INTRODUCTION TO ACCOUNTING

Financial Accounting vs Managerial Accounting (Controlling)

Financial Accounting (FI)
- Tracks financial impact of transactions on financial statements
- Presents current financial situation of company
- External, legally required reporting focus
- Requirements defined by laws, govt. policies (US-GAAP, IFRS, etc.)
- Country-specific variations and requirements

Managerial Accounting (CO)
- Allocate and manage costs and revenues
- Reporting to support managing the company
- Internal focus
- Reporting requirements are based on company needs
Financial Accounting Process Integration

- Financial Accounting Focal Elements
  - General Ledger: Balance Sheet and Profit & Loss (Income Statement) focus.
  - Asset Accounting: transactions related to company assets.
  - Bank Ledger: booking of cash flows.
  - Accounts Receivable: transactions related to customers. (SD focus)
  - Accounts Payable: transactions related to suppliers. (Purchasing/MM focus)
General Ledger (G/L)

All accounting relevant transactions recorded in G/L.
Each G/L structured per chart of accounts (orderly definition of all accounts in the G/L).
Account definitions in COA consist of account number, name, and account type.
Each account designated as profit and loss statement account (sales, expenses) or balance sheet account (assets, liabilities, equity).

The G/L contains collective postings where the details are contained in subsidiary ledgers (or subledgers) which pass summary data on to the G/L.
Subledgers are not part of the G/L.

Subledgers

Subledgers exist for customer accounts, vendor accounts, and assets.
Subledgers connect to G/L reconciliation accounts.
Reconciliation accounts cannot be posted to directly.
Posting to subledger account automatically posts to reconciliation account.

Automatic posting is accomplished through process called account determination.
‘T account’ fundamentals

Within double entry accounting, each transaction results in 2 offsetting account postings. One posting debits an account and the other credits an account.

Debits and credits always equal.

Asset accounts have a debit balance. Debiting increases the total balance; crediting reduces the balance.

Liabilities and Equity accounts have a credit balance. Crediting increases the total balance; debiting reduces the balance.

Postings often illustrated using T accounts. Left side is debit; right side is credit.

Accounts and classifications

Balance Sheet

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities &amp; Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>Equity Capital</td>
</tr>
<tr>
<td>Materials</td>
<td>Loans</td>
</tr>
<tr>
<td>Receivables</td>
<td>Liabilities</td>
</tr>
<tr>
<td>Bank Accts</td>
<td>FI AP</td>
</tr>
</tbody>
</table>
## Account types, Balance Changes

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase Asset</td>
<td>Decrease Asset</td>
</tr>
<tr>
<td>Increase Expense</td>
<td>Decrease Expense</td>
</tr>
<tr>
<td>Decrease Revenue</td>
<td>Increase Revenue</td>
</tr>
<tr>
<td>Decrease Liability</td>
<td>Increase Liability</td>
</tr>
<tr>
<td>Decrease Equity</td>
<td>Increase Equity</td>
</tr>
</tbody>
</table>

## Example Scenario

We take out a loan from a bank for $10,000 and put that money in our bank account.

<table>
<thead>
<tr>
<th>Bank Account</th>
<th>Notes Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit $10,000</td>
<td>Credit $10,000</td>
</tr>
</tbody>
</table>

Example Scenario

We buy $1,000 of materials on credit from Johnson Lumber.

<table>
<thead>
<tr>
<th>Materials Account</th>
<th>Accounts Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>$1,000</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

Automated Posting

Example Scenario

We pay $1,000 to Johnson Lumber to settle our account.

<table>
<thead>
<tr>
<th>Cash Account</th>
<th>Accounts Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>$1,000</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

Automated Posting
**Example Scenario**

We sell $500 of merchandise to ACME Anvils on account

<table>
<thead>
<tr>
<th>Sales Revenue</th>
<th>Accounts Receivable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>$500</td>
<td></td>
</tr>
</tbody>
</table>

Automated Posting

ACME Anvils Customer Acct

Subledger Acct

**Example Scenario**

ACME Anvils pays us the $500 owed on their account

<table>
<thead>
<tr>
<th>Bank Account (Cash)</th>
<th>Accounts Receivable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit Credit</td>
<td>Debit Credit</td>
</tr>
<tr>
<td>$500</td>
<td></td>
</tr>
</tbody>
</table>

Automated Posting

ACME Anvils Customer Acct

Subledger Acct
### Example Scenario

**Ultimate outcome of ACME Anvils Purchase**

<table>
<thead>
<tr>
<th>Sales Revenue</th>
<th>Bank Account (Cash)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>$500</td>
<td>$500</td>
</tr>
</tbody>
</table>

### Role of Company Code in Financial Accounting

FI focused on legal requirements. CC is *smallest* legal entity where FI can be conducted.

Tax law, commercial law, and accounting standards must be considered before considering something as a candidate to be CC.

Without 1 operating CC in a client, FI cannot be undertaken and the system is *not* considered *live*.
Charts of account

Each company code must have one chart of accounts designated as the **operative COA**. The same COA may be used by multiple company codes. The COA segregates accounts into **account groups**. Accounts within account groups are segregated into number ranges and share the same **field status variant** settings (which fields are suppressed, required, displayed, or optional).

“New” General Ledger

G/L allows **parallel accounting**. Companies can maintain multiple **parallel ledgers**. The primary ledger is the **leading ledger**, the others are **non-leading ledgers**. Accounts in the operative COA are mapped to alternative COAs. Common structures: country-specific COAs, use common COAs to consolidate records across subsidiaries or Business Areas.

**Features of new G/L:**
- Ability to associate debits/credits with organizational entity.
- Ability to split documents among entities.
- Real-time reconciliation between FI and CO.
- Multiple books (parallel accounting with leading ledger).
Financial Accounting (FI) document

**Header section**
- Document date
- Company Code
- Document type
- Posting date
- Currency
- Reference number

**Detail/line item section**
- Account number
- Description
- Posting key (debit/credit)
- Amount

**Situational Data**
- Business Areas

**Organizational Data**

**Business Areas**

Business Areas can be used to consolidate FI reporting in a manner apart from company codes.

- BAs facilitate external reporting across company codes where that reporting is legally required.
- BAs are entirely optional and flexible.
- BAs typically differentiate company structure based on product lines and/or subsidiaries.
- BAs are company-code independent and posting can be made to them from any company code.
Cost Centers

Cost Centers within CO reporting allow tracking of costs based on where they were incurred. Organizational areas are designated as cost centers. These cost centers absorb costs. All costs within an organization are assigned to cost centers. Cost Objects are documents such as production orders related to business process execution that accumulate costs until they are settled to cost centers. Costs assigned to a cost center can be reallocated by the cost center to other cost centers.

Asset Accounting

3 types of assets: tangible (equipment, buildings, etc.), intangible (intellectual property, patents, etc.), and financial (securities, receivables). Tangible asset categories: fixed assets, leased assets, assets under construction. Each asset tracked in its own subledger account. Assets are assigned to company codes, business areas, and cost centers. Like kinds of assets are grouped in an asset class. An account for the asset class is used as the G/L reconciliation account. 3 primary transactions types: acquisition, depreciation, retirement.
Example Scenario

We buy a $10,000 lathe from Custom Millworks.

\[
\begin{align*}
\text{Factory Equipment} & \quad \text{Debit} \quad \text{Credit} \\
$10,000 & = \quad \text{Accounts Payable} \\
\text{Debit} & \quad \text{Credit} \\
$10,000 &
\end{align*}
\]

Clearing Accounts

Assets can also be acquired through use of a clearing account.

**Clearing account**: account that receives temporary postings to achieve time synchronization between transactions or record additional data on process steps.

Clearing accounts can be used in buying, selling, or other processes.

Often used for ‘one time’ transactions where we do not want to establish a customer or vendor account.
Asset acquisition using a clearing account

Scenario: We buy a $5,000 shredder on credit. This is a one-time transaction, so we do not want to set up a vendor account.

Office Equipment

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000</td>
<td></td>
</tr>
</tbody>
</table>

Asset Acquisition Clearing

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$5,000</td>
</tr>
</tbody>
</table>

Automated Posting

Shredder #182

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000</td>
<td></td>
</tr>
</tbody>
</table>

Subledger Account

We receive the invoice for the shredder.

Misc. Payables

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000</td>
<td></td>
</tr>
</tbody>
</table>

Asset Acquisition Clearing

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000</td>
<td></td>
</tr>
</tbody>
</table>

Customer Subledger Account
Asset acquisition using a clearing account

We pay for the shredder.

<table>
<thead>
<tr>
<th>Misc. Payables</th>
<th>Bank Account (Cash)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>$5,000</td>
<td>=</td>
</tr>
</tbody>
</table>

Why?

Why did we need to use a clearing account?
Why not bypass the clearing account?
Answer

Asset Depreciation

Most fixed assets’ value goes down over time. Depreciation reflects an estimation of the item’s current value. Depreciation is an expense and reflects the company being charged for using an asset over time.

Key concepts:

- Useful life: How long an asset is expected to last.
- Residual value: Amount received when asset is disposed of
- Book value: Asset cost less accumulated depreciation
- Depreciation Posting Run: A transaction, generally run annually, that posts depreciation expenses to G/L and cost centers.
FI Reporting

Account Information
Balance display, line item listing (if enabled for the account), original FI document

Asset Explorer
Detailed reporting on asset acquisition, depreciation (shown using multiple variations), all asset-related transactions

Financial Statements
Variations possible depending on reporting requirements—financial statement version

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