Activities in Organizations

Most organizations are involved in the following 4 functions:

Planning - strategies/tactics/needs/etc.
Financing - the means organizations use to pay for resources needed to carry out plans. Capital (money) may come from owners or from creditors.
Investing - the acquiring and disposing of resources (assets) used to continue operations.
Operating - this describes the main purpose of an organization: using resources to research, develop, purchase, produce, distribute, and market products and services.

Fundamentals of Accounting

WHAT IS ACCOUNTING?

Accounting is often characterized as the "language of business." The topic of accounting includes both the method for recording financial data systematically and the way of communicating the type of financial information that is useful for decision-making purposes.

In effect, accountants serve decision makers by providing them with financial information to help them make better decisions.

External decision makers include:

present and potential investors
lenders of money
owners and managers of businesses
government agencies (regulators) and labor unions (employees)
engineers and attorneys
auditors

Internal users of accounting information (often a manager of one of the following operating functions):
Research and development; purchasing; human resources; production; distribution; marketing; servicing

Bookkeeping is the part of accounting that records transactions and other events either manually or with a computer. When people talk about accounting they are usually referring to that part of the accounting process that is concerned with identifying *how transactions and events should be described in financial reports*. Accounting requires more professional expertise, analysis, and evaluation than bookkeeping.

The study of accounting requires you to learn some basic bookkeeping practices in order to understand how accounting gathers financial data and uses it to produce useful reports.

THE ACCOUNTING PROCESS & ECONOMIC EVENTS

The accounting process involves:
1. Analyzing the economic events of a business and recording the effects of those events. Transactions are analyzed to determine their effects on the accounting equation. Those effects are then recorded in the accounting records known informally as "the books".
The printed documents that businesses use in the process of completing transactions are called source documents. Examples include sales slips, invoices, checks, purchase orders, bank statements, or cash register

tapes. Source documents are the starting point in the accounting process to provide *evidence* of completed transactions and the amount for which they should be recorded.
2. Classifying and summarizing the recorded effects in reports or financial statements. In accounting for a business, the different effects of its transactions must be recorded and stored in seperate locations so that they can be sorted and combined when financial reports are prepared. These locations are called accounts.

TYPES OF ACCOUNTANTS

Private
Public
Government

LEGAL FORMS OF BUSINESS ORGANIZATION

Sole Proprietorship = Business owned by one person.

Characteristics:

1. Easy to start
2. Owner makes all the decisions
3. Owner receives all the profits and assumes all losses.
4. Business subject to fewer regulations than a corporation.
5. Unlimited liability. Legally, the business does not exist separate from owner.
6. Investment capital (money, etc.) limited to that of the owner.
7. Owner cannot draw a salary.

Partnership = Business owned by two or more people.

Characteristics:

1. Relatively easy to form.
2. Greater expertise should be available.
3. Greater investment capital available.
4. Owners share profits and losses.
5. Unlimited liability.
6. Still, limited investment capital available.
7. Partnership ends upon death or departure of partner.
8. Owners cannot draw a salary.
9. *Mutual agency*: partners can make decisions on behalf of one another.

Corporation = A separate legal entity formed, or incorporated, under the laws of a state or the federal government. Unlike a sole proprietorship or partnership, a corporation is *legally separate* and distinct from its owners.

Characteristics:

1. Greater availability of investment capital.

2. Professional management for large business.
3. Limited liability of owners.
4. Perpetual existence; ownership can be transferred easily.
5. Investors may be employees and draw a salary.
6. The business is a legal entity.
7. Double taxation.
8. Expensive to start.
9. Subject to more regulations by government.

FINANCIAL STATEMENTS

The official reports prepared by accountants are called financial statements and they communicate financial information to managers and other decision makers. The three basic financial statements are *Income Statement*, the *Balance Sheet*, and the *Statement of Changes in Owner's Equity*.

These statements are the primary product of the accounting process. In summary, financial statements describe the condition of the organization and the events that happened during the year.

A. *Income Statement* = conveys a picture of *profitability for a specific period of time* and has the following parts:

1. Revenue = inflows of assets (cash or other properties) received in exchange for goods or services provided to customers as part of the major or central operations of the business. It represents the sales by a business of goods or services. INCOME IS NOT REVENUE!

2. Expenses = goods or services consumed in operating a business. Results from *outflows* or the using up of assets as a result of the major or central operations of a business.

B.*Balance Sheet* = Conveys a concise picture of a company's *financial position on a specific date*. The balance sheet helps users understand the company's financial status:
Will the buisness be able to pay its debts?
How much is the investment of the owner?
The balance sheet must balance. The left side must equal the right side. The left side shows the assets owned by the business and the right side shows who has claim to the assets.

1. Assets = properties or economic resources owned by a business. Titles are used to identify assets.

EXAMPLES:

Accounts Receivable = amounts owed to the business by its customers for goods or services sold on credit.

Other assets: merchandise held for sale, supplies, equipment, buildings, land, copyrights...

2. Liabilities = debts of a business. The title used indicates that money is owed for goods or services bought on credit.

EXAMPLES: Accounts payable, Notes Payable, Interest Payable, Taxes Payable...

3. Equity = The ownership of the assets that remains after subtracting claims of liabilities. The title used for the

equity of the owner is the owner's name followed by the word CAPITAL. (i.e. Bubba Brown, Capital)

Balance Sheet Equation (Accounting Equation)

The financial position of a business is reflected in the equation: Assets = Liabilities + Owner's Equity.

C. *Statement of Changes in Owner's Equity* = Summarizes the changes in the Owner's Capital by reporting *net income* and *owner's investments* and *withdrawals*.
D. *Statement of Cash Flows* = Reports on cash flows for operating, investing, and financing activities over a period of time.

GAAP

The financial statements should reflect the company's financial position and operating results following Generally Accepted Accounting Principles (GAAP). These principles are established by the Financial Accounting Standards Board (FASB). An *audit* determines if they do. These principles are the rules adopted by the accounting profession as guides in measuring, recording, and reporting the financial activities of a business.

For a person to understand financial statements, some knowledge of GAAP is essential. The primary purpose of GAAP is to help accountants provide relevant and comparable information.

GAAP Principles

The Financial Accounting Standards Board (FASB) publishes a list of GAAP Principles that are guidelines for accountants to follow. Examples include:

BUSINESS ENTITY PRINCIPLE = requires a business to be accounted for separately from its owner(s).
OBJECTIVITY PRINCPLE = requires that financial statement information be supported by independent, unbiased evidence.
COST PRINCIPLE = requires that financial statement information be based on actual costs incurred in business transactions.
GOING-CONCERN PRINCIPLE = requires financial statements reflect the assumption that the business will continue to operate.
MONITARY UNIT PRINCIPLE = requires that transactions and events will be expressed in money units.
REVENUE RECOGNITION PRINCPLE = requires revenue be recorded when earned, not necessarily when paid.