Case Study #1 **BAF3M - Accounting** **Feb 8, 2012**

This activity will introduce two (2) concepts important to the understanding of accounting. The first concept is Generally Accepted Accounting Principles (GAAPS) which are a set of accounting rules. The second concept is how businesses are owned. The type of business ownership determines how the accounting rules will be applied.

Overall Expectations:
FAV.01 describe the discipline of accounting and its importance for business;
FAV.02 describe the differences among the various forms of business organization.

Specific Expectations:
FA1.04 identify the Generally Accepted Accounting Principles (GAAP) and explain their importance;
FA2.01 describe the characteristics of different forms of business organization, including sole proprietorship, partnership, and corporation;
FA2.02 describe the advantages and disadvantages of different forms of business organization, including sole proprietorship, partnership, and corporation.

Scenarioooo:

“I want to show as little profit as possible so my taxes are not as high” said Al, the owner of Big Al’s Audio and Video. He continued speaking to his accountant, “We should count the money when we get it not when we make the sale”. Al’s accountant looked frustrated. Al’s Audio and Video was located next to Meadowvale High School, and the store sells digital cameras, cell phones and mp3 players to primarily high school students. Big Al was famous for the “NOW 360” sale. Students buying now would not have to pay the bill for 360 days. “But Al, you should count the money for the sale now not when you get the money”, replied Al’s accountant. Al was not convinced, “But sometimes those kids skip town and don’t even pay me!”

When should the sale be counted? When the sale is made or when the money is received for the sale?

What is a GAAP?
There are many ambiguous situations in accounting such as the one in the above case. There needs to be clear guidelines and rules that everyone understands and follows when accounting for money. In accounting these guidelines and rules are referred to as generally accepted accounting principles or GAAPs. GAAPs are the ground rules used by business in presenting financial information. They allow the users of accounting information to make accurate comparisons of data from different businesses. In Canada, much of what is GAAP is contained in the Canadian Institute of Chartered Accountants (CICA) handbook. GAAPs are made up of assumptions and principles.

GAAP Assumptions

1. Going Concern - assumes the business will continue into the foreseeable future.

2. Monetary Unit - only data that can be expressed in terms of a stable monetary unit is included in the accounting records. The monetary unit in Canada is the Canadian dollar. However, many companies around the world including some Canadian companies use the US dollar. For example, hockey players in Canada are paid in US dollars.

3. Economic Entity - Each business is distinct from its owner or owners, and each business will also be considered as distinct from any other business. For example, in order to be distinct from its owner the business should have its own bank account separate from the owner's bank account.

4. Time period assumption - The ongoing life of the business is divided into time periods. (Time periods include fiscal years (e.g. April 1 to March 31), semi-annual periods, quarters and months.)

GAAP Principles

1. Cost principle - The cost principle dictates that items purchased by the business are recorded and remain at their cost. For example a business may purchase a building for $200,000. Years later the value of the building may increase to $500,000 but the value of the building to the business is still $200,000.

2. Consistency principle – Although there are general accounting rules there may be several ways to apply those rules. The specific accounting methods used by a business are to be used in the same way from one period to the next. If a method is changed it must be disclosed or made known.

3. Objectivity Principle - Accounting will be recorded on the basis of objective evidence. Objective evidence means that different people looking at the evidence will arrive at the same dollar values. Simply put, this means that accounting entries will be based on fact and not on personal opinion or feelings.

What do you think GAAP would have to say about Al's situation?

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