

# **ACCT 101: Welcome and Intro to FA**

## **Session 1**

**Dr. Richard M. Crowley**

# About Me

# Teaching

- Fourth year at SMU
  - Also teaching ACCT 420
- Before SMU: Taught at the [University of Illinois Urbana-Champaign](#) while completing my PhD



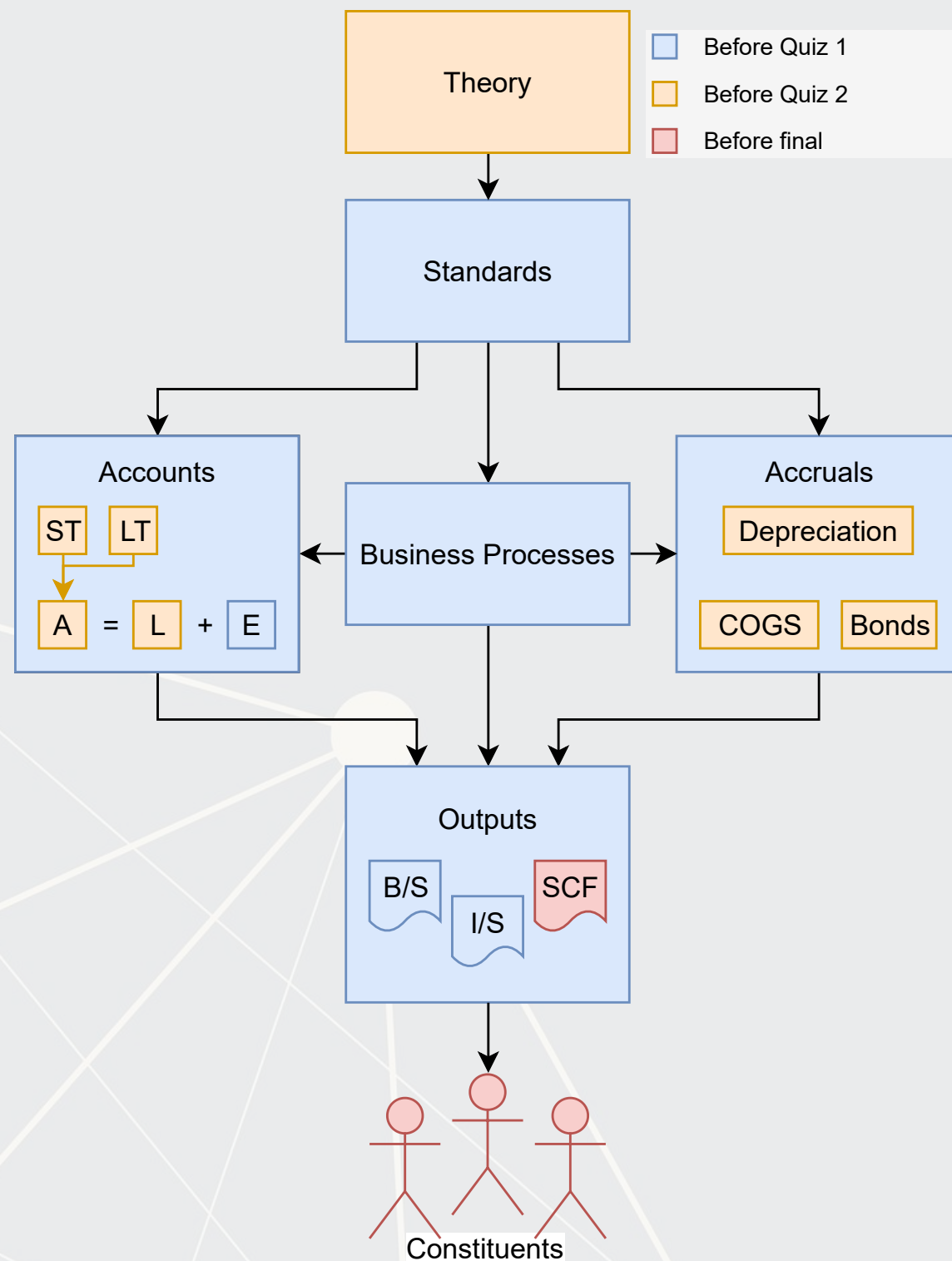
# Research

- Accounting disclosure: What companies say, and why it matters
- Approach this using AI/ML techniques



# About this course

# What will this course cover?



1. Basic elements of FA
2. FA statements
  - Income & Balances
  - Cash flows
3. Financial accounting rules
4. Complex transactions
5. Financial statement analysis

# Teaching philosophy

1. Accounting is best learned in a seminar style
  - Less lecture, more thinking
2. Working with others greatly extends learning
  - If you are ahead:
    - The best sign that you've mastered a topic is if you can explain it to others
  - If you are lost:
    - Gives you a chance to get help and catch up

# Grading

- Standard SMU grading policy
- Participation @ 10%
- Homework @ 10% (equally weighted)
- 2 quizzes @ 7.5% each
- Group project @ 15%
- Final exam @ 50%

# Participation

- Come to class
  - If you have a conflict, email me
    - Excused classes do not impact your participation grade
    - Excused quizzes add to the final's weighting
- Ask questions to **extend or clarify**
- Answer questions and explain answers
  - Give it your best shot!
- Help those in your group to understand concepts
- Present your work to the class

Actively learn & learn from others

# Outside of class

## Homeworks

- Only 10% because they are for learning
  - Submit on eLearn
- Reinforce lesson
- Apply to the real world
  - Useful after graduation
- Answers are expected to be your own work
  - No sharing answers
  - Automatically checked by eLearn

## Practices

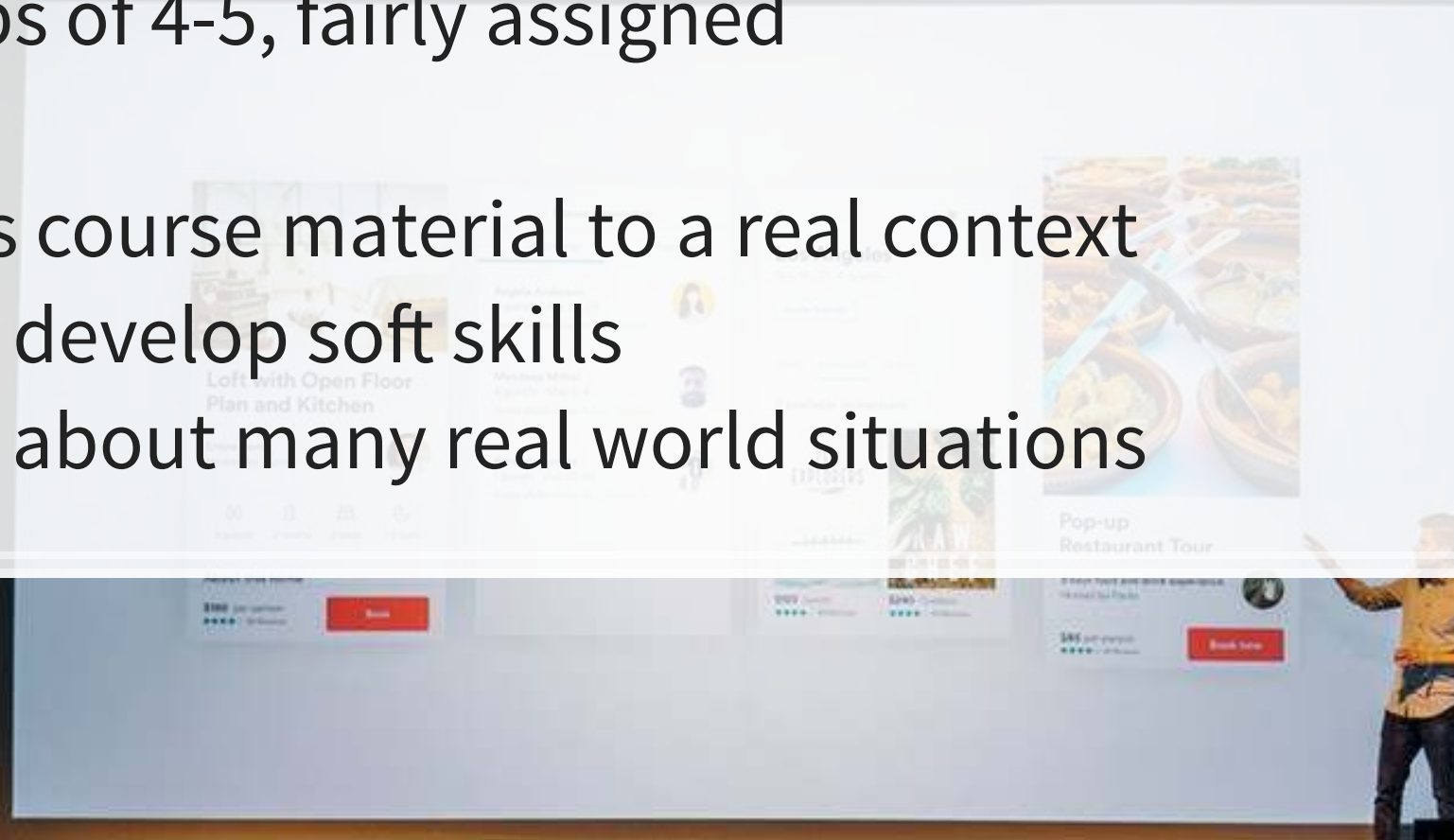
- For you to practice material
- Not required, no direct impact on grades
- Can do in study groups, individually, etc.
- All practices are on eLearn
  - Automatically graded for quick feedback
- These questions are easier than exam questions

# Quizzes

- Why?
  - Reinforce what you have learned
  - Early progress indicator
- What to expect?
  - 1 hour each
  - Context based
  - Long format
    - Extracting information from a situation
    - Problem solving

# Group project

- What to expect
  - 1 case per group covering a recent or ongoing accounting issue
  - Groups of 4-5, fairly assigned
- Why?
  - Brings course material to a real context
  - Helps develop soft skills
  - Learn about many real world situations



# Final exam

- Why?
  - Ex post indicator of attainment
- How?
  - 3 hours
  - Long format (like quizzes)
    - Potentially some MCQ
  - Same exam across all sections

# Expectations

## In class:

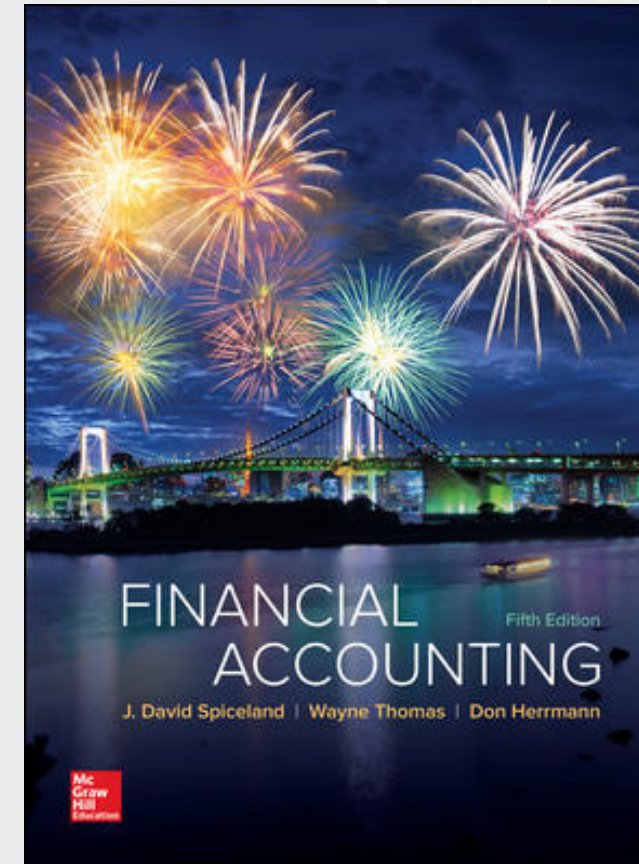
- Participate
  - Ask questions
    - Clarify
    - Add to the discussion
  - Answer questions
  - Work with classmates

## Out of class

- Check eLearn for course announcements
- Read in advance of class
  - This will help a lot
- Do homeworks on your own
  - Submit on eLearn
- Do practices on your own or in groups
- Office hours and TA hours are there to help!
  - Short questions can be emailed instead

# Textbook

Spiceland, Thomas and  
Herrmann  
Financial Accounting, 5th  
edition, McGraw Hill.



Brand new book this semester. Consider the slides to be more reliable. There are also videos for early chapters on eLearn.

# Tech use

- Laptops and other tech are OK!
  - Use them for learning, not messaging
- Examples of good tech use:
  - Taking notes
  - Viewing slides
  - Working out problems
  - Group work
- Avoid:
  - Watching livestreams of pandas or Overwatch
  - Messaging your friends on Telegram
  - Working on homework for the class in a few hours

# Office hours

- TA Office hours: Fixed time slots, TBD
- Prof office hours:
  - Walk in hours from 2:30 to 4:30pm on Mondays
  - Bookable at [rnc-link.youcanbook.me](https://rnc-link.youcanbook.me)
  - I may host extra office hours around quizzes and the exam, subject to demand.
- **Short** questions can be emailed
  - I try to respond within 24 hours

Office hours begin the week of Session 2

Fixed time slots are for drop-ins – no appointment necessary. Any other office hours should be booked using the link above

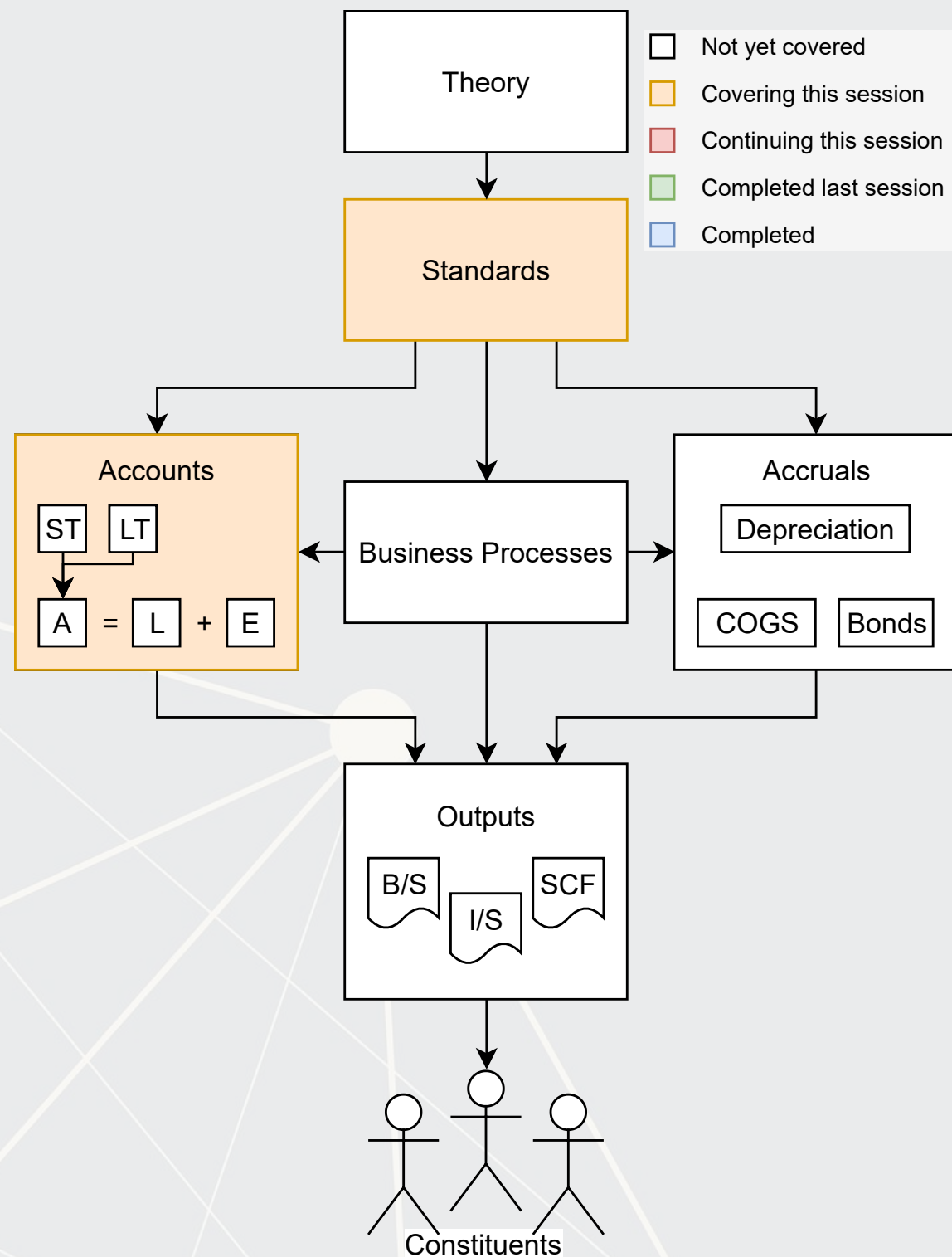
# About you

# About you

- Results are anonymous

# Introduction to accounting

# Learning objectives



1. Develop a base understanding of accounting institutions
2. Understand the building blocks of the accounting system
3. Apply the “accounting equation”

# What is accounting?

The language of business

1. Measure business activities
  - Ex.: Sales, wages, inventory changes, ...
2. Process reports into data
  - For managers, investors, etc.
3. Communicate results to financial statement (F/S) users
  - Ex.: Statements, disclosures, press releases, ...

# Types of accounting

## 1. Financial

- Provides information to external users.
- Needs to be decision relevant
- Audit fits in here

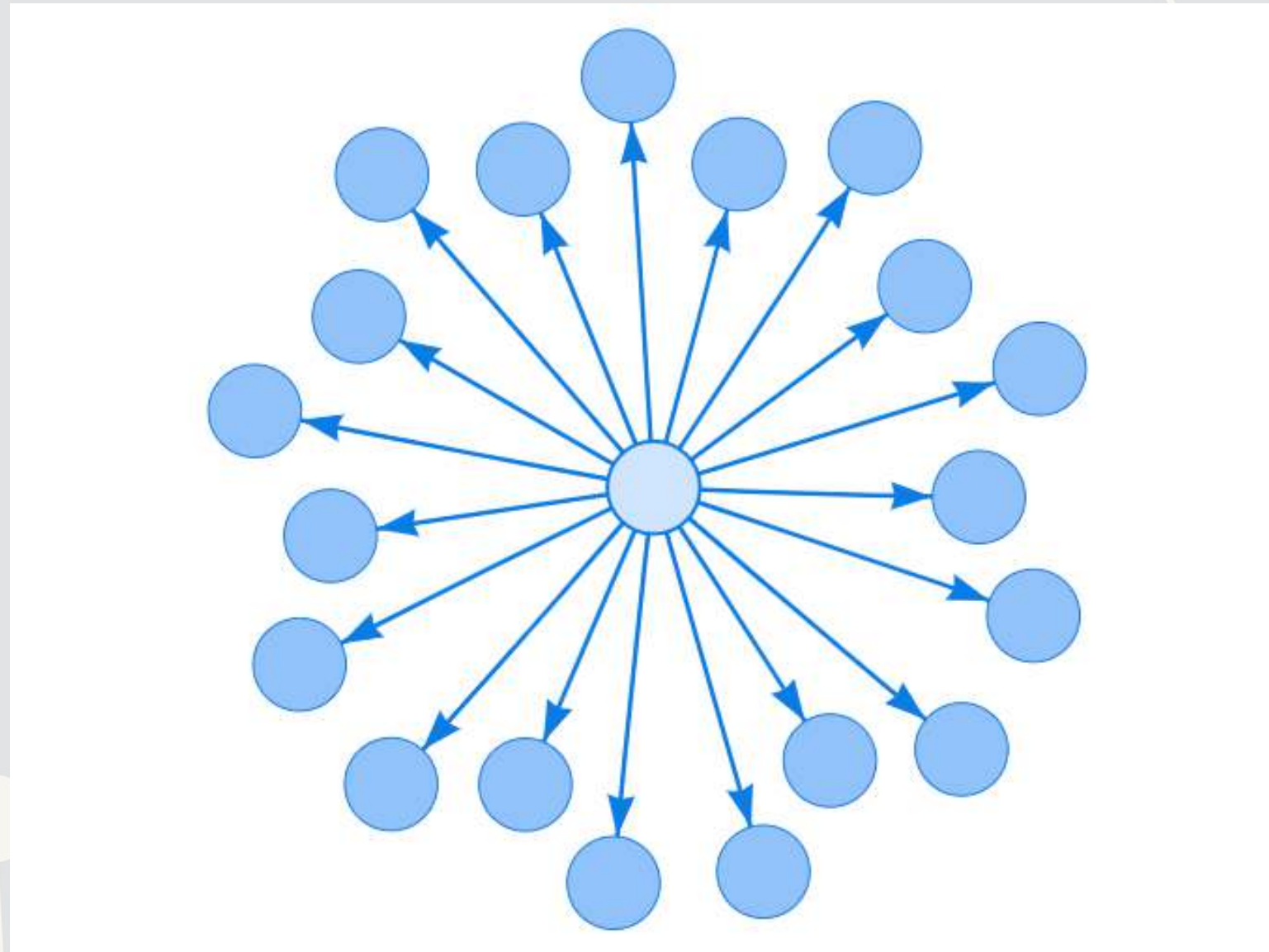
## 2. Managerial

- Provides information to internal users
- Used for budgeting, forecasting, strategy

## 3. Tax

- Technically a subset of financial accounting
- Used for determining tax liability

# Financial Accounting



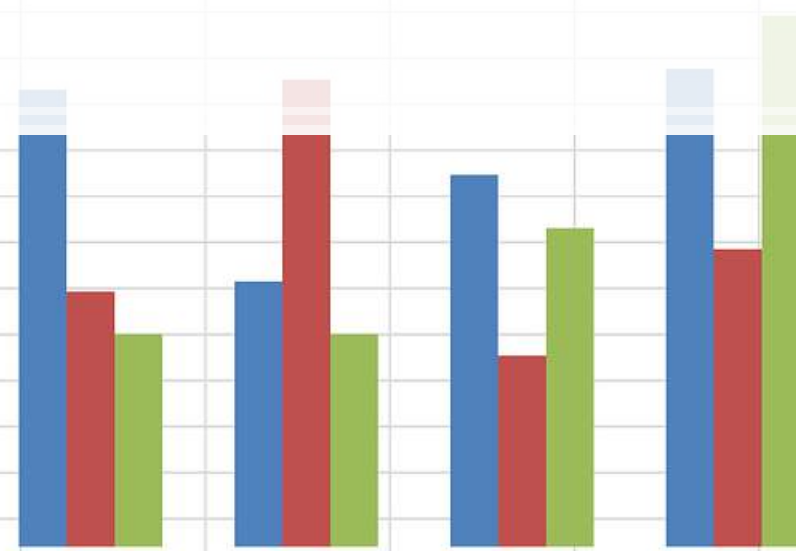
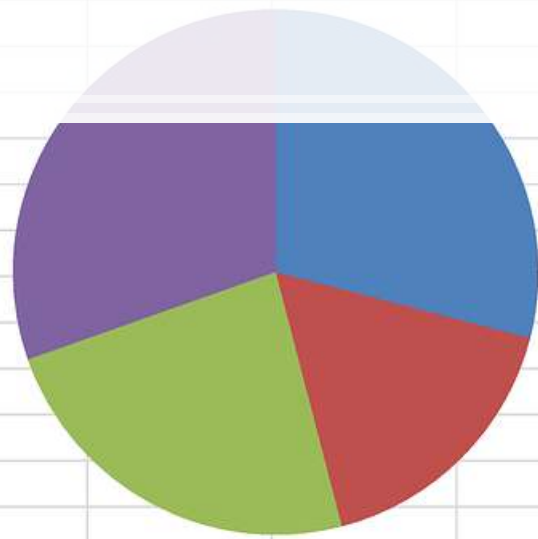
How companies communicate information publicly

# Audit

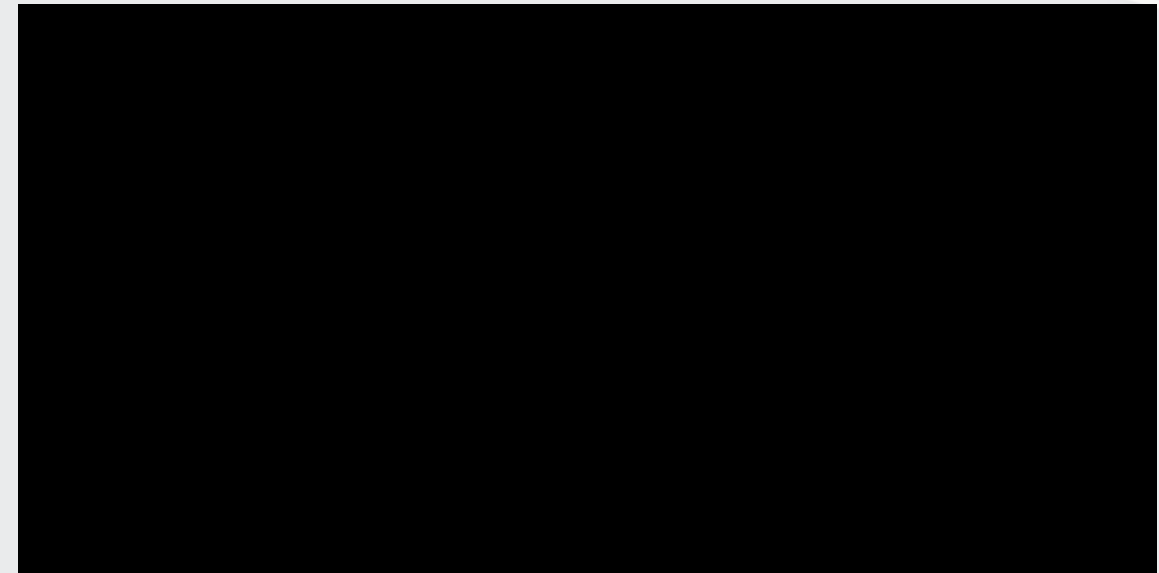
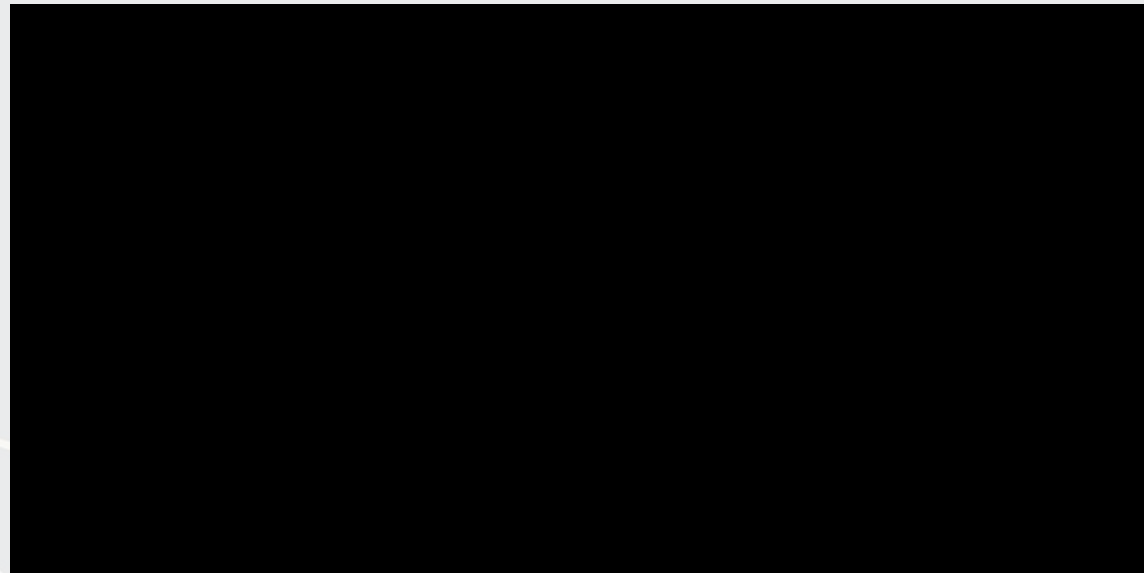
Looking for a needle – it may or may not be there

# Managerial Accounting

How companies generate and communicate information internally



# Tax accounting



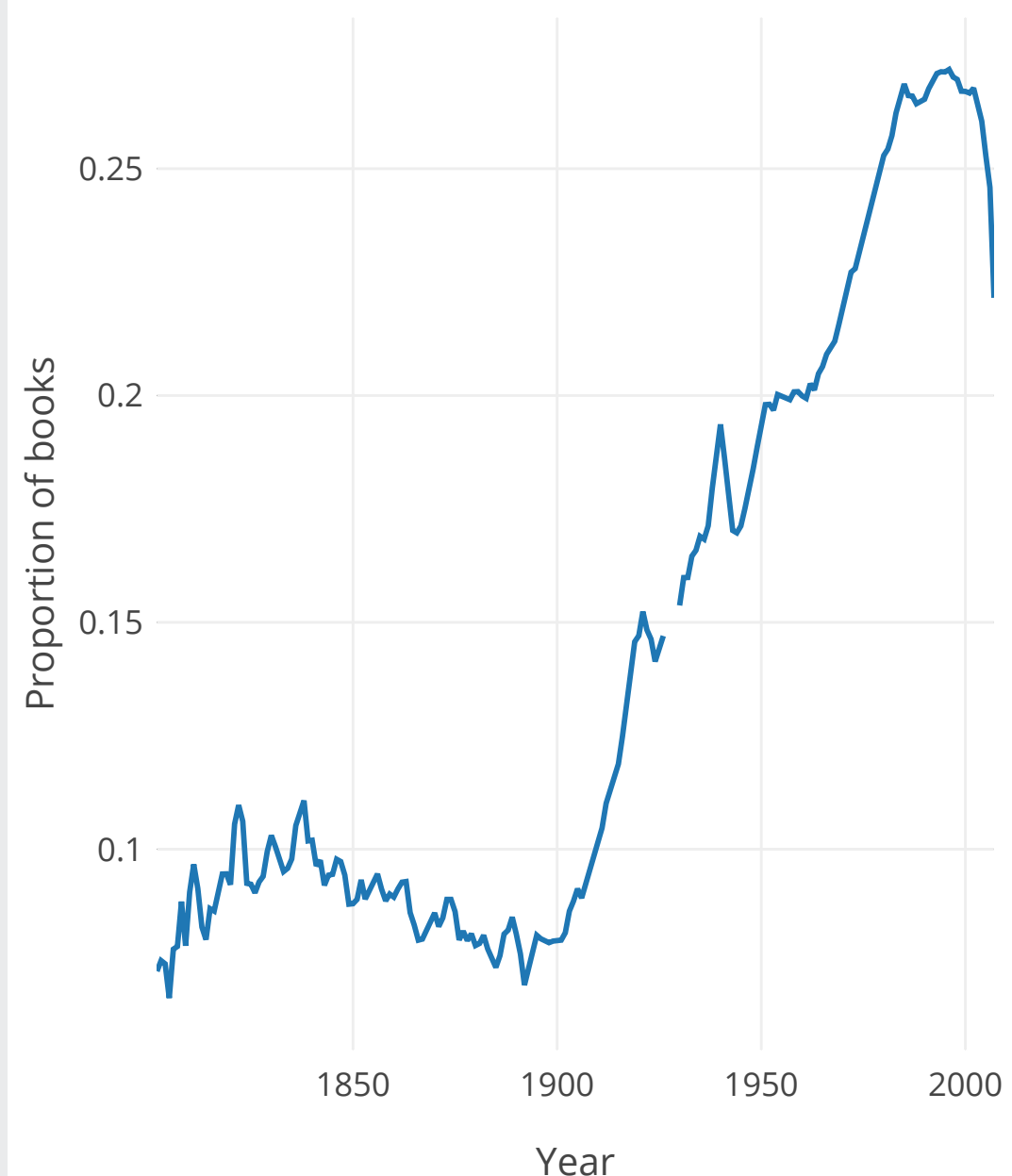
Pay money to save even more money

# Why should we care?

“Small-business owners tend to hate accounting because it’s boring. [...] The mistake they make is not thinking about how they can use certain numbers as tools to better manage where their business is headed tomorrow.”

- Basics of Accounting Are Vital to Survival for Entrepreneurs, NYTimes

Books mentioning accounting (Google Ngrams)



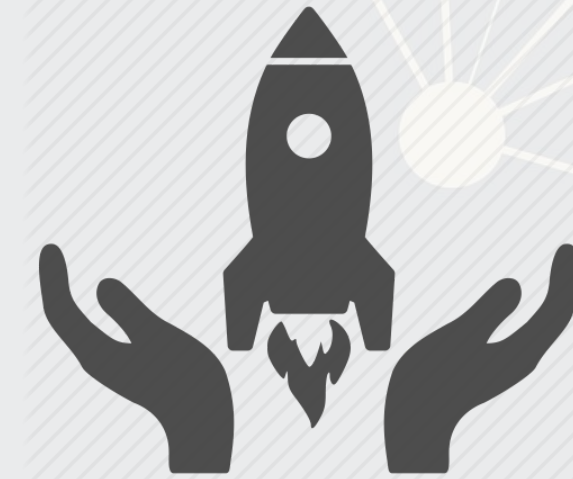
# Forms of business

## 1. Sole proprietorship

- *1 owner*, usually small service firms
- Not a legal entity
- Owner receives all profit and loss

## 2. Partnership

- *Multiple owners*, at least one is a General Partner while others are Limited Partners
- Not a legal entity
- Owners receive all profit and loss



**KPMG**

# Forms of business

## 3. Corporation

- Has a board of directors, CEO, CFO, COO, etc.
- One or more stock classes
  - From Initial Public Offering (IPO) or Secondary/Seasoned Equity Offering (SEO)
    - IPO: When a company first offers stock to investors
- Separate legal entity under corporate law
- Profit/loss goes to the company



# Forms of business

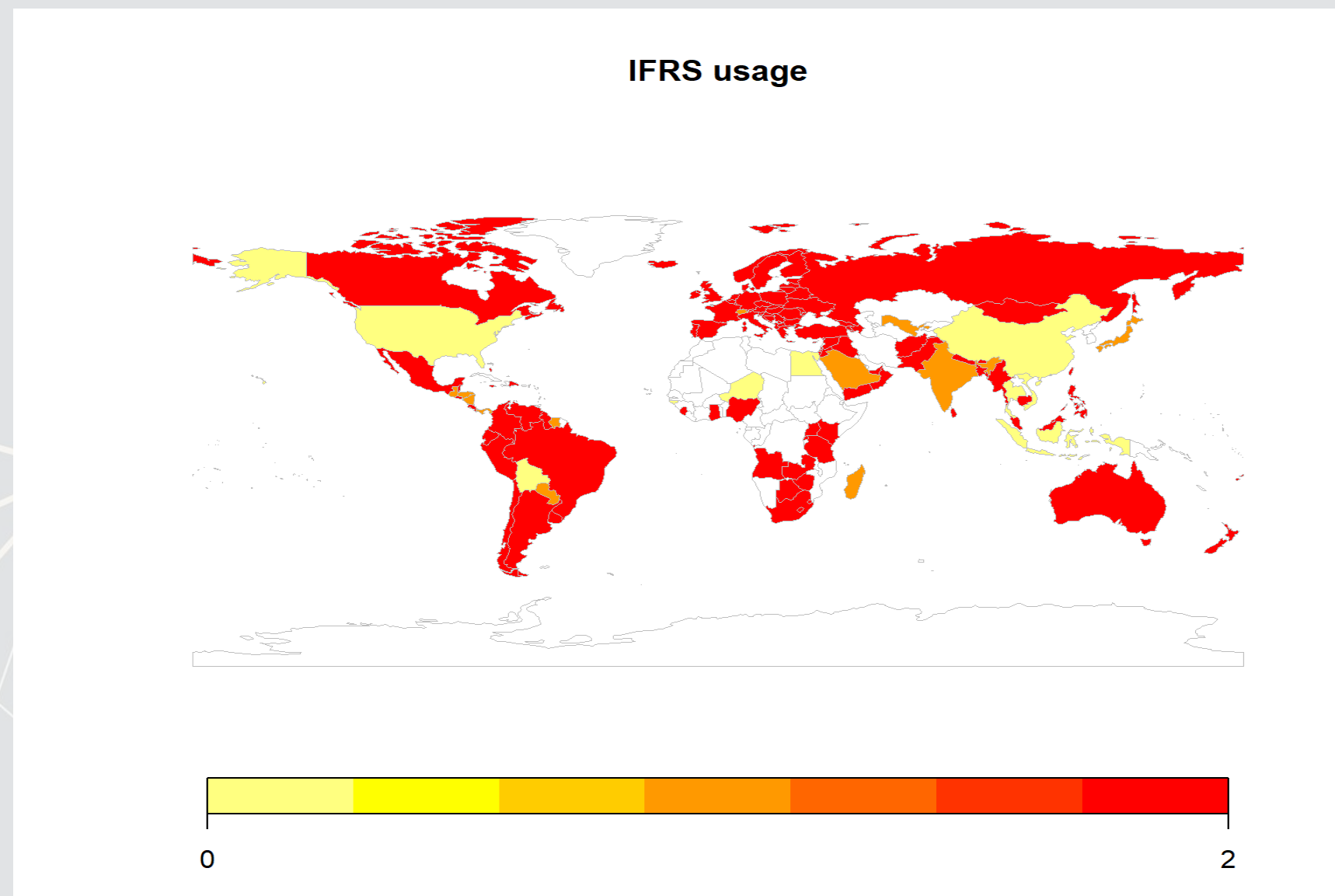
## Summary:

Characteristic	Proprietorship	Partnership	Corporation
Owner(s)	One owner (proprietor)	>1 owner, at least 1 general partner (GP), may have limited partners (LPs)	Shareholders, usually many, but could be as low as 1
Liability for debt	Proprietor is personally liable	GPs are personally liable, LPs are not liable	Shareholders are not personally liable
Tax status	Income tax passed through to owner	Income tax passed through to partners	Own legal entity, corporation taxed directly

# International Financial Reporting Standards

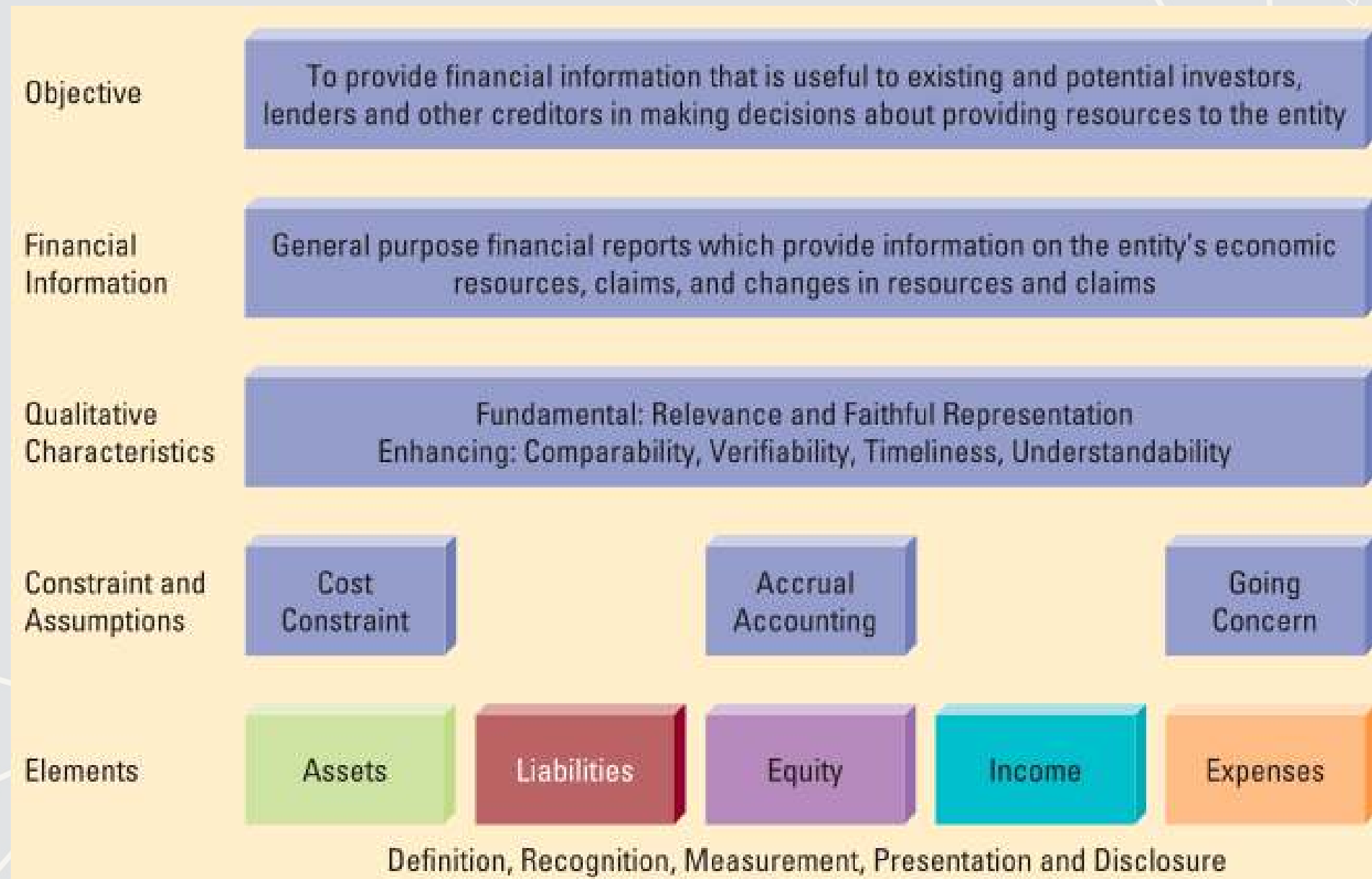
# IFRS (our accounting rules)

- IASB created IFRS in 2001
  - An attempt to standardize accounting rules across countries
  - Over 100 countries and **49,890 companies** using IFRS



0: not used; 1: optional; 2: mandatory

# IFRS conceptual framework



# IFRS conceptual framework

- Prescribes nature, function, and boundary of an accounting system
- Purpose: To provide financial information that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity

The conceptual framework lays a foundation for resolving big issues

# Financial Information

- Focused on general purpose financial statements prepared at least annually
  - Usually quarterly
  - Semiannually in the UK
- Economic resources: what you own
  - Inventory, buildings, patents, etc.
- Claims: claims on the company's assets
  - Claims by lenders and creditors (debt)
  - Claims by owners (shareholders)

# Relevance

- **Fundamental characteristic**
- Is the information material?
  - Material: Important enough to warrant sharing
  - Would not disclosing (or incorrectly disclosing) affect users' decisions?

The information is useful

# Faithful Representation

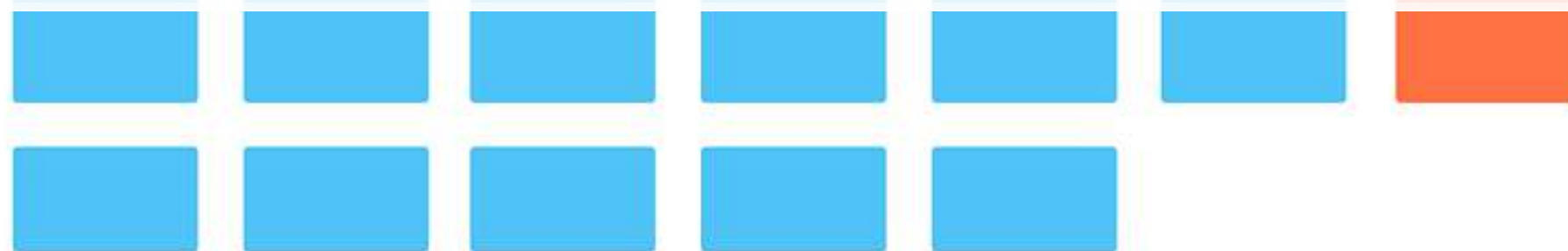
- **Fundamental characteristic**
- **Complete:** Includes all necessary information to understand economic phenomenon
- **Neutral:** No bias
- **Free from error:** no errors or omissions

Information is complete, neutral and free from error

# Comparability

- **Enhancing characteristic**
- Information by the firm can be compared across years
  - *Not across firms*
- If you change the way something is calculated, show the new and the old way

Compare over time for the same firm



# Verifiability

- Enhancing characteristic
- All accounting figures can be verified from a paper trail
  - Receipts
  - Records of counts
  - Calculations

Verifiability: Paper trail

# Timeliness

- Enhancing characteristic
- Takes time to prepare and verify information
- More timely is a tradeoff with other characteristics

Is the information useful when released?

# Understandability

- Enhancing characteristic
- Regardless of how useful the content is, it isn't useful unless users can understand it
- Baseline is a *reasonably educated* user
  - You after you finish this class

Can a *reasonably educated* user use it?

# Accrual Accounting

- **Assumption**
- The basis for our accounting system and many others
- Alternative is cash basis
  - Record when cash changes hands
- This will be the focus next week

Record when something happens, not when cash changes hands

# Going concern

- **Assumption**
- Entity will last long enough to use all assets and pay all liabilities

Assume the company isn't collapsing

# Cost constraint

## Costs

- Companies paying money to employees and auditors
- Theoretical societal loss from leaking of confidential information

## Benefits

- Gain from distribution of information
  - Leads to more informed investments
  - Better contracts
  - Better economy

Benefit of accounting to society outweighs its cost

# Review

## Fundamental Characteristics

Relevance

Faithful Representation

## Enhancing Characteristics

Comparability

Verifiability

Timeliness

Understandability

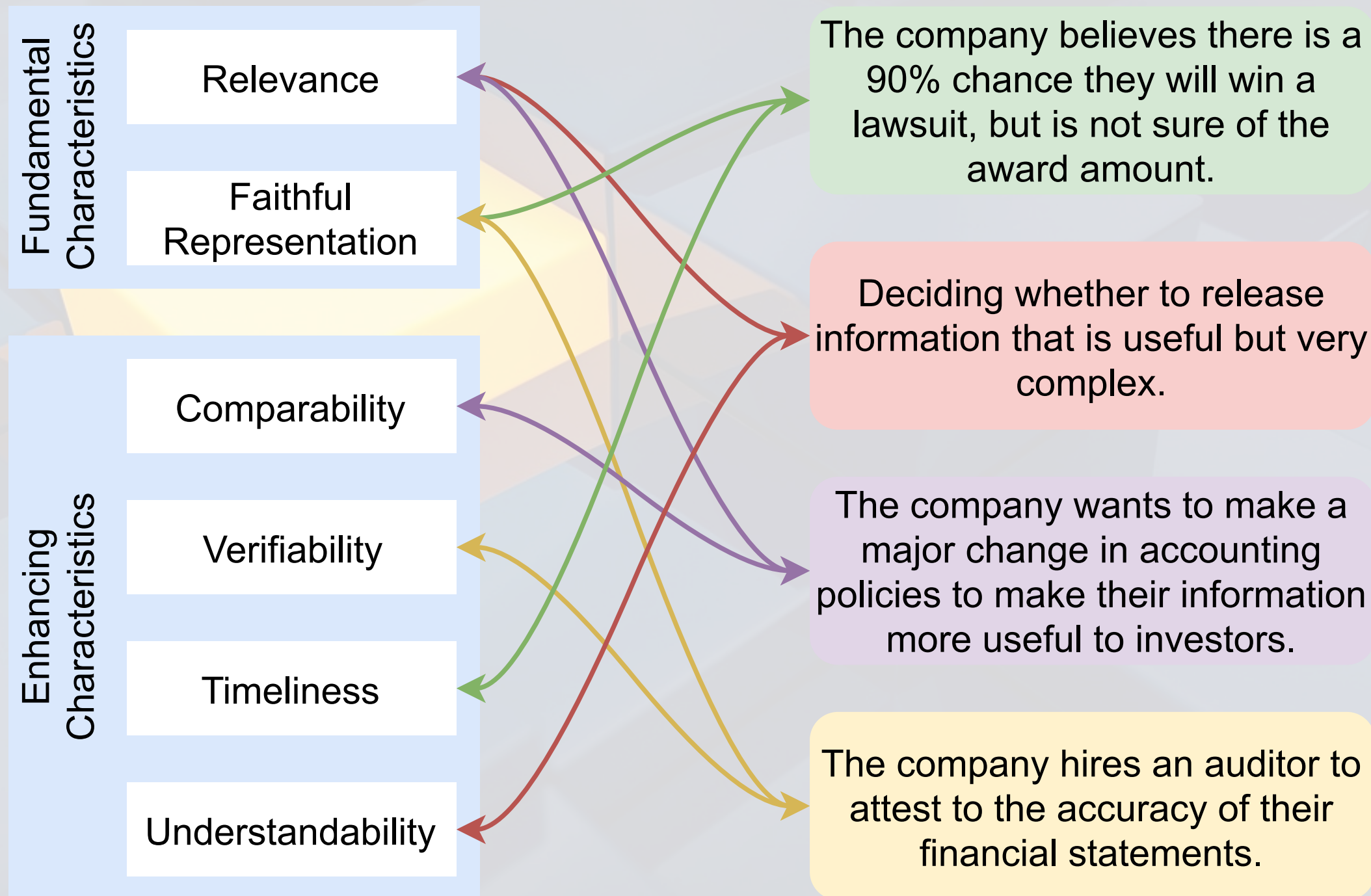
The company believes there is a 90% chance they will win a lawsuit, but is not sure of the award amount.

Deciding whether to release information that is useful but very complex.

The company wants to make a major change in accounting policies to make their information more useful to investors.

The company hires an auditor to attest to the accuracy of their financial statements.

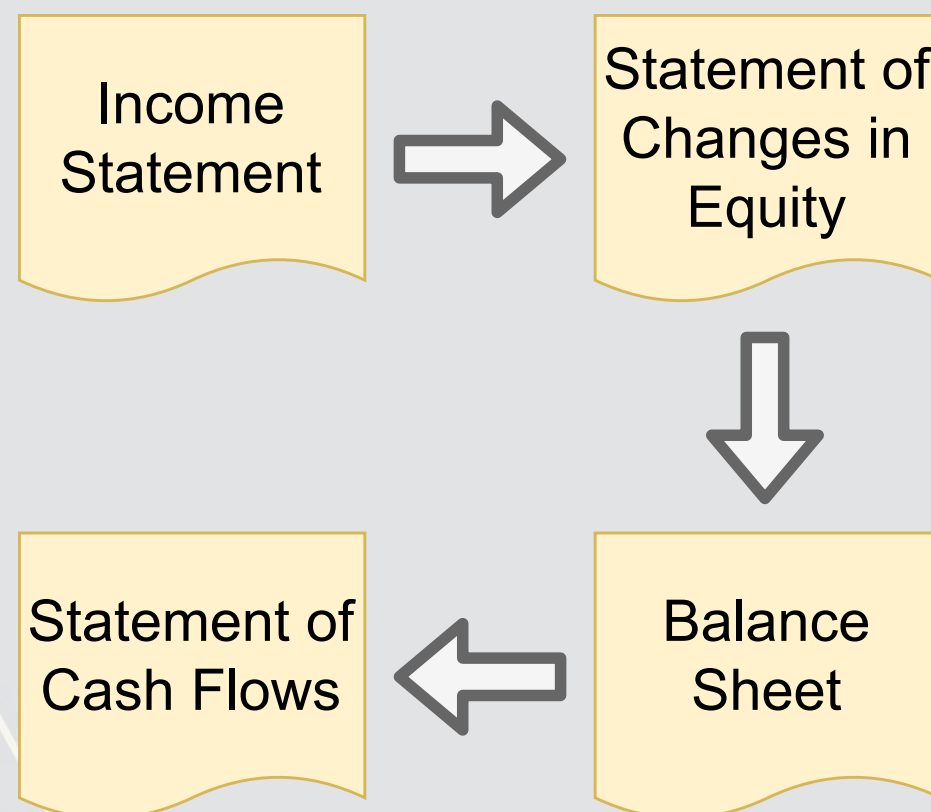
# Review



# Financial Statements

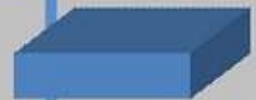
# Note

- We'll cover each of these at length later
- Covered in Session 3:
  - Income Statement
  - Changes in Equity
  - Balance Sheet
- Covered in Sessions 10 and 11:
  - Statement of Cash Flows



# Income Statement

- Part of the *Statement of Comprehensive Income*
  - We'll get to this later
- Shows net profit or loss for a **period**
  - Comprised of:
    - Revenues and gains
    - Expenses and losses



# Statement of Changes in Equity

- Shows transactions with owners
- Net income flows from the Income Statement to this Statement
- Includes outflows from dividends

# Balance Sheet

- More formally known as the *Statement of Financial Position*
- A snapshot at a point in time of a company's:
  1. Assets
  2. Liabilities
  3. Equity

# Statement of Cash Flows

- Measures cash receipts and payments
- Breaks cash activities into:
  1. Operating activities
  2. Investing activities
  3. Financing activities





# Examples

- Breathtalk 2018
- Samsung 2018
- DBS 2018

# Building blocks of accounting

# Building blocks

- Everything is classified as one of:
  1. Assets
  2. Liabilities
  3. [Shareholders'] Equity
- All elements of a transaction

# Assets

Economic resources controlled by an entity which are expected to produce future economic benefits to the entity.

- Cash, accounts receivable (A/R)
- Inventory, equipment
- Factories, machinery
  
- Coffee shop:
  - Cash
  - Inventory (coffee beans, food)
  - Fixed assets (building, espresso machine)

Debit = **Increase**

Credit = **Decrease**

# Liabilities

Present obligations of the entity which are expected to result in an outflow of economic benefits from the entity.

- Accounts payable
- Bills outstanding: Wages payable, utilities payable
- Debt
  
- Coffee shop:
  - Bank loan (maybe used to buy the building)
  - Outstanding utility bill
  - Bill from coffee supplier

Debit = **Decrease**

Credit = **Increase**

# Equity

The residual interest in the entity's assets after deducting the entity's liabilities and represents shareholder's residual claim to the entity's assets.

- Share capital: Amount paid in by owners
- Retained earnings: net profit not released as dividends
- Revenue: Sales, income
- Expenses: costs of doing business
  
- Coffee shop:
  - The money put in by the founder
  - Revenue from selling coffee and expenses from paid wages

Debit = **Decrease**

Credit = **Increase**

# In class activity

## Instructions:

1. Get into a group of 3-4
2. Pick any company
3. Determine 3 each of:
  - Assets
  - Liabilities
  - Equity

## Fill out:

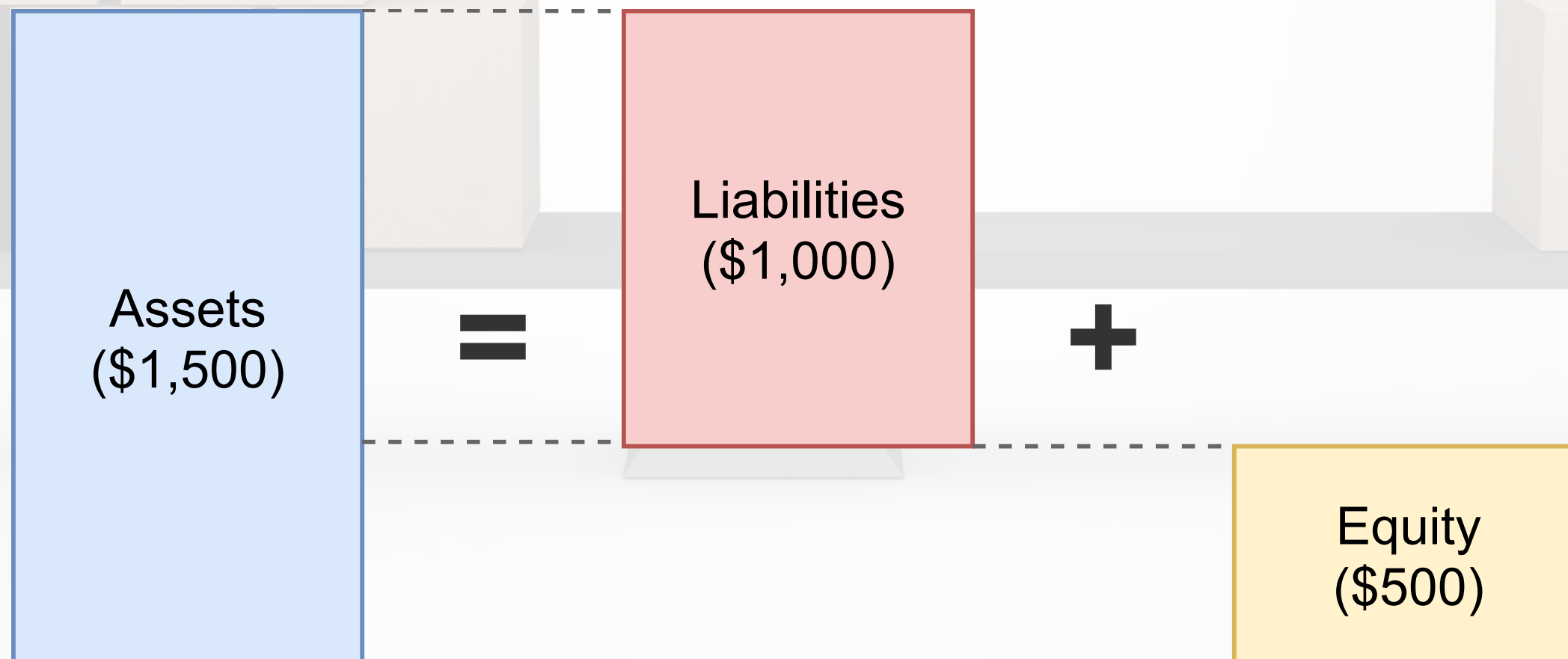
- Company:
- Assets:
  - 1.
  - 2.
  - 3.
- Liabilities:
  - 1.
  - 2.
  - 3.
- Shareholders' Equity:
  - 1.
  - 2.
  - 3.

# The Accounting Equation

# Base equation

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

- Intuition:
  - All the assets must be owned by someone
  - Liabilities and Equity represent all the claims on assets
  - Assets must equal liabilities plus equity



# Changing assets

## Increase

- Receiving assets
- Creating assets

## Decrease

- Selling assets
- Using assets

# Changing liabilities

## Increase

- Receiving a debt
  - Payables: like bills
  - Loans
- Recognizing something you owe

## Decrease

- Paying off a debt

# Changing equity: Income and expenses

## Increase

- Income increases equity
  - Revenues: Income from ordinary operations
  - Gains: Income from other activities

## Decrease

- Expenses decrease equity
  - Expenses: Expenses from ordinary operations
  - Losses: Expenses from other activities

Effect on equity	Ordinary activity	Not ordinary
Increase equity	Revenue	Gain
Decrease equity	Expense	Loss

# Changing equity: other accounts

## Increase

- Share capital
  - Money paid in by owners
  - For corporation: money paid in at IPO or SEO
- Retained earnings
  - Economic contribution of the firm (lifetime)

## Decrease

- Dividends
  - Paid to shareholders
  - Not an expense!

Retained earnings:

$$\sum_{\text{all years}} (\textit{Revenues} - \textit{Expenses} - \textit{Dividends})$$

## Expanded equation:

$$\textit{Assets} = \textit{Liabilities} + \textit{Equity}$$

$$\begin{aligned} \textit{Equity} = & \textit{Shares} + \textit{Retained Earnings} - \textit{Dividends} \\ & + \textit{Revenues} - \textit{Expenses} \end{aligned}$$



# Tips on the accounting equation

- Raising capital: assets ↑ (cash), equity ↑ (share capital)
- Paying an expense early: assets ↑ (prepaid expense), assets ↓ (cash)  
[no net effect]
- Paying prerecorded wages: assets ↓ (cash), liability ↓ (salaries payable)
- Revenue: asset ↑ (cash), revenue ↑
  - With inventory, add: asset ↓ (inventory), expense ↑ (cost of goods sold)
- Paying debt: assets ↓ (cash), liabilities ↓
  - No change in equity unless there's an interest payment

# Group problems

- How would the following transactions affect the expanded accounting equation for a small coffee shop?
  1. Sell a latte to a customer.
  2. Pay the utility bill.
  3. Buy lunch for the supplier's representative.
  4. Take a business trip to Guatemala to visit coffee farms. Paid by cash.
  5. Take a vacation to Guatemala (not for business).
  6. Bought a new coffee maker on credit.

# Answers

1. Assets ↑ (cash), Equity ↑ (revenue)
  - Also: Assets ↓ (inventory), Equity ↓ (expense)
2. Assets ↓ (cash), Liabilities ↓ (unpaid utilities)
  - OR Assets ↓ (cash), Expenses ↑ (Utilities expense)
3. Assets ↓ (cash), Expenses ↑ (misc expense)
4. Assets ↓ (cash), Expenses ↑ (misc expense)
5. None
6. Assets ↑ (equipment), Liabilities ↑ (A/P)

# In class work

# Harder group problem

1. Pick a company
2. Come up with 3 transactions the company might have
3. How would each transaction affect the company's accounting equation, and why?

- Company:
- Transactions:
  1. A ↑/↓, L ↑/↓, E ↑/↓
    - Explanation:
  2. A ↑/↓, L ↑/↓, E ↑/↓
    - Explanation:
  3. A ↑/↓, L ↑/↓, E ↑/↓
    - Explanation:

- Post on the eLearn discussion board by the end of the day
  - Accounting Equation Exercise
  - *Include all group members' names*

# Wrap up

- For next week:
  1. Recap the reading for this week
  2. Read the pages for next week
    - Bookkeeping (Chapter 2)
    - Accrual accounting and adjusting entries (Chapter 3)
  3. Practice on eLearn
    - Automatic feedback provided
    - Make sure you have the accounts and accounting equation down!
      - You'll need to know these next week