

# Financial Accounting

## 1: Introduction to Accounting

### 1.1 Basics of Business Accounting

#### Overview

- Business Accounting is structured in external accounting (financial accounting) and management (internal) accounting
- External accounting includes Bookkeeping, Inventory & Financial Statements

#### Financial Accounting

- representing companies financial situation to its stakeholders
- financial reporting/accounting pursuant to legal requirements
- preparation of financial statements

*transparency to stakeholders (legally required)*

#### Management Accounting

- representing important financial and operational processes of a company
- Planning, monitoring and controlling of company's operations

*Controlling operating business*

#### Definitions & Fields of Accounting

Financial- & Investment Planning	cash-outflow	Cash (-equivalent) spent, decrease in amount of cash in banks & on hand.	Booking entries containing <b>cash or bank</b>
	cash-inflow	Cash (-equivalent) flown to the company, increase in amount of cash in banks & on hand.	
Financial Accounting	expense	amount of consumed/used economic goods (not those in a warehouse)	Booking entries including Raw Materials, Consumables, Supplies, etc.
	income	amount of realized increase in value of economic goods	
Cost- & Performance Accounting	cost	Monetary assessed consumption of goods and services by providing/producing goods and services	//
	performance	Monetary assessed increase in value due by providing/producing goods and services	
//	expenditure	Monetary value of acquired economic goods (regardless of cash-outflow)	Booking entries including Raw Materials, Consumables, Supplies, Finished Goods, etc.
	receipt	Monetary value of delivered economic goods (regardless of cash-inflow)	

## 1.2 Basics of Financial Accounting

### Concept of ‚Market Orientation‘

- capital market oriented: equity instruments or bonds are traded on an organized market
- listet: equity instruments are traded on an organized market

### Capital Markets

White:

- Characteristics: government ruled by regulatory authorities (e.g. BaFin, SEC, ESMA, etc.)
- Products: shares, corporate bonds
- Markets: organized market

Grey:

- Characteristics: not regulated and not illegal
- Products: Company Participations, real estate participations, other
- Markets: over-the-counter-trading

Black:

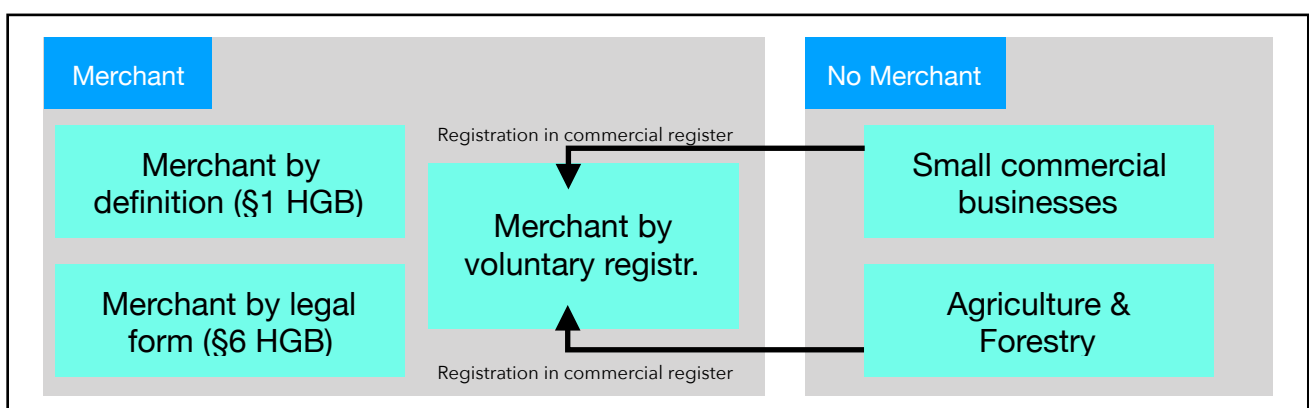
- Characteristics: illegal (subject to authorization - but without authorization)
- Products: insurances, gambling or bets (by non-authorized organization/people)
- Markets: „diverse places“

### General Accepted Accounting Principles (GAAP)

General Accepted Accounting Principles

	Generally accepted bookkeeping principles (Principles relating to proper bookkeeping)	Generally accepted inventory-taking principles (Principles relating to inventory-taking)	Generally accepted financial accounting principles (Principles relating to financial statements)
formal	- Transparency & Understandibility	- Accountability	- Consistency (formal)
material	- Completeness - Accuracy - Neutrality	- Completeness - Single-asset registration - Accuracy	- Realization principle - Imparity principle - Prudence - Coniteny (material)
	Primary Purpose: Documentation		Primary Purpose: Information

### Basic Concept ‚Merchant‘



**Merchant Definition §1 HGB**

Business AND Commercial Enterprise

- Business:
  - > recognizable from the outside
  - > independent
  - > systematic and for certain length of time
  - > not a liberal profession (§ 1 PartGG)
- Commercial Enterprise (both)
  - > requirement for commercial organization according to company's nature
  - > requirement for commercial organization according to company's size

**Merchant by legal form §6 HGB**

- Commercial business
- Legal Person (e.g. stock companies, Llc., etc.)
- Natural Person with commercial business

**Not a merchant by legal form**

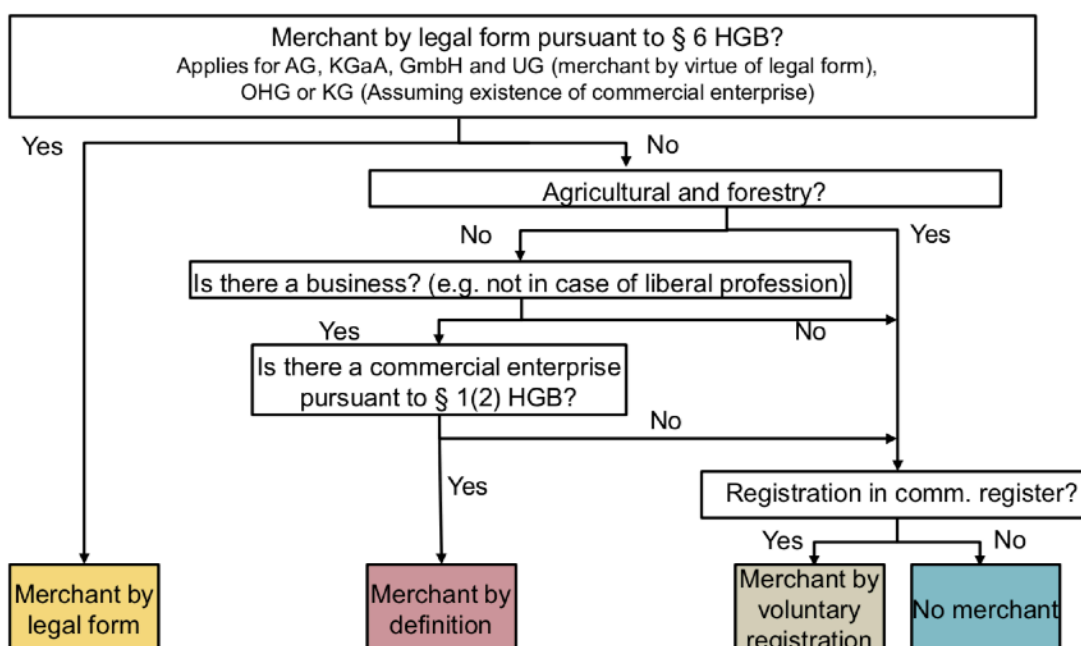
- Silent partnership (§230 HGB) which is not a commercial business
- Associations (§6.2 HGB)
- Private companies (GbR)
- Working communities
- National Businesses (e.g. universities, cemeteries)

**Basic concept ,legal person'**

Def.: independent organization, to which the legal system confers legal capacity and thus the ability to participate in legal transactions through its own bodies. It's detached from the inventory of its members and their assets.

- Examples: AG, KGaA, GmbH, UG, SE, SPE

**Check**

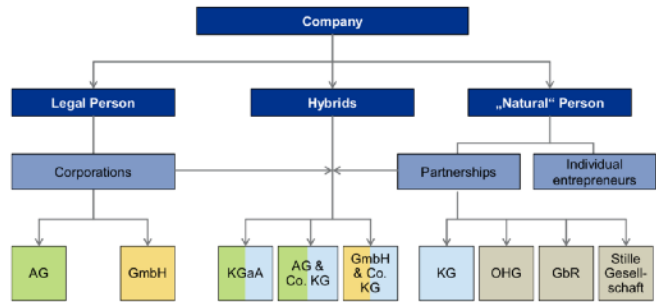


## 2: Bookkeeping

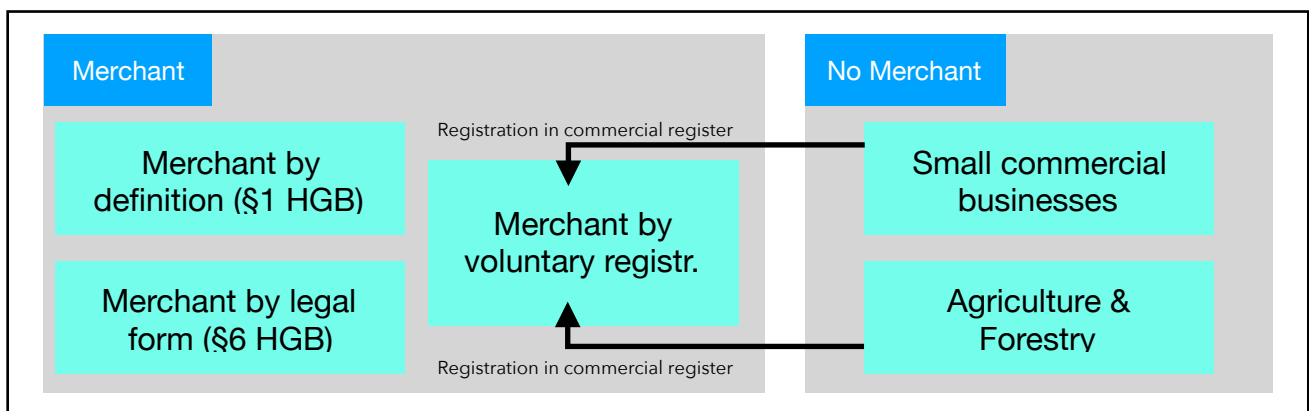
### 2.1 Introduction

#### A Company

- Missing uniform definition for the term „company“ in German law (e.g. differences in tax & commercial legislation)



#### A Merchant



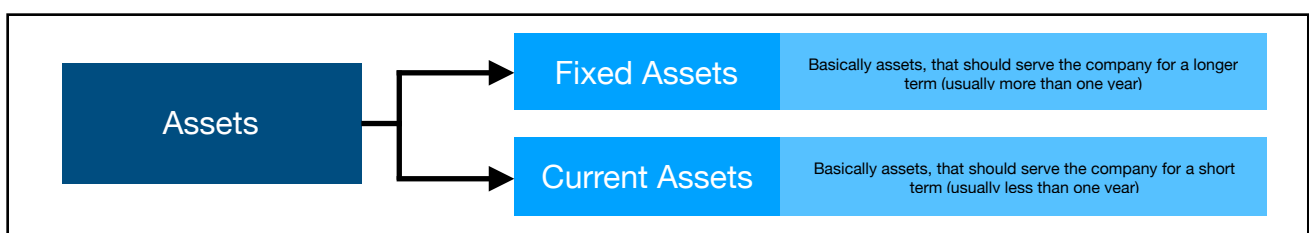
#### Duty to keep books (§238 HGB)

- Every Merchant is required to keep books.
- Exception: Individual Merchant with Revenues  $\leq 600.000\text{€}$  AND net profit  $\leq 60.000\text{€}$  (each in two consecutive reporting dates)

#### Equity Capital & Outside Capital



#### Equity Capital & Outside Capital



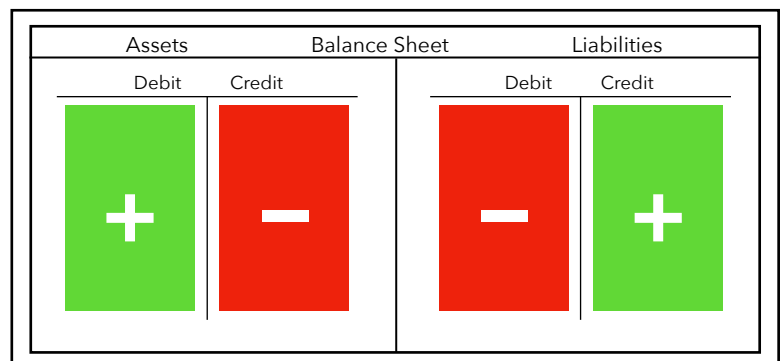
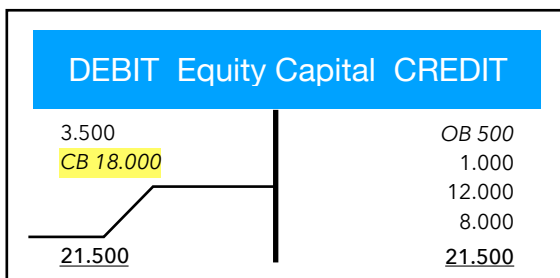
## 2.2 Basic Concepts of Bookkeeping

### Definition ‚Business Transactions‘

- event, which changes company’s financial situation (= assets or liabilities)
- has to be expressed in monetary value
- has to be posted without any exception (in context of double-entry bookkeeping)
- has two impacts always (two commercial effects)

### T-Accounts

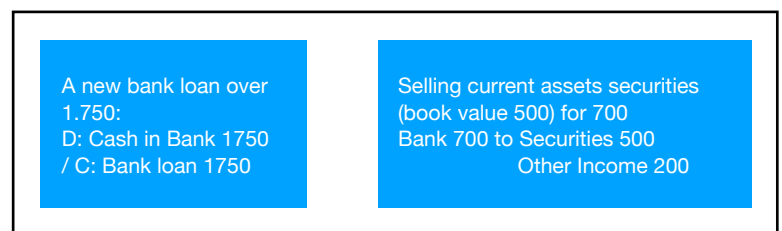
- two page statement, contain opening balance (OB) and additions & reductions and closing balance (CB)
- Permanent Accounts (Asset & Liabilities) and Temporary Accounts (Revenue & Expense)



- Balancing: Adding missing amount to balance T-Account. Balance is Opening Balance for next year

### Vouchers and Journal Entry

- Postings are made DEBIT to CREDIT
- Debit and Credit of a posting equal in their monetary value
- Postings contain:
  - > the accounts affected
  - > the amount
  - > an explanatory text
- No posting without a voucher
  - > Internal Vouchers (own document) e.g. payrolls, receipts, outgoing invoices, etc
  - > External Vouchers (third party’s document) e.g. incoming invoices, bank statements, etc.



### Income - Profit & Loss

- Expense: decrease in equity capital (income affecting)
- Revenue: Increase in equity capital (income affecting)

### Equity capital accounts and its subaccounts

- Change through Profit & Loss via Revenue & Expense accounts
- Change through Capital via Private accounts

**Stocktaking and Inventory**

## Raw-Materials, Supplies &amp; Consumables

**Raw-Materials**

Main parts of the product  
> e.g. bicycle frames

**Supplies**

Other small parts of the product  
> e.g. screws

**Consumables**

Not related to the product  
> e.g. oil, detergent

Assets: raw materials, supplies, consumables, unfinished goods, finishes goods, goods for resale

Liabilities (income affecting): material expenses, sales

- Expenses are booked while purchasing
- Sales are booked while selling
- Sales and Material Expenses are balanced for loss, after unused inventory is booked to material expenses credit side
- annual stocktaking is obligatory for merchants in accordance with §238 HGB

**2.3 Basic Concepts of Bookkeeping****Significant adjusting journal entries**

- Stocktaking: Credit: material expenses to Debit (unused) material
- Depreciation: decrease in value by time/use of fixed (tangible or intangible) assets
  - > income affecting (seperate Depreciation Account)
  - > depreciation = expense = cashflow independent
- Value Adjustment: adjusting current assets bookvalue
- Deffered revenues and charges: Expenses and Revenues have to be recorded in the period which they are assigned to
- Provisions: Liabilities, which are not certain in amount of payment

**Profit calculation and Equity capital account closing**

- Private Accounts: Withdrawals, Investments
- Revenue & Expense Accounts: closed to P&L, incl. Material expenses, sales, interests, etc.

**Closing balance sheet and closing balance sheet account**

Consisting of: fixed- and current assets, equity- and outside capital

**Opening balance sheet and opening balance sheet account**

01s closing balance sheet is 02s opening balance sheet

**Books and Bookkeeping**

- Journal (Grundbuch): listing all entries in chronological order (date, memo, posting text, journal entry, amount)
- General ledger (Hauptbuch): all accounts of the company
- Subsidiary books of account (Nebenbücher): further accounts, which are not part of the main account system (e.g. payroll account for special employee)