information to make decisions fall into three categories: (1) those who manage a business; (2) those outside a business enterprise who have a direct financial interest in the business; and (3) those people, organizations, and agencies that have indirect financial interest in the business, as shown in Figure 1-3.

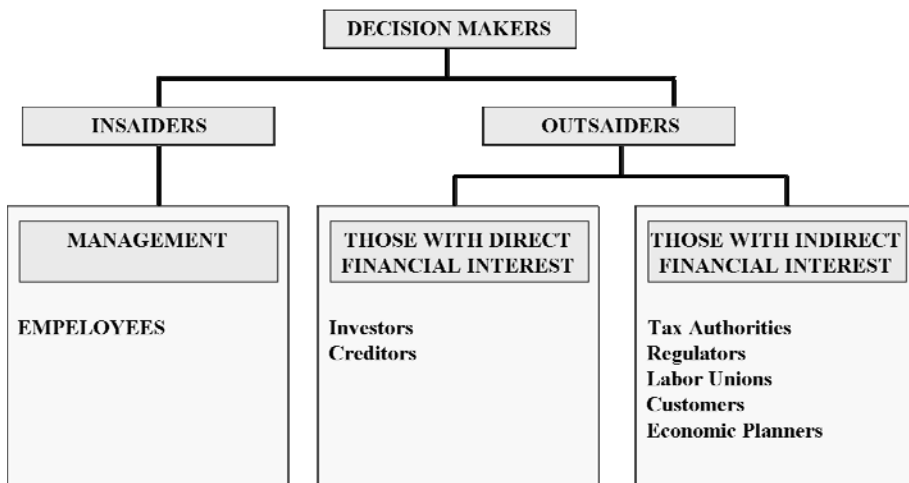


Figure 1.3. The Users of Accounting Information

Because so many key decisions are based on accounting data, management is one of the most important users of accounting information. Management, collectively, is the people who have overall responsibility for operating a business and for meeting its profitability and liquidity goals. Investors who invest or may invest in a business and acquire a part

ownership are interested in its past success and its potential earnings. The financial statements help potential investors judge the prospects for a profitable investment. Creditors who lend money or deliver goods and services before being paid, are interested mainly in whether a company will have the cash to pay interest charges and repay debt at the appropriate time.

Accounting Measurement

To make an accounting measurement, the accountant must answer four basic questions. All these question deal with basic assumptions and generally accepted accounting principles.

- ❖ What is measured?
- ❖ When should the measurement be made?
- ❖ What value should be placed on what is measured?
- ❖ How should what is measured be classified?

What is measured?

The world contains an unlimited number of things to measure and ways to measure them. Some of these measurements are relevant to accounting; some are not. Every system must define what it measures, and accounting is no exception. Basically, financial accounting uses money measures to gauge the impact of business transactions on separate business entities. The related concepts such as business transactions, money measure, and separate entity are discussed in the next sections.

Business Transactions as the Object of Measurement

Business transactions are economic events that affect the financial position of a business entity. To be recorded, a transaction must relate directly to a

business entity. A transaction can be an exchange of value between two or more independent parties (such as purchase, payment). A transaction also can be an economic event that has the same effect as an exchange transaction but does not involve an exchange. Some examples of "non-exchange" transactions are physical wear and tear on machinery and equipment; losses from fire and so on.

Money Measure

All business transactions are recorded in terms of money. This concept is termed money measure. Information of a non-financial nature may be recorded, but it is from the recording of monetary amounts that the transactions and activities of a business are measured. Money is the only practical unit of measure that can produce financial data depends on alike and comparable. The monetary unit a business uses depends on the country in which the business resides.

The concept of Separate Entity

For accounting Purposes, a business is a separate entity, distinct not only from its creditors and customers but also from its owner or owners. The business should have a completely separate set of records, and its financial records and reports should refer only to its financial affairs.

Forms of Business Organization

There are three basic forms of business organization: *sole proprietorships*, *partnerships*, and *corporations*. Legal differences among the three forms are summarized in Table 1-1 and discussed briefly in the following sections.

Table 1-1. Comparative Features of the Forms of Business Organization

	Sole Proprietorship	Partnership	Organization
Legal Status	Not a separate legal entity	Not a separate legal entity	Separate legal entity
Risk of Ownership	Owner's personal resources at stake	Partners' personal resources at stake	Limited to investment in corporation
Duration or Life	Limited by choice or death of owner	Limited by choice or death of owner	Indefinite, possibly unlimited
Transferability of Ownership	Sale by owner, establishes new company	Changes in any partner's percentage of interest requires new partnership	Transferable by sale of stock
Accounting Treatment	Separate economic unit	Separate economic unit	Separate economic unit

A *sole proprietorship* is a business owned by one person. This form of organization gives the individual a means of controlling the business apart from his or her personal interests. The individual receives all profits or losses and is liable for all obligations of the business.

A *partnership* is like a proprietorship in most ways except that it has more than one owner. The partners share the profits and losses of the partnership according to an agreed-on formula. In some cases, one or more partners limit their liability, but at least one partner must have unlimited liability.

A corporation is a business unit that is legally separate from its owners (Stockholders). The owners do not control the operations of the corporation directly. Instead, they elect a board of directors, which appoints managers to run the corporation for the benefit of the stockholders. In exchange for

limited involvement in the corporation's actual operations, they enjoy limited liability.

REVIEW OF LEARNING OBJECTIVES

Define accounting, identify business goals and activities, and describe the role of accounting in making informed decisions. Accounting is an information system that measures, processes, and communicates information, primarily financial in nature, about an identifiable entity for the purpose of making economic decisions. Management accounting focuses on the preparation of information primarily for internal use by management. Financial accounting is concerned with the development and use of accounting reports that are communicated to those external to the business organization as well as to management. Accounting is not an end in itself but a tool that provides the information that is necessary to make reasoned choices among alternative uses of scarce resources in the conduct of business and economic activities.

Identify the many users of accounting information in society. Accounting plays a significant role in society by providing information to managers of all institutions and to individuals with a direct financial interest in those institutions, including present or potential investors or creditors. Accounting information is also important to those with an indirect financial interest in the business—for example, tax authorities, regulatory agencies, and economic planners.

Explain the importance of business transactions, money measure, and separate entity to accounting measurement. To make an accounting measurement, the accountant must determine what is measured, when the measurement should be made, what value should be placed on what is measured, and how what is measured should be classified. Generally

accepted accounting principles define the objects of accounting measurement as business transactions, money measure and separate entities. Relating these three concepts, financial accounting uses money measure to gauge the impact of business transactions on a separate business entity.

Identify the three basic forms of business organization. The three basic forms of business organization are sole proprietorships, partnerships, and corporations. Legally, sole proprietorships, which are formed by one individual, and partnerships, which are formed by more than one individual, are not economically separate from their owners. In accounting, however, they are treated separately. Corporations, whose ownership is represented by shares of stock, are separate entities for both legal and accounting purposes.

REVIEW OF CONCEPTS AND TERMINOLOGY

The following concepts and terms were introduced in this chapter.

Accounting: An information system that measures, processes, and communicates financial information about an identifiable economic entity.

Bookkeeping: The process of recording financial transactions and keeping financial records.

Business: An economic unit that aims to sell goods and services to customers at prices that will provide an adequate return to its owners.

Business transactions: Economic events that affect the financial position of a business entity.

Computer: An electronic tool for the rapid collection, organization, and communication of large amounts of information.

Corporation: A business unit granted a state charter recognizing it as a separate legal entity having its own rights, privileges, and liabilities distinct from those of its owners.

Financial accounting: The process of generating and communicating accounting information in the form of financial statements to those outside the organization.

Financial Accounting Standards Board (FASB): The most important body for developing and issuing rules on accounting practice, called Statements of Financial Accounting Standards.

Financial statements: The primary means of communicating important accounting information to users. They include the income statement, statement of owner's equity, balance sheet, and statement of cash flows.

Liquidity: Having enough funds on hand to pay debts when they are due.

Management: Collectively, the people who have overall responsibility for operating a business and meeting its profitability and liquidity goals.

Management accounting: The process of producing accounting information for the internal use of a company's management.

Management information system (MIS): The interconnected subsystems that provide the information needed to run a business.

Money measure: The recording of all business transactions in terms of money.

Partnership: A business owned by two or more people.

Profitability: The ability to earn enough income to attract and hold investment capital.

Separate entity: A business that is treated as distinct from its creditors, customers, and owners.

Sole proprietorship: A business owned by one person.

QUESTIONS

1. What is the definition of accounting?
2. Why is accounting considered as an information system?

3. What is the role of accounting in the decision-making process, and what broad business goals and activities does it help management to achieve and manage?
4. Distinguish between management accounting and financial accounting.
5. Distinguish among these terms: accounting, bookkeeping, and management information systems.
6. Which decision makers use accounting information?
7. Why are investors and creditors interested in reviewing the financial statements of a company?
8. Use the terms business transactions, money measure, and separate entity in a single sentence that demonstrates their relevance to financial accounting.
9. How do sole proprietorships, partnerships, and corporations differ?

SHORT EXERCISES

1. Which of the following is not a step in accounting definition?
 - a) Measures
 - b) Verification
 - c) Processes
 - d) Communicates
2. Which of the following statements about users of accounting information is incorrect?
 - a) Management is considered an internal user
 - b) Tax authorities are considered external user with indirect financial interest
 - c) Present creditors are considered external user with direct financial interest
 - d) Customers are considered external user with direct financial interest
3. Accounting concepts and techniques change because ...

- a) Accounting thought is changing
 - b) The environment in which the accounting operates changes
 - c) The authoritative bodies release new standards
 - d) None of the above
4. The process of supplying financial information to outsiders by business enterprises is called
- a) Management accounting
 - b) Public accounting
 - c) Financial accounting
 - d) Financial reporting
5. Which of the items mentioned below show the sources and the amounts of capital obtained and used by the enterprise during the period?
- a) Operating activities
 - b) Investing activities
 - c) Financing activities
 - d) All of them

CHAPTER 2

Communication through Financial Statements

Learning Objectives:

1. Define financial position, state the accounting equation
2. Identify four basic financial statements
3. Describe the generally accepted accounting principles
4. State the relationship of generally accepted accounting principles to financial statements and auditing
5. Define ethics and describe the ethical responsibilities of accountants
6. In second chapter we identify the accounting equation, the four basic financial statements and the effects of business transaction on financial position. It describes the generally accepted accounting principles (GAAP), the relationship of GAAP to financial statements and auditing. This chapter concludes with discussion of ethical consideration in accounting.

Financial Position and the Accounting equation

Financial position refers to the economic resources that belong to a company and the claims against those resources at a point in time. Another term for