

2011 UNCP

Entrepreneurial Summit

**Accounting as an
Information System**

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Agenda

- Basic Information about Accounting and Business Organizations
 - What is Accounting?
 - Accounting’s role in “informed” decision making
 - Forms of Business Organizations
- Financial vs Managerial Accounting
 - Financial Accounting
 - GAAP
 - Organizations that create GAAP
 - Managerial Accounting
- Accounting Information
 - Users of Accounting Information
 - Financial Accounting Information

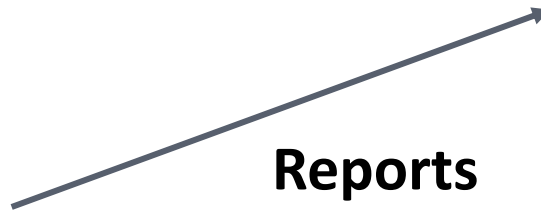
What is Accounting?

- Accounting is an information system that *measures, processes, and communicates information, primarily financial* in nature, about an identifiable entity for the purpose of making economic decisions.

The Accounting System



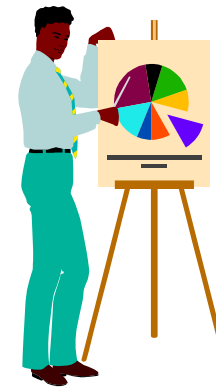
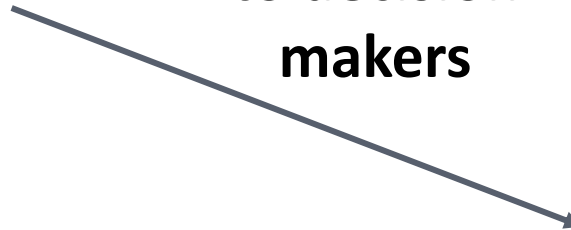
**Collects and processes
financial information**



**Reports
information
to decision
makers**



**Managers
(internal
decision
makers)**



**Investors and
Creditors
(external
decision
makers)**

Accounting's role in "informed" decision making

- It is not an end in itself *but is a tool* to be *used in providing information* that is *useful in making reasoned choices among alternative uses of scarce resources* in the conduct of business and economic activities

Forms of Business Organizations

- Sole Proprietorship
- Partnership
- Corporation

Forms of Business Organizations

- **Sole Proprietorship**

- unincorporated business owned by one person
- Usually small in size
- Often the owner is the manager
- Legally, the business and the owner are not separate entities
- Accounting views the business as a separate entity that must be accounted for separately from its owner.
- THE SOLE PROPRIETOR HAS UNLIMITED LIABILITY

Forms of Business Organizations

• Partnership

- unincorporated business owned by two or more persons known as partners
- agreements between the owners are specified in a partnership contract which deals with matters such as division of income each reporting period and distribution of resources of the business on termination of its operations
- not legally separate from its owners. Legally, each partner in a general partnership is responsible for the debts of the business (each general partner has unlimited liability)
- The partnership, however, is a separate business entity to be accounted for separately from its several owners.

Forms of Business Organizations

- **Corporation**

- A separate business entity incorporated under the laws of a particular state.
- The owners are called stockholders or shareholders.
- Ownership is represented by shares of capital stock that usually can be bought and sold freely.
- Governed by board of directors elected by stockholders
- Advantages: (1) limited liability for the stockholders, (2) continuity of life, (3) ease in transferring ownership (stock), and (4) opportunities to raise large amounts of money by selling shares to a large number of people.
- Disadvantage - may be subject to double taxation

Financial vs Managerial Accounting

Accounting System

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graph TD; A[Accounting System] --> B[Financial Accounting System  
Periodic financial statements and related disclosures]; A --> C[Managerial Accounting System  
Detailed plans and continuous performance reports]; B --> D[External Decision Makers  
Investors, creditors, suppliers, customers, etc.]; D --> E[Governed by GAAP]; C --> F[Internal Decision Makers  
Managers throughout the organization];
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Financial Accounting System
Periodic financial statements and related disclosures

External Decision Makers
Investors, creditors, suppliers, customers, etc.

Governed by GAAP

Managerial Accounting System
Detailed plans and continuous performance reports

Internal Decision Makers
Managers throughout the organization



It turns out "creative accounting"
is a creative term for "white collar crime".

Generally Accepted Accounting Principles (GAAP)

GAAP are the measurement rules used to develop the information in financial statements.

Financial Accounting Standards Board (FASB) – Private sector body given primary responsibility to work out the detailed rules that become GAAP

GAAP govern financial accounting!!!

GAAP Examples:

Historical Cost Principle

Matching Principle

Revenue Recognition

Conservatism

Assumptions and Balance Sheet Equation

Underlying Assumptions

Separate entity: Activities of the business are separate from activities of owners.

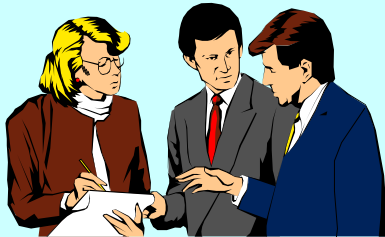
Continuity: The entity will not go out of business in the near future.

Unit-of-measure: Accounting measurements will be in the national monetary unit (\$).

Balance Sheet Equation -

ASSETS = LIABILITIES + EQUITY

Users of Accounting Information



Owner-Managers

Founders of the business who also function as managers are called **Owner-Managers**.



Creditors

Creditors lend money for a specific period of time and gain by charging interest on the money they lend.

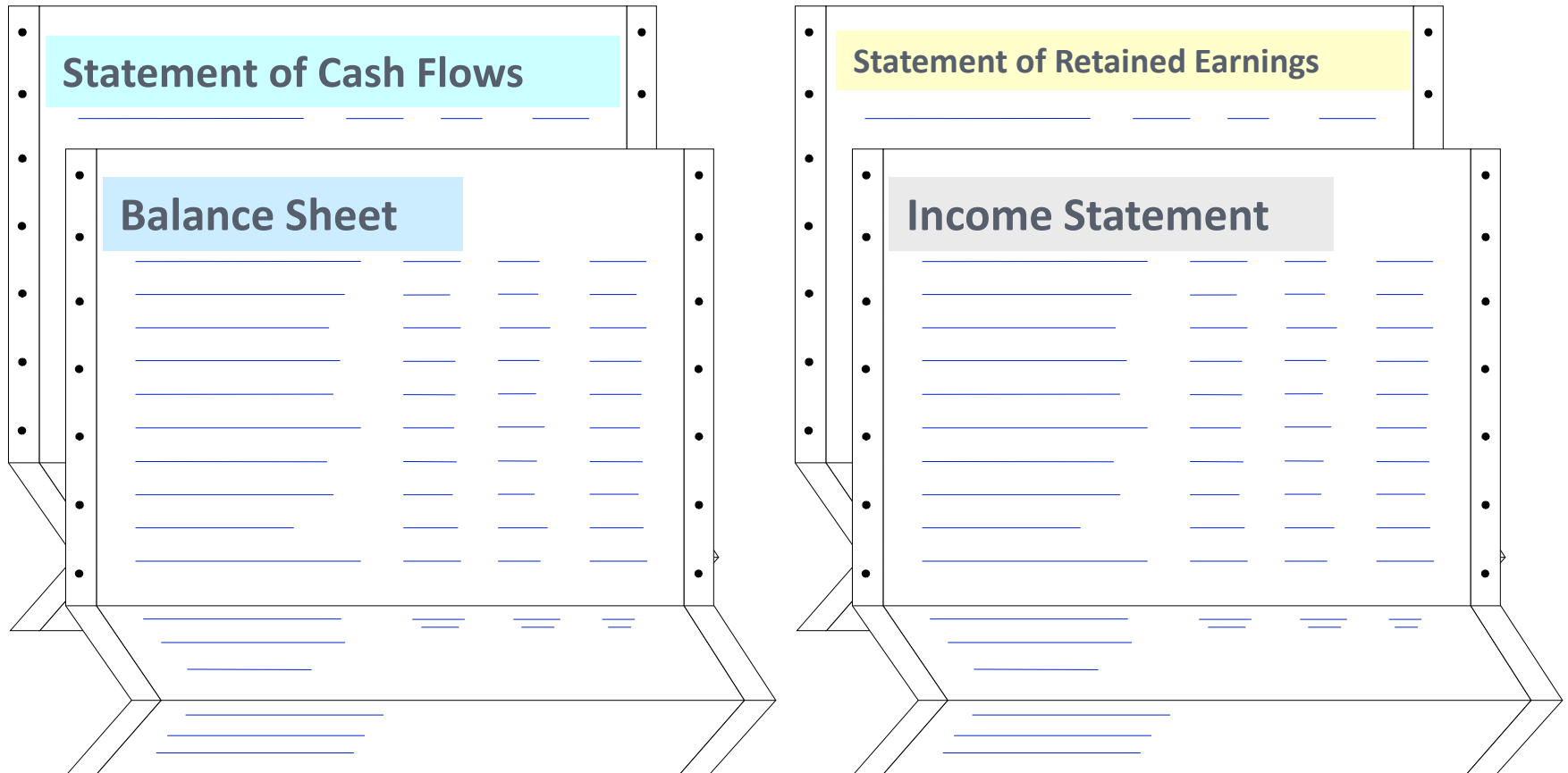


Investors

Investors buy ownership in the company in the form of stock.



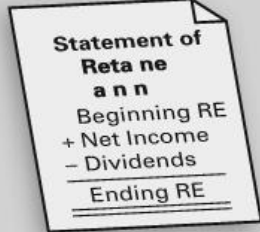
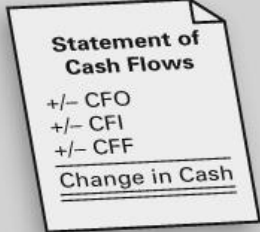
Accounting information is also important to those with indirect financial interest, such as taxing authorities, regulatory agencies, economic planners, and other groups.

The Four Basic Financial Statements



Financial statements are the means by which accountants communicate the financial condition and activities of a business to those who have an interest in the business.

Financial Statements

Financial Statement	Purpose	Structure	Examples of Content
Balance Sheet (Statement of Financial Position)	Reports the financial position (economic resources and sources of financing) of an accounting entity <i>at a point in time</i> .	 <p style="text-align: center;">BALANCE SHEET</p> <p style="text-align: center;">Assets = Liabilities + Stockholders' Equity</p>	Cash, accounts receivable, plant and equipment, notes payable, contributed capital
Income Statement (Statement of Income, Statement of Earnings, Statement of Operations)	Reports the accountant's primary measure of economic performance <i>during the accounting period</i> .	 <p style="text-align: center;">Income Statement</p> <p style="text-align: center;">Revenues - Expenses <u>Net Income</u></p>	Sales revenue, cost of goods sold, selling expense, interest expense
Statement of Retained Earnings	Reports the way that net income and the distribution of dividends affected the financial position of the company <i>during the accounting period</i> .	 <p style="text-align: center;">Statement of Retained Earnings</p> <p style="text-align: center;">Beginning RE + Net Income - Dividends <u>Ending RE</u></p>	Net income is taken from the income statement; Dividends are distributions to stockholders
Statement of Cash Flows (Cash Flow Statement)	Reports inflows (receipts) and outflows (payments) of cash <i>during the accounting period</i> in the categories operating, investing, and financing.	 <p style="text-align: center;">Statement of Cash Flows</p> <p style="text-align: center;">+/- CFO +/- CFI +/- CFF <u>Change in Cash</u></p>	Cash collected from customers, cash paid to suppliers, cash paid to purchase equipment, cash borrowed from banks

The Balance Sheet

MAXIDRIVE CORP.
Balance Sheet
At December 31, 2006
(in thousands of dollars)

name of the entity
title of the statement
specific date of the statement
unit of measure

Assets

Cash	\$ 4,895
Accounts receivable	5,714
Inventories	8,517
Plant and equipment	7,154
Land	981
Total assets	<u>\$27,261</u>

the amount of cash in the company's bank accounts
amounts owed by customers from prior sales
parts and completed but unsold disk drives
factories and production machinery
land on which the factories are built

Liabilities

Accounts payable	\$ 7,156
Notes payable	9,000
Total liabilities	<u>16,156</u>

amounts owed to suppliers for prior purchases
amounts owed on written debt contracts

Stockholders' Equity

Contributed capital	2,000
Retained earnings	9,105
Total stockholders' equity	<u>11,105</u>
Total liabilities and stockholders' equity	<u>\$27,261</u>

amounts invested in the business by stockholders
past earnings not distributed to stockholders

The notes are an integral part of these financial statements.

The Income Statement

MAXIDRIVE CORP.
Income Statement
For the Year Ended December 31, 2006
(in thousands of dollars)

Revenues	
Sales revenue	\$37,436
Total revenues	37,436
Expenses	
Cost of goods sold expense	26,980
Selling, general, and administrative expense	3,624
Research and development expense	1,982
Interest expense	450
Total expenses	33,036
Pretax income	4,400
Income tax expense	1,100
Net income	\$ 3,300

name of the entity

title of the statement

accounting period

unit of measure

cash and promises received from sale of disk drives

cost to produce disk drives sold

operating expenses not directly related to production

expenses incurred to develop new products

cost of using borrowed funds

income taxes on period's pretax income (\$4,400 × 25%)

The notes are an integral part of these financial statements.

Statement of Retained Earnings

MAXIDRIVE CORP.
Statement of Retained Earnings
For the Year Ended December 31, 2006
(in thousands of dollars)

Retained earnings, January 1, 2006	\$6,805
Net income for 2006	3,300
Dividends for 2006	<u>(1,000)</u>
Retained earnings, December 31, 2006	<u><u>\$9,105</u></u>

name of the entity

title of the statement

accounting period

unit of measure

last period's ending retained earnings

net income reported on the income statement

dividends declared during the period

ending retained earnings on the balance sheet

The notes are an integral part of these financial statements.

Statement of Cash Flows

MAXIDRIVE CORP.

Statement of Cash Flows

For the Year Ended December 31, 2006

(in thousands of dollars)

Cash flows from operating activities

Cash collected from customers	\$33,563
Cash paid to suppliers and employees	(30,854)
Cash paid for interest	(450)
Cash paid for taxes	(1,190)

Net cash flow from operating activities 1,069

Cash flows from investing activities

Cash paid to purchase manufacturing equipment	(1,625)
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Net cash flow from investing activities (1,625)

Cash flows from financing activities

Cash received from bank loan	1,400
Cash paid for dividends	(1,000)

Net cash flow from financing activities 400

Net decrease in cash during the year (156)

Cash at beginning of year 5,051

Cash at end of year \$ 4,895

name of the entity

title of the statement

accounting period

unit of measure

directly related to earning income

purchase/sale of productive assets

from investors and creditors

change in cash during the period (\$1,069 - 1,625 + 400)

last period's ending cash balance

ending cash on the balance sheet

The notes are an integral part of these financial statements.

Relationship of Financial Statements

Income Statement

Revenues	\$ 37,436
- Expenses	34,136
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Net Income	\$ 3,300
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Statement of Retained Earnings

Beginning Retained Earnings	\$ 6,805
+ Net Income	3,300
- Dividends	(1,000)
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Ending Retained Earnings	\$ 9,105
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Statement of Cash Flows

+/- Cash Flows from Operating Activities	\$ 1,069
+/- Cash Flows from Investing Activities	(1,625)
+/- Cash Flows from Financing Activities	400
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Change in Cash	(156)
+ Cash at the Beginning of Period	5,051
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Cash at End of Period	\$ 4,895
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Balance Sheet

Cash	\$ 4,895
Other Assets	22,366
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Total Assets	\$27,261
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Liabilities	\$16,156
Contributed Capital	2,000
Retained Earnings	9,105
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Total Liabilities & Stockholders' Equity	\$27,261
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