BASIS OF ACCOUNTING AND FINANCIAL STATEMENTS

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POWERING ARIZONA’S FUTURE
Outline

• Accounting Terms and Definitions
• Accounting Periods
• Basis of Accounting
Terms and Definitions

- Revenue Recognition Principle – Recognize revenues when earned, not when cash is received.
- Matching Principle – Requires expenses be recognized when incurred and in the same period expenses were used to derive revenues.
- Basis of Accounting – How you construct financial statements.
- GAAP – Generally Accepted Accounting Principles.
Accounting Periods
Basis of Accounting

• A foundation for financial transactions

• Focuses accountant on how to apply rules

• Several different types of basis
  • Examples include Cash, Accrual, and Tax basis for accounting
What’s the difference?

• **Cash Basis**
  - Record revenues when cash is received
  - Record Expenses when cash is paid
  - Not approved for use by GAAP
  - Does not accurately reflect business performance

• **Accrual Basis**
  - Record revenues when earned
  - Record expenses when incurred
  - Approved by GAAP
  - More accurately reflects business performance
Financial Statements

• **Income Statement**
  - Reports income and expenses during the Company’s accounting period

• **Statement of Owner's Equity**
  - Reports the changes of owner’s equity value over the Company’s accounting period

• **Balance Sheet**
  - Reports the financial position of a company at a specific period in time.

• **Cash Flow Statement**
  - Reports the sources and disbursements of cash made by a company during the Company’s accounting period.
Income Statement

• Revenues
  • Earned money derived from a company’s operations, whether collected or not

• Expenses
  • The cost to acquire or use something, whether paid or not.

Revenues minus expenses equals Net Income

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\text{Revenues} - \text{Expenses} = \text{Net Income}
\]
Statement of Owner’s Equity

• Displays accounting period’s beginning balance.

• Displays accounting period’s net income

• Displays any contributions made by the owner

• Displays any withdrawals by the owner

• Beginning Balance plus Net Income plus Owner’s Contributions minus Owner’s Withdrawals equal Ending Equity Balance.
Balance Sheet

• Not just a clever name
• Lists all assets of the Company
• Lists all liabilities of the Company
• Displays the ending balance of the Equity account as calculated on the statement of owner’s equity.

• Total assets must equal the sum of liabilities and equity.
• If total liabilities are greater than total assets, then the Company would have a negative retained earnings in the equity section.
Cash Flow Statement

• Cash flows from Operating Activities

• Cash Flows from Investing Activities

• Cash Flows from Financing Activities

• Used differently in public accounting than for Commission use.

• Commission uses a variation not approved by GAAP

• Commission determines how much cash is available for contingencies or other factors.
Why does all this matter?

Example:
Water Works Company is a Class E water Company that operates on the Cash Basis of Accounting. They have currently experienced a cash flow problem and are not able to meet some of their obligations. Brian Jones, business manager, and Grace Miller, owner, agree it’s time for a rate case. After reviewing the records, Grace and Brian determine the following:

- Total bills received were for $4,000.
- Cash payout for bills were $2,500.
- Bills sent to customers during the year equaled $3,500.
- Cash collections of bills sent out equaled $3,000.
Net Income Calculation

Water Sales (Revenues) - Expenses = Net Income
Why does Basis Matter?

• Staff’s analysis using the Cash Basis
  • Cash collections of $3,000.
  • Cash payout for expenses of $2,500.
  • Net Income calculated as $500.

• Staff’s analysis using the Accrual Basis
  • Water Sales of $3,500
  • Total expenses incurred for $4,250.
  • Net loss calculated of $750.
THANK YOU

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