



Accounting as a Source of Financial Information

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Fundamental concepts

What is accounting?

- The language of business.
- A means to communicate financial information.
- A way to convey information about a business to users.

Definition

- Accounting is an information system for the documentary, continuous and interactive coverage cash measure of economic facts and processes within the enterprise by applying *specific techniques*.

L1 NATURE OF ACCOUNTING

Every element of society—from the individual to an entire industry or government branch—has to make decisions on how to allocate its resources. *Accounting is the process that aids these decisions by (1) recording, (2) classifying, (3) summarizing, and (4) reporting business transactions and interpreting their effects on the affairs of the business entity.* This definition makes it clear that the recording of data, or *bookkeeping*, is only the first and simplest step in the accounting process.

Financial Information & Accounting

- Financial Information
 - Central to every organization
 - Key for decision making
- Accounting
 - Converts the details of financial transactions into reports
 - Backbone of the business

Who uses accounting information?

- × Owners
- × Managers
- × Investors (including potential)
 - + Analysts on their behalf
- × Creditors (including potential)
- × Government (tax assessment)
- × Regulators
- × Customers

Accounting has two main divisions:


- **Financial accounting**
 - Primarily prepared for users external to the company.
 - Revenues, earnings, assets, etc.
- **Management accounting**
 - Primarily for internal purposes
 - Costing, budgeting, net present value, etc.

Accounting

- **Types of Accounting**
 - Financial
 - Managerial
- **Types of Accountants**
 - **Public Accountants**
 - Independent, fee for service
 - **Private Accountants**
 - Work for the company

Characteristics of accounting

- Accounting is regulated by law.
- Accounting as a practical activity takes place not at all, and within the enterprise.
- Full, interconnected and continuous coverage of economic facts and processes the entire property of the company and changes in it as a result of business operations.
- Use of the monetary measure.

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- Documentary support.
 - Accounting apply specific techniques, which together form the accounting method.
 - Accounting is continuously
 - Generated by the accounting information may have probative value in resolving disputes between companies in court.

Accounting method

- Combination of methods, which include a full accounting of the objects.
- The methods are:
 - balance summary
 - documentation
 - inventory
 - evaluation
 - calculation
 - Accounts system
 - Double entry accounting
 - Financial statements

Accounting principles

- Accounting principles should be considered as starting productions (rules) that must be met in order to fulfill its accounting community functions.
Their application ensures comparability and understandability of identity reflected in the accounts information in individual companies, industries, national and international.

Accounting policy

- **Definition:**

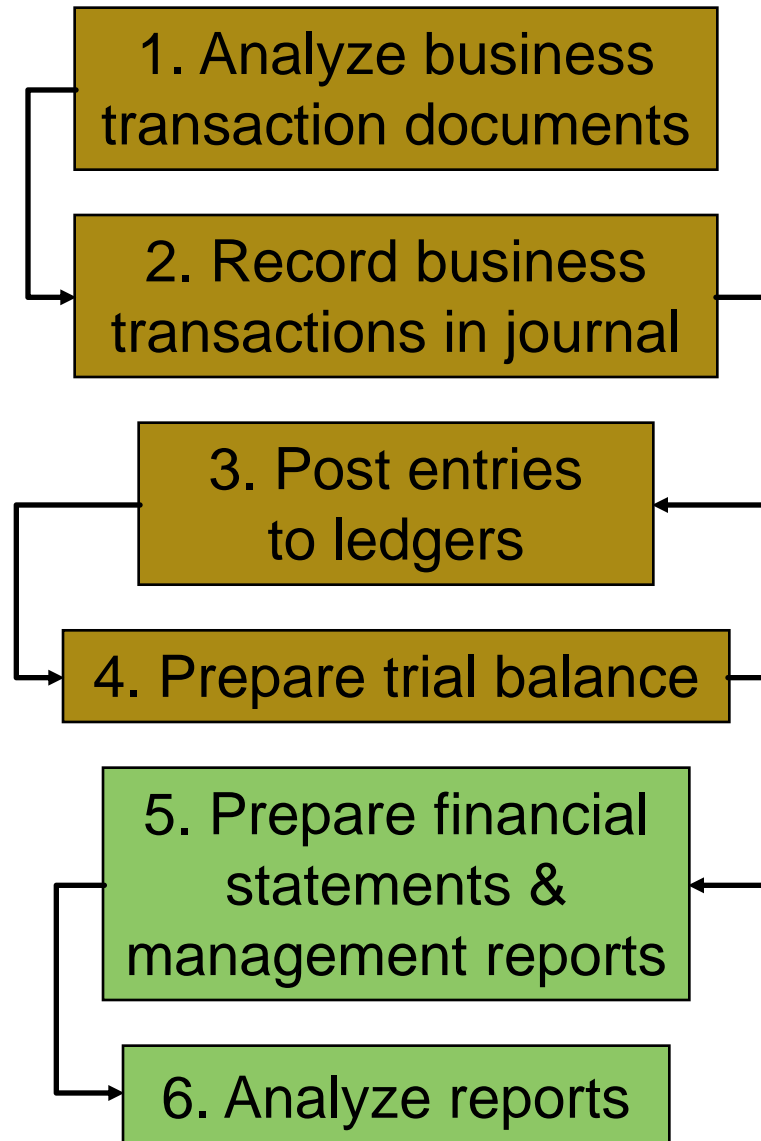
Set of principles, rules, basic assumptions, concepts, facilities and procedures that an entity adopts in its activities accounting.

Accounting Basics

- Assets
 - Current
 - Non-current
 - Tangible /Fixed/
 - Intangibles
 - Financial
- Liabilities
 - Current
 - Non-current /Long term/
- Owner's Equity
- Revenues and Expenses

Assets = Liabilities + Owner's Equity

The Accounting Cycle



Financial Reports

- Provide information about a company's past, present, & future performance
- Used internally & externally
- Must follow GAAP or IAS or National AS (GAAP) when creating
- Primary financial statements
 - Statement of Financial Positions /Balance Sheet/
 - Income Statement
 - Statement of Cash Flows
 - Statement of changes in equity for the period

Statement of financial positions /Balance Sheet/

- Snapshot of the company as of a date
- Reports assets, liabilities, & owner's equity
- Assets listed in order of liquidity
- Liabilities listed in order of maturity

statement of comprehensive income for the period /Income Statement/

- Reports on the company for a certain period of time
 - Revenues
 - Gross Sales – sales discounts – returns & allowances = net sales
 - Expenses
 - Cost of Goods Sold
 - Operating Expenses
 - Taxes
 - Net Profit or Net Loss

Statement of Cash Flows

- Shows how much cash was generated and where it was spent for a certain period of time
- Sources of cash flow
 - Cash flow from operating activities
 - Cash flow from investment activities
 - Cash flow from financing activities

Equity statements

- shows changes in equity of the entity as a result of the operation and contributions from owners

Analyzing Financial Statements

- Look at the financial statements individually as well as the relationships among them
 - Ratio Analysis
 - Liquidity Ratios
 - Profitability Ratios
 - Activity Ratios
 - Debt Ratios

Ratios

- **Liquidity ratios**
 - current ratio
 - acid-test (quick) ratio
 - net working capital
- **Profitability ratios**
 - net profit margin
 - return on equity
 - earnings per share
- **Activity Ratios**
 - inventory turnover ratio
- **Debt Ratios**
 - debt to equity ratio

Trends in Accounting

- Expanding roles for accountants
 - More involved in consulting & operations
- Increased value from Knowledge Assets
 - Determining how to correctly value these intangible assets
- Tightening GAAP and IAS /convergence/
 - Reducing loopholes to lower concerns over the validity and quality of financial reports
- Looking Ahead
 - Harmonization and Convergence of Accounting Standards



The End !