

Financial and Cost Accounting

Lecture 3

Forms of Business Organizations

Business enterprise may be organized as a sole proprietorship, partnership or a corporation.

GAAP apply to the financial statements of all three forms of organizations

- Sole Proprietorship: An Unincorporated business owned by one person is called a sole proprietorship (often the owner also acts as a manager).
 - This form of business organization is common for small retail stores, service businesses and professional practices in law, medicine and public accounting.

Sole proprietorship

From accounting point of view

- A sole proprietorship is regarded as a business entity separate from the other affairs of its owners. (Most common business type)

From legal point of view

- The owners and the business are not regarded as separate entities. The owners are personally liable for the debts of the business
- If the business becomes insolvent, creditors can force the owners to sell his or hers personal assets to pay for the business debts.

Partnerships

- An unincorporated business owned by two or more persons, voluntarily acting as partners(co-owners) is called a partnership.
 - Widely used for small businesses
 - From accounting point of view

A partnership is viewed as a business entity separate from the personal affairs if its owners

From legal point of view

- The owners of partnership are held personally responsible for all debts of the business.

Corporations

- A corporation is the only type of business organization recognized under the law as an entity separate from its owners
 - The owners of the business are not personally liable for the debt of the business
 - These owners cannot lose more than the amount they have invested in the business-this concept is known as limited liability. This is why this form of business is most attractive to investors

Corporation

- Ownership of the corporation is divided into transferable shares of capital stock and the owners are called stock holders
- Stock certificates are issued by the corporation to stock holders showing the number of shares he/she owns
- The stockholders are free to sell some or all of these shares to other investors at any time
- The transferability of ownership adds to the attractiveness of corporate form of organization, as investors can quickly get their money out of the business
- Large businesses are generally organized as corporations

Owner's Equity for 3 types of business entities

Sole Proprietorship: one owner

e.g

Owner's equity:

Ahmed Ali, Capital.....Rs. 800,000

Partnership:(2 partners)

Partner's equity:

Ahmed Ali, Capital..... Rs. 800,000

Abdullah, Capital.....200,000

Total Partner's Equity.....Rs.1,000,000

Stockholder's equity:

Capital Stock.....Rs.2,000,000

Retained Earnings.....25,000,000

Total Stockholder's equity...Rs.27,000,000

Financial Statements

Balance Sheet : a balance sheet shows at a specific date the **financial position** of a company by indicating the resources that it owns, the debt that it owes and the amount of owner's equity(investment) in the business.

Owe, obligations, debt and liabilities are terms used interchangeably .
These all mean the same that is 'liability',

2. Income Statement

Income Statement : indicates the profitability of the business over the preceding year(or some other time period).

Statement of Owner's Equity

Statement of Owner's Equity is a financial statement summarizing the changes in owner's equity occurring in business organized as a sole proprietorship or partnership and covers the same period of time as does the income statement.

Statement of Retained Earnings: is a financial statement explaining certain changes in the amount of owner's investment in a business organized as a corporation.

Statement of Cash Flows

Statement of Cash Flows: show the summary of the cash receipts and cash payments of the business over the same period as covered by the income statement.

This period is called the accounting period. The duration after which a business prepares its formal financial statements. The period could be yearly, quarterly, monthly, or weekly.