

Cihan University / Sulaymaniyah
Faculty of Administration and Financial
Sciences / Business Administration Department



Intermediate Accounting (I)

Second Stage

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Definition of Accounting

- Accounting is a systematic process of identifying, recording, measuring, classifying, verifying, summarizing, interpreting and communicating financial information.
- Accounting called the language of a business communicates accounting information to help various types of users.

Conceptual Framework of Accounting

It is necessary for any science to have an organized framework of rules and foundations that govern and organize the work of this science so that it includes a set of principles and assumptions.

The conceptual framework is comprised of three levels:

- **First Level** = Basic objectives
- **Second Level** = Qualitative characteristics and basic elements
- **Third Level** = Recognition and measurement concept

Recognition, Measurement, and Disclosure Concepts

ASSUMPTIONS

1. Economic entity
2. Going concern
3. Monetary unit
4. Periodicity

PRINCIPLES

1. Measurement
2. Revenue recognition
3. Expense recognition
4. Full disclosure

CONSTRAINTS

1. Cost
2. Industry practice

Third level:
The "how"—
implementation

QUALITATIVE CHARACTERISTICS

1. Fundamental qualities
 - A. Relevance
 - (1) Predictive value
 - (2) Confirmatory value
 - (3) Materiality
 - B. Faithful representation
 - (1) Completeness
 - (2) Neutrality
 - (3) Free from error
2. Enhancing qualities
 - (1) Comparability
 - (2) Verifiability
 - (3) Timeliness
 - (4) Understandability

ELEMENTS

1. Assets
2. Liabilities
3. Equity
4. Investment by owners
5. Distribution to owners
6. Comprehensive income
7. Revenues
8. Expenses
9. Gains
10. Losses

Second level: Bridge
between levels 1 and 3

OBJECTIVE

Provide information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in their capacity as capital providers.

First level: The "why"—
purpose of accounting

First Level: Objective of Financial Reporting

- To provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions about providing resources to the entity.
- The purpose of accounting is to accumulate and report on financial information about the performance, financial position, and cash flows of a business. This information is then used to reach decisions about how to manage the business, or invest in it, or lend money to it.

Second Level: Fundamental Concepts

A) Qualitative characteristics of accounting information:

- **Fundamental (Primary) Qualitative characteristics**
 - Relevance
 - Faithful representation
- **Enhancing (Secondary) Qualitative Characteristics**
 - Timeliness
 - Understandability
 - Comparability
 - Verifiability

B) Basic elements of financial statements:

- Assets
- Liabilities
- Equity
- Revenue
- Expenses
- Gains
- Losses

Third Level: Recognition and Measurement

A) Basic Assumptions:

- Economic entity
- Periodicity
- Monetary unit
- Going Concern

B) Basic Principles:

- Revenue recognition
- Expense recognition
- Full disclosure
- Measurement

C) Cost Constraint

Accounting Branches (Types)

Accounting can be divided into several fields including:

- **Financial Accounting** is the process of preparing financial statements that companies' use to show their financial performance and position to users outside the company, including investors, creditors, suppliers, and customers.
- **Managerial Accounting** is the process of identification, measurement, analysis, interpretation and communication of financial information, which is used by management to plan, evaluate, and control within an organization.
- **Cost Accounting** is the process of classifying and recording of all the costs incurred in a business in a way that can be used to improve its management.

- **Tax Accounting** is a structure of accounting methods focused on taxes rather than the appearance of public financial statements.
- **Governmental Accounting** is the process of recording and the management of all financial transactions incurred by the government which includes its income and expenditures.
- **Auditing** is an unbiased examination and evaluation of the financial statements of an organization. It can be done internally (by employees of the organization) or externally (by an outside firm).

Users of Accounting Information

Users of accounting information are divided into two main groups which are:

- **Internal Users**
- **External users**

Accounting information helps users to make better financial decisions. Users of financial information may be both internal and external to the organization.

Internal Users

- **Internal Users** are users who are directly involved in the planning, organizing, and running the business. They use the information to help improve the performance and profitability of the organization.

Internal Users are:

- **Managers**
- **Employees**
- **Owners**

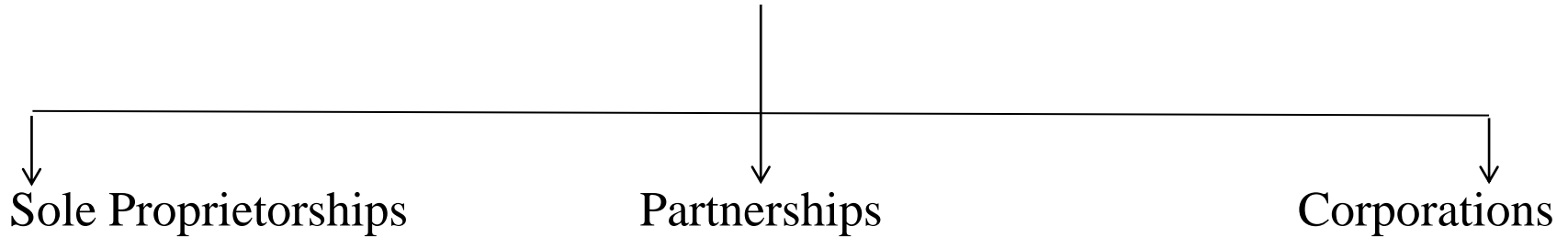
External Users

- **External users** are users who are not directly involved in the running of an organization, have limited access to a firm's accounting information, depend on reliable, relevant and comparable accounting information to make important decisions.

External Users are:

- **Investors**
- **Creditors**
- **Suppliers**
- **Customers**

Different Types of Business Organizations



Proprietorship or Partnership
<ul style="list-style-type: none">● Owner's Capital● Owner's Drawing

Corporation
<ul style="list-style-type: none">● Common Stock● Paid-in Capital● Dividends● Retained Earnings

Financial Statements

- Financial statements are formal and structured reports that provide a comprehensive overview of a company's financial performance, financial position, and cash flows during a specific period of time.

There are four main types of financial statements, which are as follows:

- **Income Statement (Profit and Loss Statement).**
- **Balance Sheet (Statement of Financial Position).**
- **Statement of Retained Earnings.**
- **Cash Flow Statement.**

Income Statement

The Income Statement is one of a company's financial statements that shows their profit and loss over a period of time.

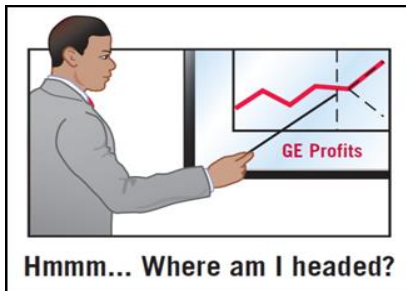
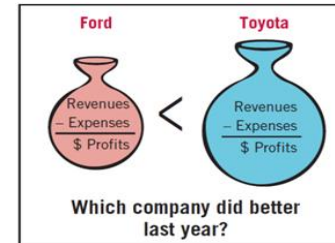
Elements of the Income Statement:

- **Revenue:** What the business has earned over a period (e.g. sales revenue, dividend, interest revenue, rent revenue etc.)
- **Expense:** The cost incurred by the business over a period (e.g. salaries and wages, depreciation, rental charges, cost of goods sold etc.)
- **Gains:** Increases in equity (net assets) from peripheral or incidental transactions.
- **Losses:** Decreases in equity (net assets) from peripheral or incidental transactions.

Income Statement

Usefulness of Income Statement:

- Evaluate past performance.



Predicting future performance.

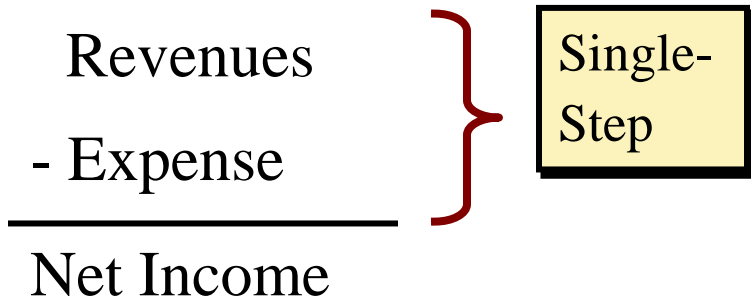
- Help assess the risk or uncertainty of achieving future cash flows.

IBM	Recurring?
Income for Year Ended 12/31/14	
Revenues	
- Operating expenses	
Operating income	Yes
± Unusual or extraordinary items	No
<u>\$ Net Income</u>	?

Recurring items are more certain in the future.

Format of the Income Statement

Single-Step Income Statements



CABRERA COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2014

Revenues

Net sales	\$2,972,413
Dividend revenue	98,500
Rent revenue	72,910
Total revenues	<u>3,143,823</u>

Expenses

Cost of goods sold	1,982,541
Selling expenses	453,028
Administrative expenses	350,771
Interest expense	126,060
Income tax expense	66,934
Total expenses	<u>2,979,334</u>

Net income

\$ 164,489

Earnings per common share

\$1.74

Format of the Income Statement

Multiple-Step

CABRERA COMPANY

Income Statement

For The Year Ended December 31, 2014

1. Operating Section

2. Non-operating Section

3. Income tax

Sales			
Sales revenue			\$3,053,081
Less: Sales discounts	\$ 24,241		
Sales returns and allowances	56,427		80,668
Net sales revenue			2,972,413
Cost of goods sold			
			1,982,541
Gross profit			989,872
Operating Expenses			
Selling expenses			
Sales salaries and commissions	\$202,644		
Sales office salaries	59,200		
Travel and entertainment	48,940		
Advertising expense	38,315		
Freight and transportation-out	41,209		
Shipping supplies and expense	24,712		
Postage and stationery	16,788		
Telephone and Internet expense	12,215		
Depreciation of sales equipment	9,005	453,028	
Administrative expenses			
Officers' salaries	186,000		
Office salaries	61,200		
Legal and professional services	23,721		
Utilities expense	23,275		
Insurance expense	17,029		
Depreciation of building	18,059		
Depreciation of office equipment	16,000		
Stationery, supplies, and postage	2,875		
Miscellaneous office expenses	2,612	350,771	803,799
Income from operations			186,073
Other Revenues and Gains			
Dividend revenue	98,500		
Rent revenue	72,910		171,410
			357,483
Other Expenses and Losses			
Interest on bonds and notes			126,060
Income before income tax			231,423
Income tax			66,934
Net income for the year			\$ 164,489
Earnings per common share			\$1.74

Equations of Income Statement:

- $\text{Gross Profit} = \text{Net Sales} - \text{Cost of goods sold}$
- $\text{Net Sales} = \text{Sales} - \text{Sales returns and allowances} - \text{Sales discount}$
- $\text{Cost of goods sold} = \text{Beginning inventory} + \text{Cost of purchases} - \text{Ending inventory}$
- $\text{Cost of purchases} = \text{Net purchases} + \text{Direct purchase cost}$
- $\text{Net purchases} = \text{Purchases} - \text{Purchase returns and allowances} - \text{purchase discount}$
- $\text{Sales} = \text{Cost of goods sold} + \text{Gross profit}$
- $\text{Net Profit} = \text{Gross Profit} - \text{operating expenses} + \text{other revenues and gains} - \text{other expenses and losses} - \text{Income tax}$
- $\text{Operating expenses} = \text{Selling expenses} + \text{Administrative expenses}$

Practical Examples

Ex1: The following information has been extracted from the books of Kaya Company, for the year ended 31 Dec,2015:

Opening inventory	5200	Closing inventory	6000
Purchases	12900	Sales	18000
Sales returns	400	Purchase returns	200
Sales discount	200	Purchase discount	100
Administrative expense	40	Selling expense	30
Other revenues	750	Other expenses	210
Income tax	667	-	-

Requirement: From the information above compute the following:

(a) Find cost of goods sold, (b) Prepare income statement for the company.

Ex 2: Starr Co. had sales revenue of \$540,000 in 2014. Other items recorded during the year were:

Cost of goods sold \$330,000, Salaries and wages expense 120,000, Income tax expense 25,000, Other operating expenses 10,000.

Requirement: Prepare a single-step income statement for Starr Co. for 2014.

Ex 3: Brisky Corporation had net sales of \$2,400,000 and interest revenue of \$31,000 during 2014. Expenses for 2014 were cost of goods sold \$1,450,000; administrative expenses \$212,000; selling expenses \$280,000; and interest expense \$45,000. Brisky's tax rate is 30%.

Requirement:

1) Prepare a condensed multiple-step income statement for Brisky Corporation.

Ex 4: Presented below are certain account balances of Majid Com.:

Ending inventory 48000, Rental revenues 6500, Interest expenses 12700, Purchases allowances 10500, Freight-in 10100, Dividends revenue 71000, Administrative expenses 82500, Sales returns 5800, Sales discounts 21300, Selling expenses 99400, Sales 390000, Income tax 31000, Beginning inventory 45300, Purchases 190000, Purchases discounts 17300.

Requirements:

- a) From the foregoing information compute: net sales, cost of goods sold.
- b) Prepare Single -Step income statement.

Ex 5: The following information has been extracted from the book of Mr. Ahmed, a shop owner for the year ended 31/12/2010:

- On 1/1 Mr. Ahmed had \$15000 worth of inventory on the shelves of his shop.
- During the year he purchases \$210000 worth of inventory to sell in his shop.
- At the end of the year 31/12 he counted and valued the inventory on his shelves. It was valued at \$20000.
- During the year he had sales of 290000.
- **Additional information:**
 - Rent expense \$15000
 - Heat and light expense \$12000
 - Wages and salaries expense \$25000
 - Selling and advertising expense \$10000

Requirement: a) Find Cost of goods sold. b) Prepare single-step income statement.

Ex 6: The following 2012 information related to Waleed Company:

Administrative expense: Officers' salaries \$4,900,

Depreciation of office furniture and equipment 3,960

Cost of goods sold 63,570, Rent revenue 17,230, Sales revenue 96,500, Income tax expense 7,580, Interest expense 1,860

Selling expense: Transportation-out 2,690, Sales commissions 7,980, Depreciation of sales equipment 6,480

Requirements:

(a) Prepare an income statement for the year 2012 using the multiple-step form.

(b) Prepare an income statement for the year 2012 using the single-step form.

Statement of Retained Earnings

- Statement of retained earnings is a financial statement that provides a summary of a company's retained earnings over a specific period of time, typically a fiscal year.

Format Retained Earnings Statement

UPTOWN CABINET CORP.
STATEMENT OF RETAINED EARNINGS
FOR THE YEAR ENDED DECEMBER 31, 2012

Retained earnings, January 1	\$16,200
Add: Net income	<u>12,200</u>
	28,400
Less: Dividends	<u>2,000</u>
Retained earnings, December 31	<u><u>\$26,400</u></u>

Practical Examples

Ex1: Portman Corporation has retained earnings of \$675,000 at January 1, 2014. Net income during 2014 was \$1,400,000, and cash dividends declared and paid during 2014 totaled \$75,000.

Required: Prepare a retained earnings statement for the year ended December 31, 2014.

Ex 2: The following balances were taken from the books of the Hani corp. on December 31, 2008:

Interest revenues 86000, Sales 1380000, Sales returns and allowances 150000, Sales discounts 45000, Inventory January 1, 2008 246000, Purchases 790000, Inventory December 31, 2008 332000, Purchases returns and allowances 125000, Purchases discounts 59000, Selling expenses 194000, Administrative and general expenses 97000, Interest expenses 60000, Dividends declared 140000, Retained earnings January 1, 2008 21000 . Assume the tax rate on all items is 34%.

Requirements:

- a) Prepare multiple-step income statement for the year ended in 31/12/2008.
- b) Prepare retained earnings statement for the year ended in 31/12/2008; 50,000 shares of common stock were outstanding during the year.

Ex 3: Presented below is information related to Tara corp., for the year 2006:

Net sales 1300000, Cost of goods sold 800000, Selling expenses 65000, Administrative expenses 48000, Dividend revenues 20000, Interest revenues 7000, Dividends declared 245000, Retained earnings December 31, 2005 400000, Income tax rate 34% on all items .

Requirements:

- a) Prepare single-step income statement for the year ended in 31/12/2006.
- b) Prepare retained earnings statement for the year ended in 31/12/2006; assume that 90000 shares of common stock were outstanding during the year.

Balance Sheet

- A balance sheet is a financial statement that reports a company's assets, liabilities and shareholders' equity at a specific point in time.
- It is also known as financial position statement that provides a snapshot of what a company owns and owes, as well as the amount invested by shareholders. It is comprised of the following three elements:
 - **Assets:** is any resource owned or controlled by a business (e.g. cash, inventory, plant and machinery, etc.)
 - **Liabilities:** Something a business owes to someone (e.g. creditors, bank loans, etc.)
 - **Equity:** What the business owes to its owners. This represents the amount of capital that remains in the business after its assets are used to pay off its outstanding liabilities. Equity therefore represents the difference between the assets and liabilities.

Classification of Assets, Liabilities and Equity

Assets can be grouped into two major classes:

- **Tangible assets:** tangible assets are typically physical assets or property owned by a business and contain various subclasses, including:
 1. **Current assets:** Current assets are cash and others that are expected to be converted to cash or consumed either in a year or in the operating cycle. There are 5 major items included into current assets:
 - Cash and cash equivalents
 - Short-term investments
 - Receivables
 - Inventory
 - Prepaid expense
 2. **Fixed assets (Non-current assets):** these are purchased for continued and long-term use to earn profit in a business. This group includes **land, buildings, machinery, furniture, tools, equipment's.**
- **Intangible assets:** an intangible asset is a resource controlled by an entity with no physical substance such as **goodwill, copyrights, franchises, and trademarks.**

Classification of Assets, Liabilities and Equity

Liabilities can be grouped into two types:

- 1. Current liabilities:** company's obligations or debts that are to be paid within one year are called short-term liabilities or current liabilities. E.g. accounts payable, bills payable, income tax payable, etc.
 - 2. Non-current liabilities or Long-term liabilities:** company's obligations or debts that are to be paid after one or more years. E.g. deferred tax liabilities, etc.
- **Owners equity or (Capital)** is what the owners invest in the business.
 - The statement of financial position is based on a formula called the accounting equation which states that:
$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

Practical Examples

Ex 1: The following information has been extracted from the books of Pioneer Advertising Agency for the year ended Dec,31,2016, prepare Balance sheet for the company.

Cash	80,000	Accounts Receivable	74,000
Equipment	50,000	Allowance for doubtful accounts	1,600
Supplies	10,000	Interest payable	500
Prepaid insurance	5,500	Accounts Payable	25,000
Accumulated depreciation - Equipment	400	Salaries and wages payable	14,000
Note payable	50,000	Common stock	100,000
Retained earnings	28,000	-	-

Ex 2: The following information has been extracted from the books of Kelly Corporation at December 31, 2014.

Particulars	Debit	Credit
Cash	6,850	
Supplies	1,200	
Prepaid insurance	1,000	
Equipment	48,000	
Accumulated depreciation- Equipment		4,000
Trademarks	950	
Account payable		10,000
Salaries and wages payable		500
Unearned service revenue		2,000
Bonds Payable (due 2021)		9,000
Common stock		30,000
Retained earnings		2,500

Requirement: Prepare a classified balance sheet as of December 31, 2014

Ex 3: The following Information were taken from Sara Co. on Dec,31,2020: (all in \$)

Requirement: Prepare income statement and balance sheet for the year ended Dec,31,2020.

Account payable	1600	Telephone	650
Purchase return	2500	Sales	80000
Account receivable	1500	Capital	10000
Rent	4600	Salaries	9650
Office expense	1000	Bank	9500
Short-term loan	2500	Building	6000
Light and Heat	1700	purchases	62000

Note: There was no opening inventory but, the closing inventory was valued at \$4500

Ex 4: Presented below is the partial trial balance of Janat Corporation at December 31, 2016:

Particulars	Debit	Credit
Cash	277,000	
Marketable securities	153,000	
Long - term investments in bond	546,000	
Short - term notes payable		90,000
Accounts payable		475,000
Land	260,000	
Buildings	1,040,000	
Accrued interest on notes payable		232,000
Account receivable	435,000	
Accumulated depreciation – building		152,000
Prepaid expenses	25,000	
Inventories	597,000	

Bond payable due after 5 year		900,000
Machinery and equipment	600,000	
Mortgages		1,100,000
Accumulated depreciation-equipment		40,000
Goodwill	355,000	
Common stock (5.00 par)		1,000,000
Supplies	191,000	
Retained earnings		410,000
Additional paid in capital		80,000

Requirement: Prepare a balance sheet at December 31, 2016.

Ex 5: Presented below is the trial balance for Brakat proprietor:

Particulars	Debit	Credit
Cash	13,600	
Account Receivable	64,800	
Allowance for doubtful accounts		2,000
Inventory, January,1	74,000	
Land	40,000	
Building	90,000	
Accumulated depreciation of building		14,400
Furniture	22,000	
Accumulated depreciation of furniture		6,600
Prepaid insurance	7,800	
Account Payable		74,200
Notes payable		30,000
Capital		100,000
Retained earnings, January, 1		24,730

Sales		720,000
Sales returns and allowances	2,800	
Purchases	540,000	
Purchase returns and allowances		9,500
Transportation- in	14,800	
Sales salaries	54,000	
Advertising expense	9,400	
Office salaries	31,000	
Office telephone and telex expense	16,800	
Miscellaneous selling expense	2,000	
Purchase discount		9,600
Sales discount	5,900	
Interest expense	2,130	
Total	991,030	991,030

Requirement: Prepare an income statement, retained earning and, a balance sheet. Merchandise inventory on hand December 31 was 76000.