ACCOUNTING FOR THE NEW BUSINESS

BASIC ACCOUNTING PRINCIPLES

Accounting is the process of collecting, organizing, maintaining, reporting and interpreting financial data about a business.

That financial information is useful both to the business owners and managers in operating a business in a profitable and efficient way, and to outsiders like investors or creditors who require a picture of the business' financial position and performance. In both cases the information is intended to make decision making easier: decisions inside the business about the use of resources and structuring transactions for the lowest tax liability, and decisions by outsiders about subjects like the granting or continuing of credit to the business.

The information collection, organization and maintenance parts of accounting are called bookkeeping. The reporting and interpreting parts are called statement preparation. The complexity and sophistication of bookkeeping and statement preparation depend on the size and nature of a business and the size and nature of its markets and are beyond the scope of this publication. It is valuable here, however, to understand the way in which any accounting system, small or large, handles financial information.

Accounting is the formal process performed according to a set of generally accepted accounting principles. In many cases the business can choose the principles to be used as long as they are consistently applied and any changes in the principles used are disclosed to users of the business' financial statements. Certain industries have specialized accounting principles specific to businesses in those industries.

Because both internal and external users will rely on accounting information, accounting systems contain definitional concepts and principles which both define and limit the nature and use of the information they contain.

The business entity concept provides that for accounting purposes every business is separate and distinct from both its owners and from other businesses. Defining the business entity that way prevents distortion of the financial position of the business which might occur if information on the business owners or other related businesses were included.

The going concern concept assumes that a business on which accounting information is being prepared will continue in existence and is not about to be liquidated. As a result the financial information provided offers only a snapshot of the business based on historical data and ongoing reporting rather than reflecting current market values.

The stable dollar concept requires reporting of accounting information in dollar units which remain stable in value with no adjustment for inflation or the purchasing power of money.

The accounting period concept requires that financial reports showing changes in financial position be produced at fixed annual reporting periods.

The cost principle requires that all costs be recorded at the actual acquisition cost regardless of what the asset acquired might be perceived as being "worth." The cost recorded is the actual exchange price.

The objectivity principle requires that costs be objectively established and verifiable: guesses or estimates are not acceptable.

The revenue recognition principle requires that revenue be entered in the accounting records only at the time it is earned and not before.

The matching principle requires that expenses be matched with the revenue they produced.

The full disclosure principle requires that no significant information be omitted or concealed and that statements be prepared in accordance with generally accepted accounting principles.

The materiality principle provides for an exception from full disclosure for transactions with insignificant economic effect.

The consistency principle requires that the same accounting principles be followed from period to period to allow for comparison of financial performance.

The conservative principle requires that in presenting financial information, accounting procedures should be used which present the least favorable view of the firm's owners' equity.

These concepts and principles taken together produce a periodic picture of the financial position of the business expressed in constant dollars. While all the information which goes into the system is "real," the accounting principles used can change the way transactions are structured and reported and the effects – like tax consequences – of the transaction.

In addition, an accounting system imposes a set of internal controls on the business to ensure appropriate and consistent control of financial operations.

As noted above, the substance of any accounting system will vary with the size, complexity and sophistication of the business. The choice of an accounting system, the use of bookkeeping services or broader accounting services, and the use of mechanical or computerized systems or recordkeeping aids are best discussed with an accounting professional.