

INTRODUCTION TO ACCOUNTING

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Accounting

- It is the language of business; it provides information to managers, owners, investors, governmental agencies, and others inside and outside the organization.
- It is the process of recording, analyzing, summarizing and reporting financial data to potential stakeholders.

How accounting can help you

- Help you prepare a budget and keep on target.
- Realize how much cash you have and if there is enough to pay bills.
- Uncover places where costs can be cut.

Fields of Accounting

- Financial Accounting
- Managerial Accounting
- Cost Accounting
- Tax Accounting

Financial Accounting

- It is used to prepare financial statements and report them to outsiders.
- Helps outsiders conduct informed decisions.
- **Objectives**
 - To report the financial condition of a business at a point in time.
 - To report changes in the financial condition of a business over a period of time.

Objectives continued

- First, record the economic events affecting a business.
- Second, summarize the impact of these events in a report called financial statements.
- Generally Accepted Accounting Principles (GAAP)

GAAP

- The Financial Accounting Standards Board(FASB) sets and develops Generally Accepted Accounting Principles(GAAPs) to ensure universal statements and reports.
 1. **Business Entity:** A business is distinct from personal affairs for accounting purpose
 2. **Going Concern:** A business exists indefinitely as long as it possesses sufficient resources to pay its debts
 3. **Cost Principle:** Assets are valued by their historical cost, not by their fair market value.

...GAAP

4. **Matching Principle:** Revenue must be adjusted against expenses at the end of the accounting period. E.g. Prepaid insurance should be matched with insurance expense
5. **Revenue Recognition:** Revenues should be recognized when sales are made or services are rendered, not just when cash is received.
6. **Monetary Unit Measurement.** Financial data should be measured by a stable monetary unit like US Dollars.
7. **Conservatism:** Accountants should be unbiased and objective

...GAAP

- 8. **Time Period:** Complex and large accounting data can be reported in a regular time period(e.g. physical year)
- 9. **Full Disclosure:** Any information important for decision making should be revealed.
- 10. **Consistency:** Accounting principles should be consistent from year to year

Managerial accounting

- Accounting to guide management in making decisions about the business
- Like, day to day operations of the business

Four financial statements

- Balance sheet /financial position/
- Income statement (profit/loss)
- Statement of changes in owner's equity
- Statement of cash flows

Elements of financial statements

- The information in the financial statements is organized into 10 categories called elements.
- The elements include:
 - assets,
 - liabilities,
 - equity,
 - contributed capital,
 - revenue, expenses,
 - distributions,
 - net income,
 - gains and
 - losses.

Balance sheet

- Highlights the relative strength of a company at a point in time.
- Terms related to the balance sheet: assets, liabilities, owner's equity.

Assets

- Assets are things you own or resources a business owns.
- The assets of a business belong to its creditors and investors.
- Tangible assets-this you can touch like machinery, buildings, land, computers, etc.
- Intangible assets-things you cannot touch such as right to patents, rights to payments from customers, copyrights or trademarks.

Liabilities

- Things you owe, future obligations of the business
- Creditor claims
- Examples include a bank loan or car loan, or buying supplies for your business on credit

Equity

- Rights of stockholders or their claim on assets
- There are two types of equity
 - Common stock is issued by corporations to finance their operations
 - Retained earnings which is the portion of earned assets kept in the business

Accounting equation

- This equation is how the balance sheet is completed.
- $\text{Assets} = \text{Liabilities} + \text{Equity}$
- $\text{Assets} = \text{Liabilities} + \text{Common stock} + \text{Retained earnings}$
- The equation always needs to balance on both sides of the equal sign.
- This is what people mean when they say balance the books.

Example of accounting equation

- ABC Company has assets of \$20,000 and liabilities of \$5,000. How much is stockholder's equity?
- $A = L + OE$
- $20,000 = 5,000 + ?$
- $20,000 - 5,000 = 15,000$

Income statement

- Also called the P&L (profit and loss statement)
- Shows your revenues and expenses over a period of time (month, year)
- Revenue is income from the sale of goods and rendering of services.
- If revenue is more than expenses, you have net gain
- If expenses are more than revenue, you have a net loss

Income statement

- Terms used on the income statement:
- Revenue or sales
- Cost of goods sold or Cost of merchandise sold
- Gross profit
- Operating expenses
- Net income or net loss

Statement of changes in Stockholder's Equity

- Sometimes called statement of changes in owner's equity
- Explains the effects of transactions on stockholder's equity during the accounting period.

Statement of changes in Stockholder's Equity

- Starts with beginning common stock and adds any additional shares of stock issued.
- Then it takes the beginning retained earnings and adds on net income (subtracts net loss)
- Then it subtracts any dividends paid to shareholders

Cash flow statement

- This explains how a company obtained and used cash during the accounting period.
- It tells you whether your cash increased or decreased and why.
- Receipts of cash are called **cash inflows**.
- Payments of cash are called **cash outflows**.

Cash flow statement

- There are three sections to the cash flow statement: operating, investing and financing.
- Operating section is first. Operating activities include receiving cash from revenue and paying cash for expenses.

Cash flow statement

- Investing section includes paying cash to buy productive assets (like machinery or equipment) or receiving cash when you sell productive assets.
- Financing section includes receiving cash from owners or paying cash to owners (dividends) It can also include borrowing cash from the bank or repaying the cash.

How the financial statements are interrelated

- The **income statement** is prepared first
- The income from this statement flows to the statement of **changes in stockholder's equity**
- The stockholders equity total and common stock totals flow to the **balance sheet**
- The cash from the balance sheet flows to the statement of cash flows

