BASIS OF ACCOUNTING AND FINANCIAL STATEMENTS

December 6, 2019

Brian Smith / CPA

POWERING★ARIZONA'S★FUTURE

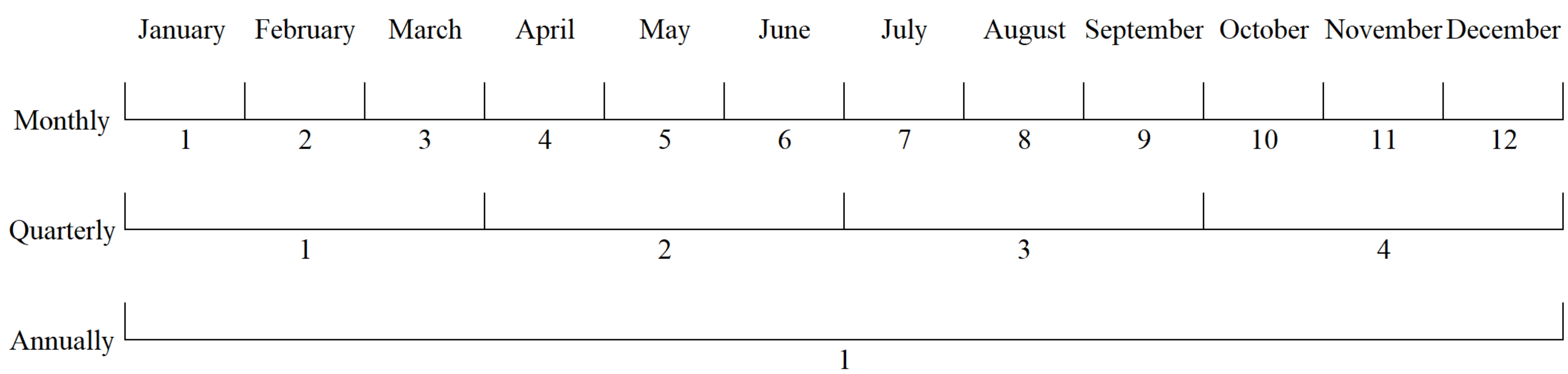
Outline

- 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.
- Financial Statements – Income Statement, Statement of Owner's Equity, Balance Sheet, and Statement of Cash Flows.
- 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.

AZCC

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

Revenues

<u>– Expenses</u>

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 Withdrawals equal Ending Equity Balance.

Beginning Balance

+Net Income (from income Statement)

+Owner's Contributions

-Owner's Withdrawals

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.

★AZCC★

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.

AZCC

ARIZONA★CORPORATION★COMMISSION

THANK YOU

Brian Smith/CPA
Brian.Smith@southmountaincc.edu / 602-243-8044

SOUTH MOUNTAIN COMMUNITY COLLEGE
A MARICOPA COMMUNITY COLLEGE

azcc.gov
@corpcommaz
facebook.com/corpcommaz

POWERING★ARIZONA'S★FUTURE