

BUSINESS KNOWLEDGE INC.

ACCOUNTING FRAMEWORK “Are we making money?”



Better Knowledge, Better Business, Better Future
BUSINESS KNOWLEDGE INC.

Accounting Framework
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ACCOUNTING FRAMEWORK

- **Accounting:**

- **Is fundamental for conducting successful business and for personal money management**
- **Deals with money related aspects coming from all our activities**
- **Provides a snapshot in time of our financial status**
- **Offers tools for assessing the personal or business financial outcome on the past financial activities**



ACCOUNTING FRAMEWORK

Accounting definition

- Accounting is used to capture, process and provide information on the monetary well being of a business, helping leaders to make decisions related to labor, services, raw material, buildings and equipment, and their use to help the business to achieve results.



ACCOUNTING FRAMEWORK

Main Areas of Accounting

- **Financial Accounting**
 - Financial Statements (Balance Sheet, Income Statement, Cash Flow)
 - Accounting Records and Revenue
 - Cost of Sales and Inventory
 - Sources of Capital (Debt, Owners' Equity)
- **Management Accounting**
 - Costs, Cost Types, Cost Behaviour and Analysis
 - Planning, Budgeting and Controlling Processes
 - Analysis, Reporting and Evaluation
 - Accounting Based Decision Making
 - Systemic Approach for Management Accounting



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Financial Statements

- Set of reports reflecting business financial status at a given moment in time
- Financial evaluation of the past, assessment of the present and projection of the future (pro-forma and financial ratios)



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- Financial Statements (Cont'd)

- Balance Sheet

- Snapshot of company financial position at a given point in time.

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

- Income Statement

- The amount of money added to Retained Earnings as result of profitable operations during a period of time.

$$\text{Revenue} - \text{Expenses} = \text{Net Income}$$

- Cash Flow Statement

- The use of cash by the business for a given period of time.
 - Cash sources: cash flow from operations, investment activities and financing activities.



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Financial Accounting

- Accounting Records

- The account: records information about each item that has to be accounted

 - Credit (left side) includes assets and expenses

 - Debit (right side) includes liabilities, owners' equity and revenue

- The ledger: collection of multiple accounts

- The worksheet: trial paper (computer file) where changes can be easily done without altering official records

- Revenue

 - Is recognized when the goods or services are delivered

 - It does not mean that the business actually received the monetary compensation for delivered goods or services



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- Financial Accounting
 - Cost of Sales and Inventory
 - Cost of Sales
 - Total costs of goods or services provided by a business
 - Inventory Cost
 - Is measured at its cost as acquisition one or product or service cost depending on the nature of the business: merchandising, manufacturing or services



ACCOUNTING FRAMEWORK

- Financial Accounting
 - Sources of Capital (Debt, Bonds, Owners' Equity)
 - Debt
 - Is represented by term loans (money borrowed for a given period to finance the business) and bonds
 - Bonds promise to pay the holder a given amount of money at a given date
 - Owners' Equity
 - Paid-in capital: amount of capital that owners have invested in the entity
 - Retained earnings: total amount of the net income that an entity has been earning since day one of its existence less total paid dividends



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- **Management Accounting**

- **Costs, Cost Types, Cost Behaviour and Analysis**

- **Correct understanding of costs helps managers to establish the selling price for products or services**

- **Cost cannot be described as a single word, thus the need to associate it with a describing word: direct cost, opportunity cost, variable cost, etc.**

- **There are multiple elements of a cost that help with cost analysis and allocation**

- **The full cost is the sum of all cost elements associated with a product or service**



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- Management Accounting

- Planning, Budgeting and Control Processes

- An entity strategy has to be implemented by management accounting through planning, budgeting and control processes

- Strategic planning is a decision process on what products or services an entity organization will undertake

- As revenue is a measure of the output of a business, and the cost is factored in, a benefit cost analysis method may be implied for deciding on new business

- Control processes are in place for ensuring that the business achieves its desired results



ACCOUNTING FRAMEWORK

- Management Accounting
 - Analysis, Reporting and Evaluation
- Analysis is conducted to assess an entity performance
- Evaluation is to be done using key performance indicators relative to predetermined standards
- Reporting is meant to present important information that quantifies entity performance against pre-selected indicators



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- Management Accounting

- Accounting Based Decision Making

- Short term decision making should be based on proper analysis of differential costs and differential revenues

- Long term decisions are associated with capital investment

- Projected cash from future activities should be good enough for the entity to take the risk of making that investment

- Net Present Value and Internal Rate of Return are methods of evaluation of such investment profitability



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- **Management Accounting**
 - **Systemic Approach for Management Accounting**
- **Management accounting should provide a decision frame work for business performance measurement, entity operations control and business investments (alternative choices)**
- **Management Accounting Systems should be designed to fit the entity business model;**
- **Cost categories, processes and organizational structure should be aligned with business strategy**



ACCOUNTING FRAMEWORK

References

- Robert N. Anthony, David F. Hawkins, Kenneth A. Merchant, Twelfth Edition, *Accounting: Text and Cases*, New York, NY, USA, McGraw-Hill Irwin, 2007



ACCOUNTING FRAMEWORK

Q&A



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Business Strategic Plan
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