MBA in Food & Agribusiness

Financial Management

Users of Accounting Information and the Financial Statements

Why Financial Accounting?

Agenda

- Accounting as an information system
- Decision makers: The Users of Accounting information
- Accounting Measurement
- The Corporate Form of Business
- Financial position and the accounting equation
- Financial statements
- Generally accepted accounting principles (GAAP)

Accounting as an Information System

- **Operating**
- **Activities**

- ✓ Selling goods and services to customers
- ✓ Employing managers and workers
- ✓ Buying and producing goods and services
- ✓ Paying taxes

- **Investing**
- **Activities**

- ✓ Buying land, buildings, and equipment
- ✓ Purchasing other resources necessary to operate the business
- ✓ Selling these resources when no longer needed

Financing Activities

- ✓ Obtaining capital from creditors
- ✓ Securing loans
- ✓ Gathering funds from owners
- ✓ Repaying creditors
- ✓ Paying returns to owners

Accounting as an Information System

Performance Measures: Ratios

- ✓ Used to compare a company's financial performance from one year to the next
- ✓ Helpful when making comparisons among companies

Return on Assets = how much is earned on each dollar invested in assets

		(in millions)	
CVS		**2004**	**2003**
Net Income / Average Total Assets	=	$918.8 / ($14,546.8 + $10,543.1) / 2	$847.3 / ($10,543.1 + $9,645.3) / 2
Return on Assets	=	7.3%	8.4%

Decision Makers: the Users of Accounting Information

Management

- ✓ Finance
- ✓ Investment
- ✓ Operations & Production
- ✓ Marketing
- ✓ Human Relations
- ✓ Accounting

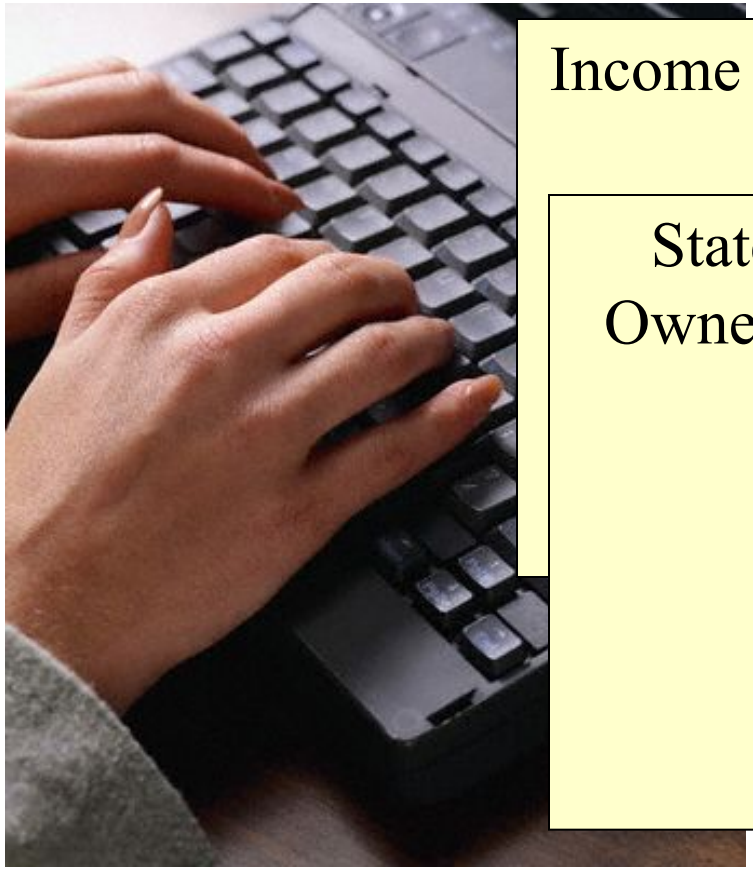
Those With Direct Financial Interests

- ✓ Investors
- ✓ Creditors
- ✓ Banks

Those With Indirect Financial Interests

- ✓ Tax Authorities
- ✓ Regulators
- ✓ Labor Unions
- ✓ Customers
- ✓ Economic Planners

Financial Statements



© Royalty-Free/Corbis

Income Statement

Statement of Owner's Equity

Balance Sheet

Statement of Cash Flows

Financial Statements - Income Statement

Date reflects revenues and expenses incurred over a period of time

Ramirez Agency
Income Statement
For the Month Ended December 31, 20xx

Revenues		
Commissions earned		$7,000
Expenses		
Equipment rental expense	$1,400	
Wages expense	800	
Utilities expense	600	
Total expenses		2,800
Net income		$4,200

Net income figure used to prepare statement of owner's equity

Financial Statements – Accounting Equation

Ramirez Agency
Balance Sheet
December 31, 20xx

Assets		**Liabilities**	
Cash	$31,200	Accounts payable	$ 1,200
Accounts receivable	2,000	Total liabilities	$ 1,200
Supplies	1,000	**Owner's Equity**	
Land	20,000		
Buildings	50,000		
		R. Ramirez, Capital	$103,000
Total assets	$104,200	Total liabilities and owner's equity	$104,200

Assets = Liability + Shareholders Equity

Financial Statements - Statement of Owner's Equity

Ramirez Agency
Statement of Owner's Equity
For the Month Ended December 31, 20xx

R. Ramirez, Capital, December 1, 20xx	$ 0
Investment by R. Ramirez	100,000
Net income for the month	4,200
Subtotal	$104,200
Less withdrawals	1,200
R. Ramirez, Capital, December 31, 20xx	$103,000

Ending balance of owner's capital used to prepare the balance sheet

Net income figure comes from income statement

Statement of Cash Flows

Ramirez Agency
Statement of Cash Flows
For the Month Ended December 31, 20xx

Cash flows from operating activities		
Net income		$ 4,200
Adjustments to reconcile net income to net cash flows from operating activities		
Increase in accounts receivable	($2,000)	
Increase in supplies	(1,000)	
Increase in accounts payable	1,200	(1,800)
Net cash flows from operating activities		$ 2,400
Cash flows from investing activities		
Purchase of land	($20,000)	
Purchase of building	(50,000)	
Net cash flows from investing activities		(70,000)
Cash flows from financing activities		
Investments by owner	$100,000	
Withdrawals	(1,200)	
Net cash flows from financing activities		98,800
Net increase (decrease) in cash		$31,200
Cash at beginning of month		0
Cash at end of month		$31,200

Begins with net income from income statement

Cash at end of month should be the same as Cash account balance on balance sheet

Generally Accepted Accounting Principles (GAAP)

RAAD VOOR DE JAARVERSLAGGEVING

Generally Accepted Accounting Principles (GAAP)

Number	Name
IFRS 3	Business combinations
IFRS 7	Financial instruments - disclosures
IAS 1	Presentation of financial statements
IAS 2	Inventories
IAS 7	Cash flow statements
IAS 16	Property plant & Equipment
IAS 17 / IFRS 16	Leases
IAS 18 / IFRS 15	Revenue
IAS 27, 28, 31, IFRS11	Consolidations, Investments in associates, Investments in Joint Ventures and Joint Operations
IAS 32	Financial instruments: Disclosure & presentation
IAS 33	Earnings per share
IAS 38	Intangible assets
IAS 39 / IFRS 9	Financial instruments: Recognition & measurement

Financial Statement Analysis

- *Balance sheet ratios*
  - Short-term *liquidity* ratios
    - **Current ratio** = Current assets/Current liabilities
    - **Days Sales Uncollected** = [(Accounts receivable Year 2 + Accounts receivable Year 1)/2 x 365]/Sales
    - **Days Inventory on hand**= [(Inventory Year 2 + Inventory 1)/2 x 365]/Sales

Financial Statement Analysis

- *Balance sheet ratios*
  - Long-term *solvency* ratios
    - **Debt to equity ratio** = Total Liabilities/ Stockholders equity.
- *Profitability ratios*
  - **Profit margin** = Net income/Sales
  - **Return on shareholders' equity (ROE)** = Net income/Average equity

Analysing Business Transactions

How Financial Accounting?

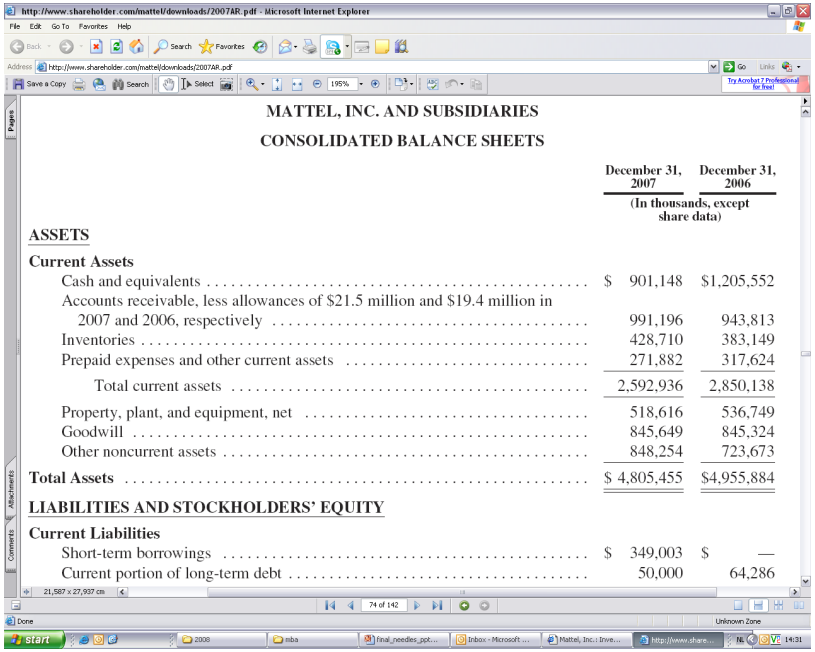
The New York Times

Lead Paint Prompts Mattel to Recall 967,000 Toys

By LOUISE STORY
Published: August 2, 2007

Mattel, the maker of Barbie dolls and Hot Wheels cars, is recalling nearly one million toys in the United States today because the products are covered in lead paint.

?



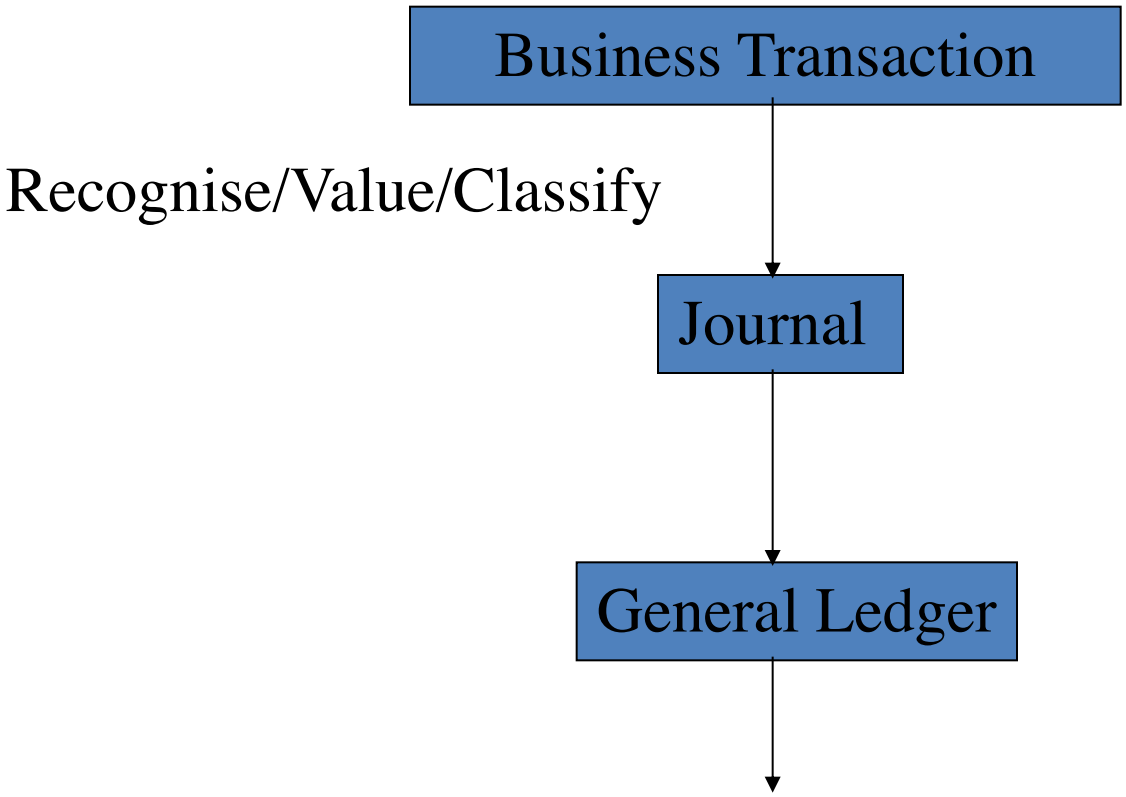
MATTEL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2007	December 31, 2006
	(In thousands, except share data)	
ASSETS		
Current Assets		
Cash and equivalents	$ 901,148	$1,205,552
Accounts receivable, less allowances of $21.5 million and $19.4 million in 2007 and 2006, respectively	991,196	943,813
Inventories	428,710	383,149
Prepaid expenses and other current assets	271,882	317,624
Total current assets	2,592,936	2,850,138
Property, plant, and equipment, net	518,616	536,749
Goodwill	845,649	845,324
Other noncurrent assets	848,254	723,673
Total Assets	$ 4,805,455	$4,955,884
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Short-term borrowings	$ 349,003	$ —
Current portion of long-term debt	50,000	64,286

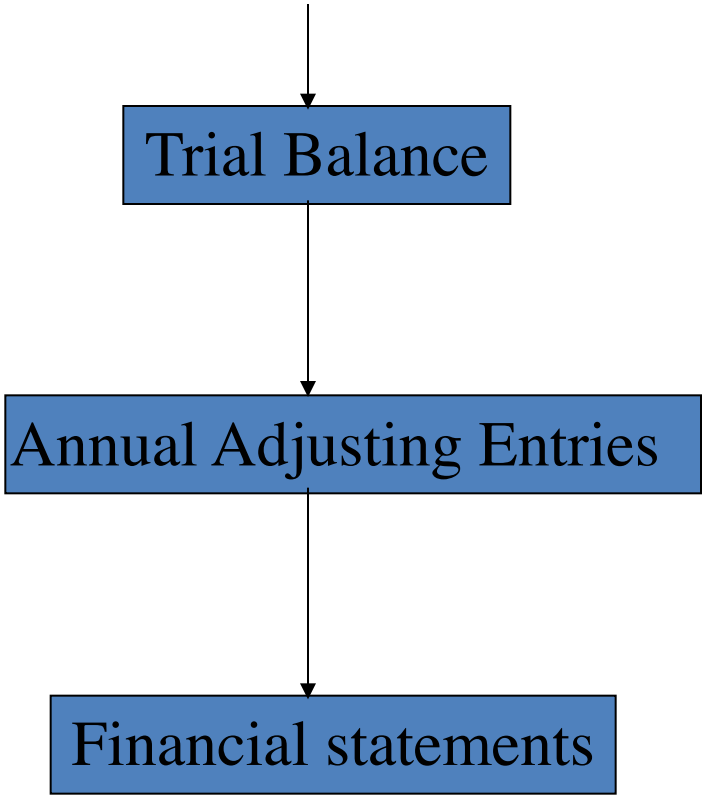
Agenda

- Measurement Issues
- Double Entry System
- Business Transaction Analysis
- The Trial Balance
- Cash flows and the Timing of transactions
- Recording and Posting Transactions

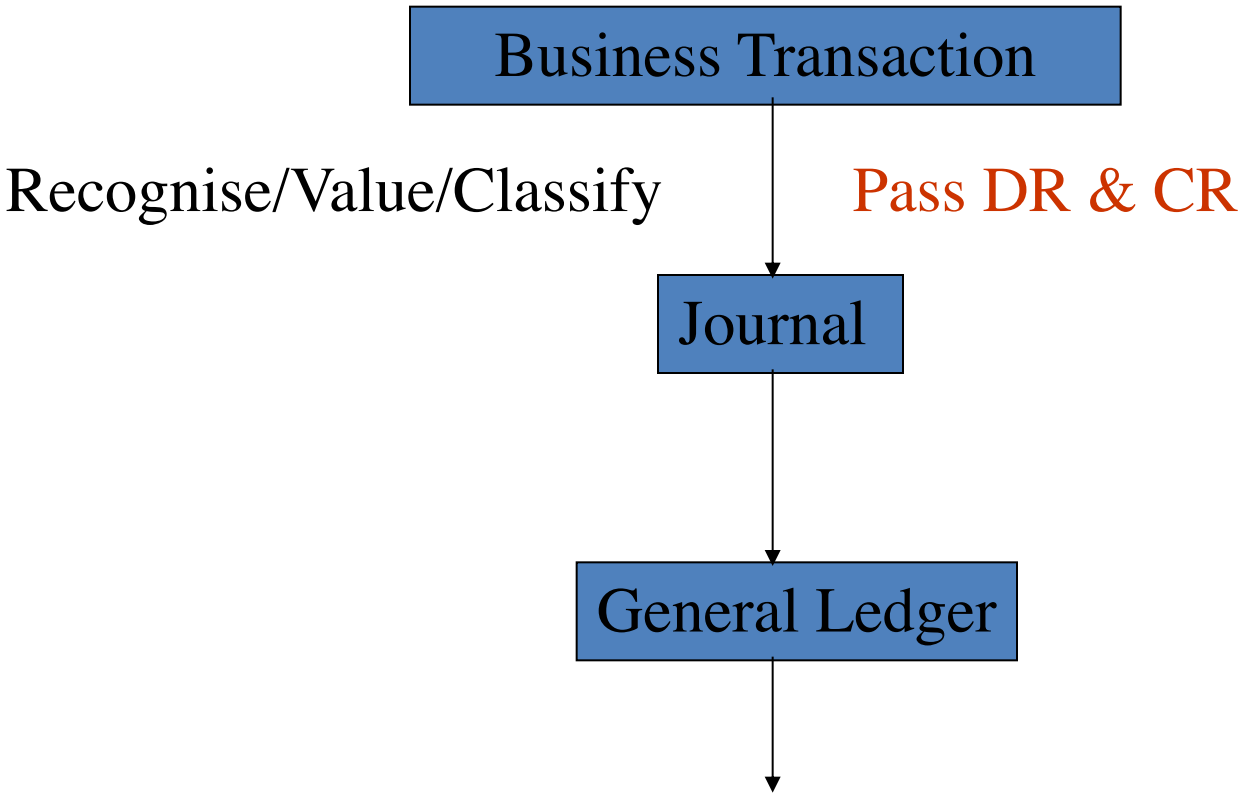
Analyzing Business Transactions



Analyzing Business Transactions



Double Entry System



Double Entry System

DEBIT	CREDIT
EXPENSE	LIABILITIES
ASSET	INCOME
DIVIDEND	CAPITAL

DR = CR

Accounts Illustrated

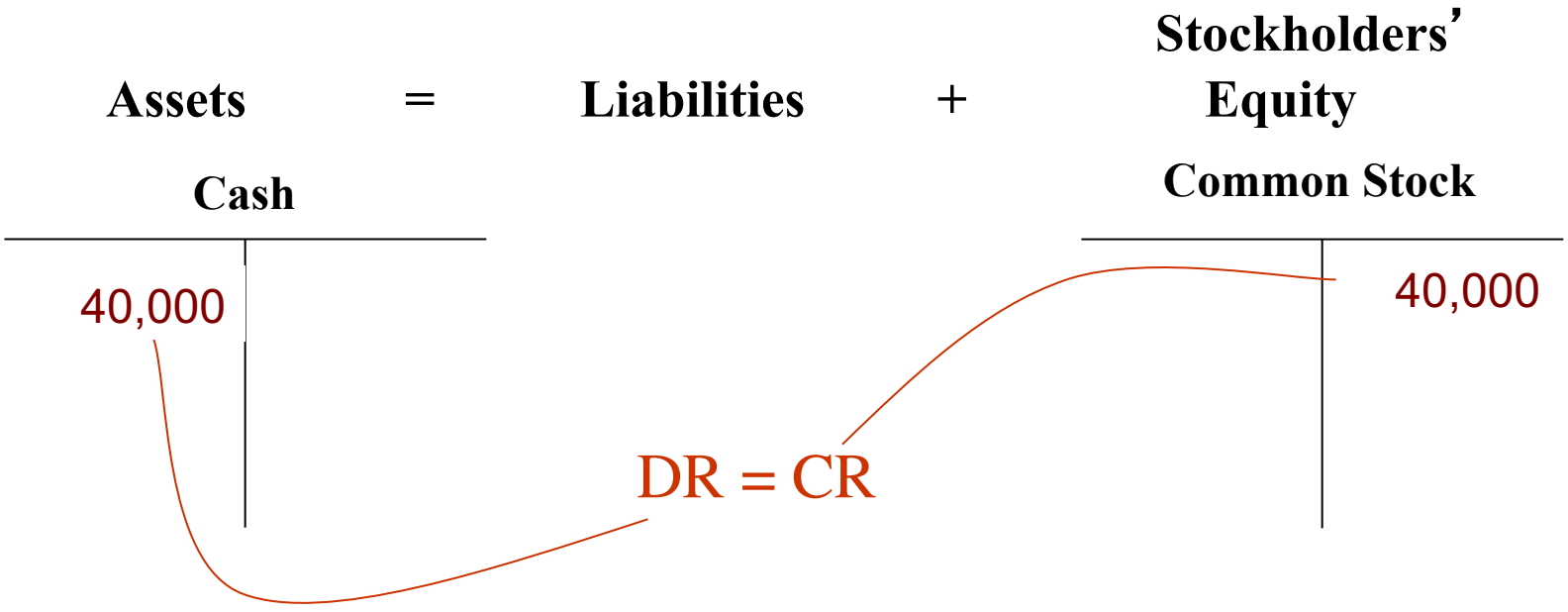
Assets	=	Liabilities	+	Stockholders' Equity
700		200		500
100		100		
800	=	300	+	500

If a debit increases assets by $100, then a credit must increase stockholders' equity or liabilities by $100 for the accounting equation to stay in balance.

Business Transaction Analysis -

Transaction: Owner's Investment

July 1: Pricilla Treadle invests $40,000 in Treadle Website Design, Inc. in exchange for 40,000 shares of $1 par value common stock.



Business Transaction Analysis -

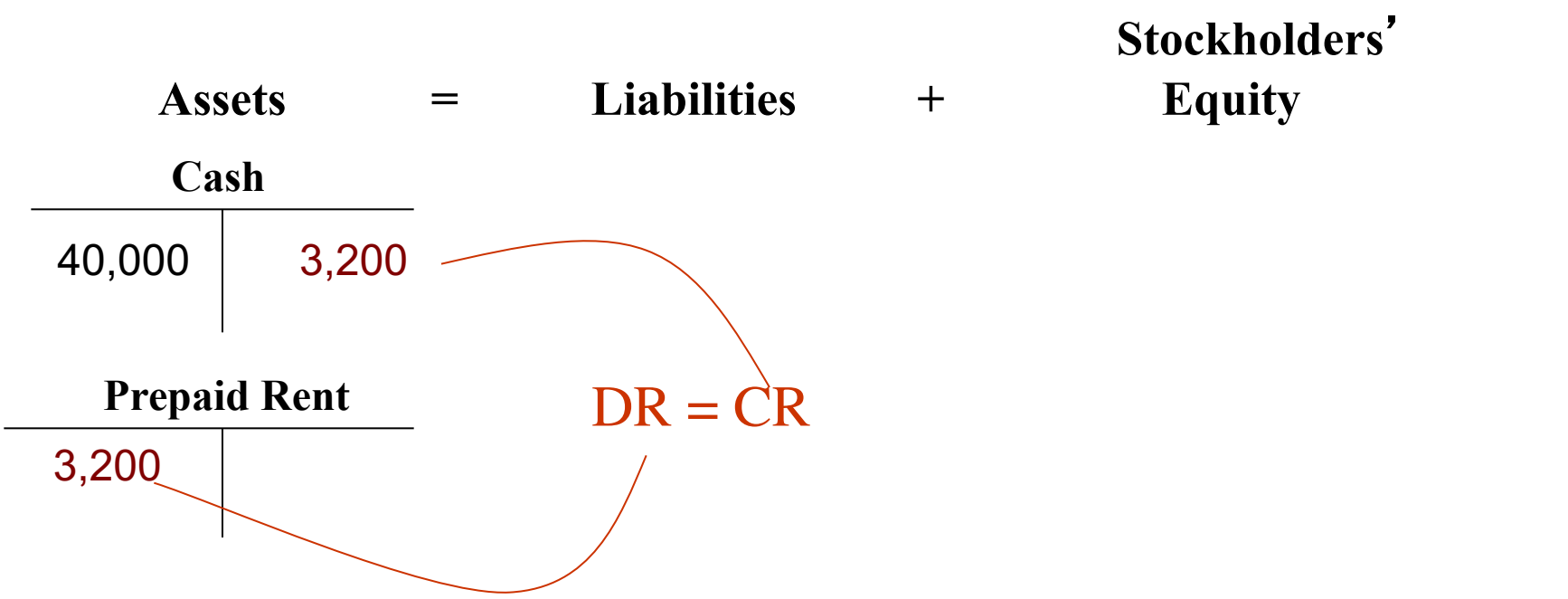
Transaction: Owner's Investment journal

1. Date recorded on first line
2. Debit account and debit amount recorded on first line
3. Indent, credit account and credit amount recorded on second line

		Dr.	Cr.
July 1	Cash	40,000	
	Common Stock		40,000

Business Transaction Analysis –

Transaction: Prepayment of Rent



July 3: Payment of 2 months rent in advance, $3,200

Business Transaction Analysis –

Transaction: Prepayment of Rent journal

		Dr.	Cr.
July 3	Prepaid Rent	3,200	
	Cash		3,200

Business Transaction Analysis –

Transaction: Purchase of Supplies on Credit

July 5: Receipt of office supplies ordered on July 2 and an invoice for $5,200.

Office Supplies	
5,200	

Accounts Payable	
	5,200

July 5	Office Supplies	5,200	
	Accounts Payable		5,200

Business Transaction Analysis –

Transaction: Service Revenue on credit

July 15: Performs design services; bill now but to be received later, $9,600

Accounts Receivable	
9,600	

Design Revenue	
	9,600

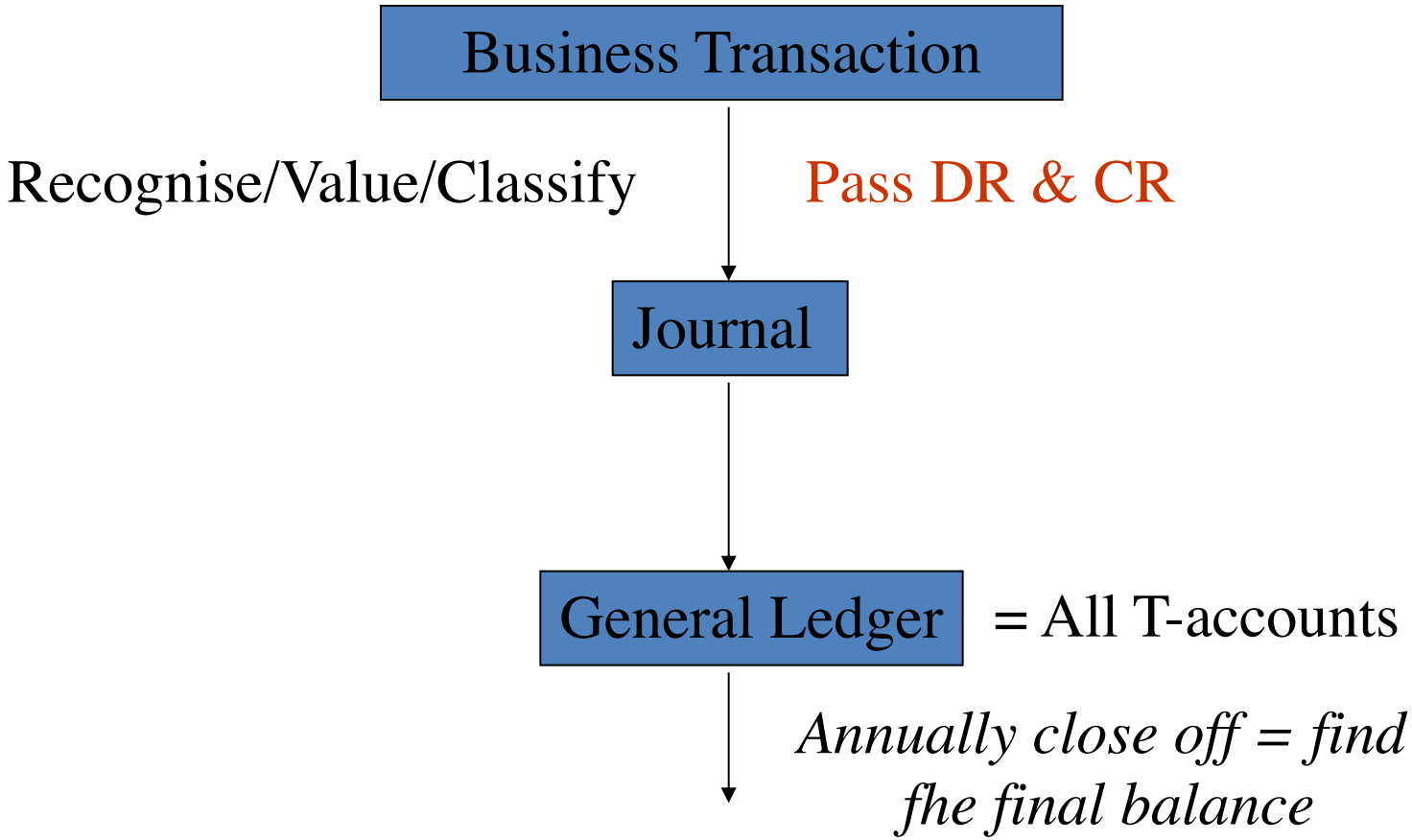
July 15	Accounts Receivable	9,600	
	Design Revenue		9,600

Debit & Credit Bookkeeping Rules - Summary

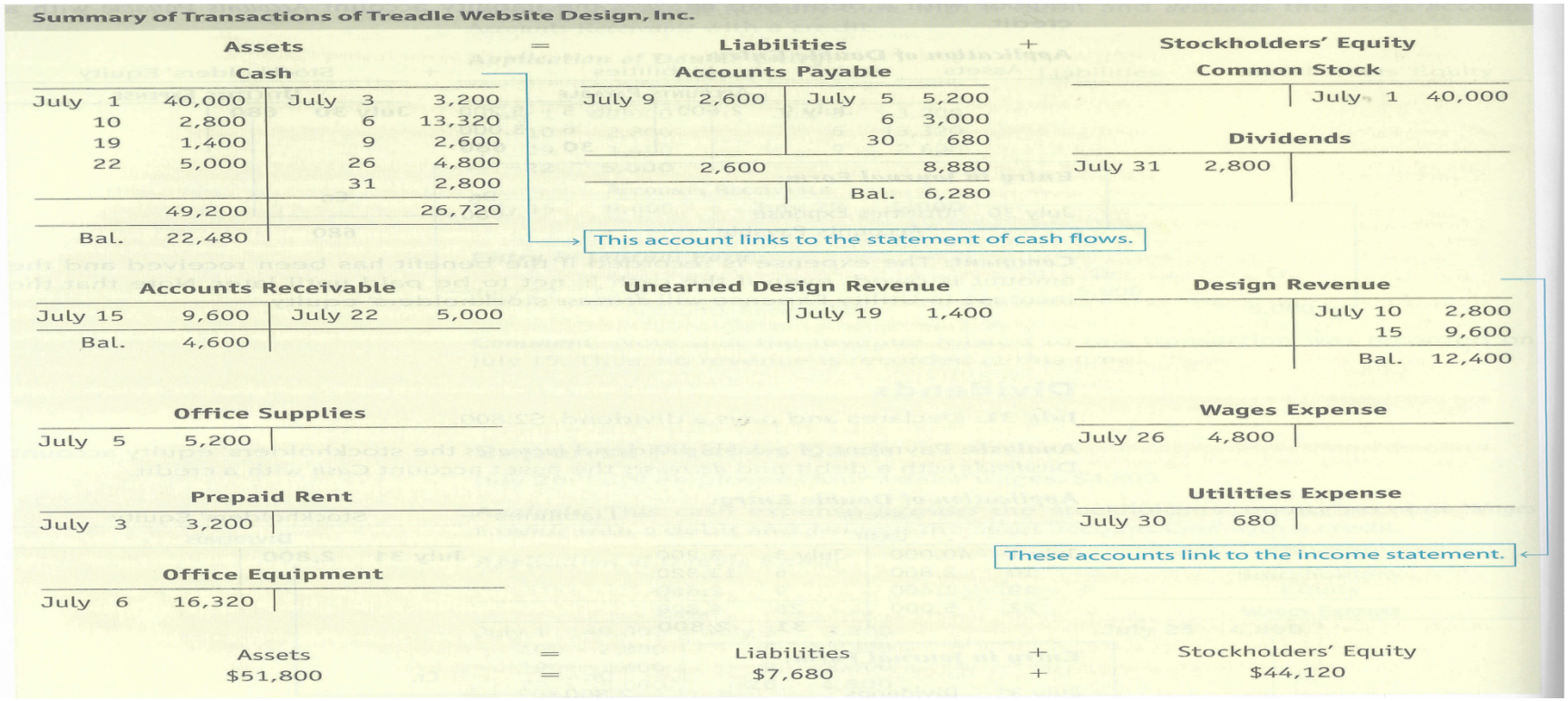
Dr (*debit*)		Cr (*credit*)
A	=	***L + SE***
↑		↑
Expenses		*Sales*

Because they increase SE(same with Capital contributed)

Double Entry System



Summary of Transactions



Summary of Transactions of Treadle Website Design, Inc.

Assets = **Liabilities** + **Stockholders' Equity**

Cash

July 1	40,000	July 3	3,200		
10	2,800	6	13,320		
19	1,400	9	2,600		
22	5,000	26	4,800		
		31	2,800		
	49,200		26,720		
Bal.	22,480				

Accounts Payable

July 9	2,600	July 5	5,200
		6	3,000
		30	680
	2,600		8,880
		Bal.	6,280

Common Stock

		July 1	40,000

Dividends

July 31	2,800		

This account links to the statement of cash flows.

Accounts Receivable

July 15	9,600	July 22	5,000
Bal.	4,600		

Unearned Design Revenue

		July 19	1,400

Design Revenue

		July 10	2,800
		15	9,600
		Bal.	12,400

Office Supplies

July 5	5,200		

Wages Expense

July 26	4,800		

Prepaid Rent

July 3	3,200		

Utilities Expense

July 30	680		

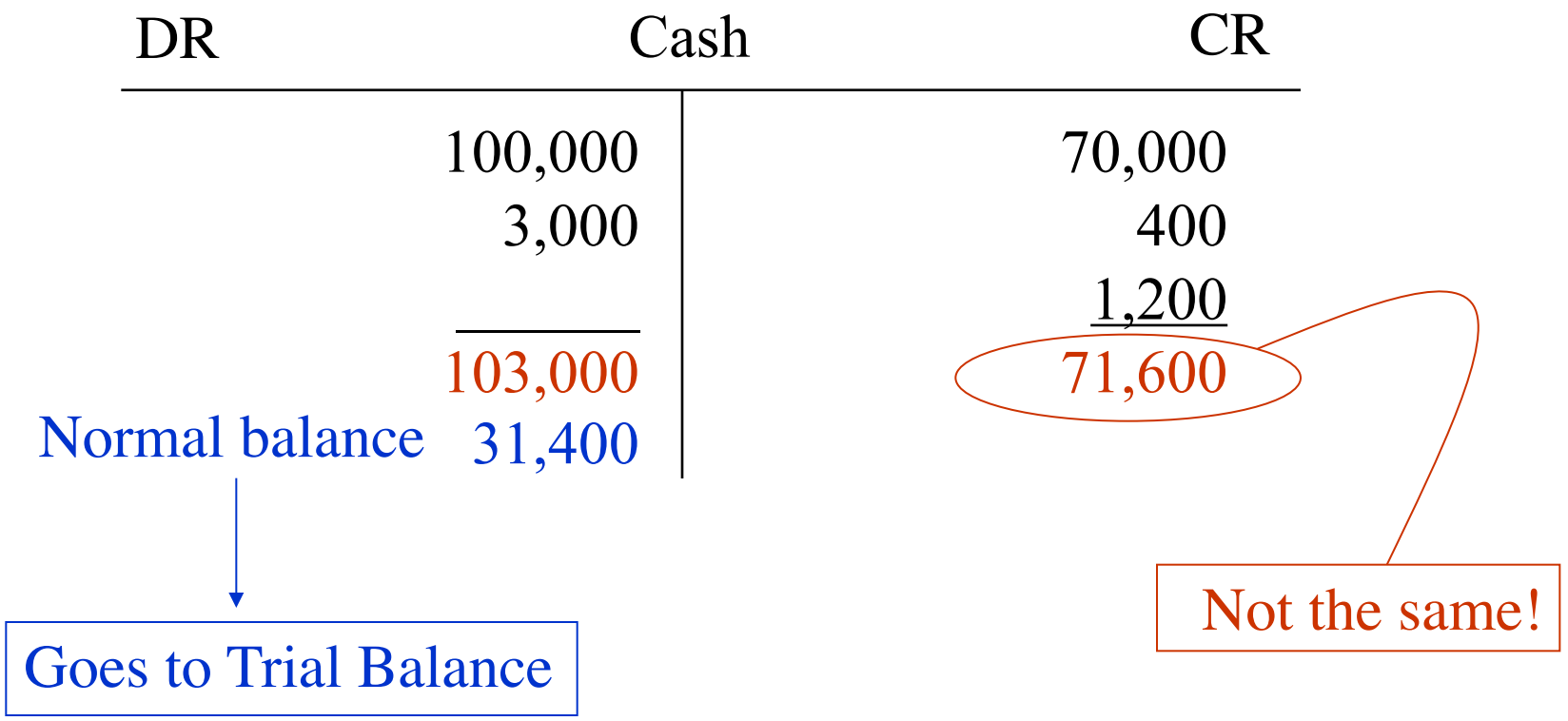
These accounts link to the income statement.

Office Equipment

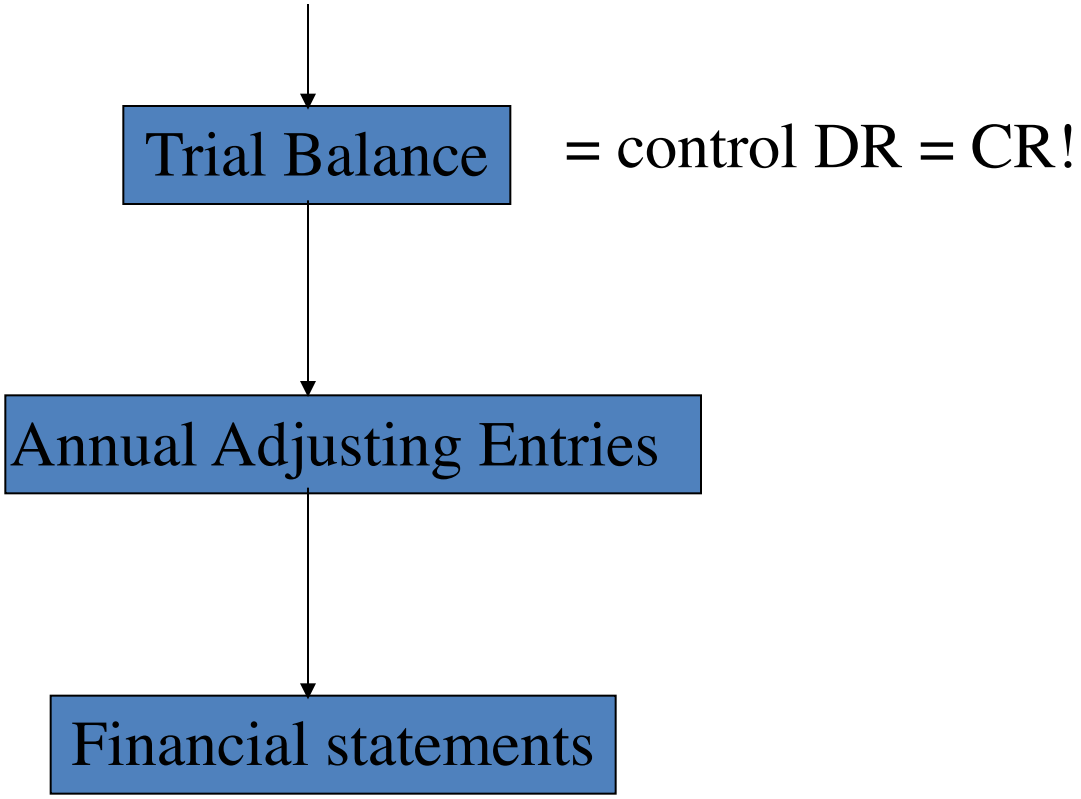
July 6	16,320		

Assets	=	Liabilities	+	Stockholders' Equity
$51,800	=	$7,680	+	$44,120

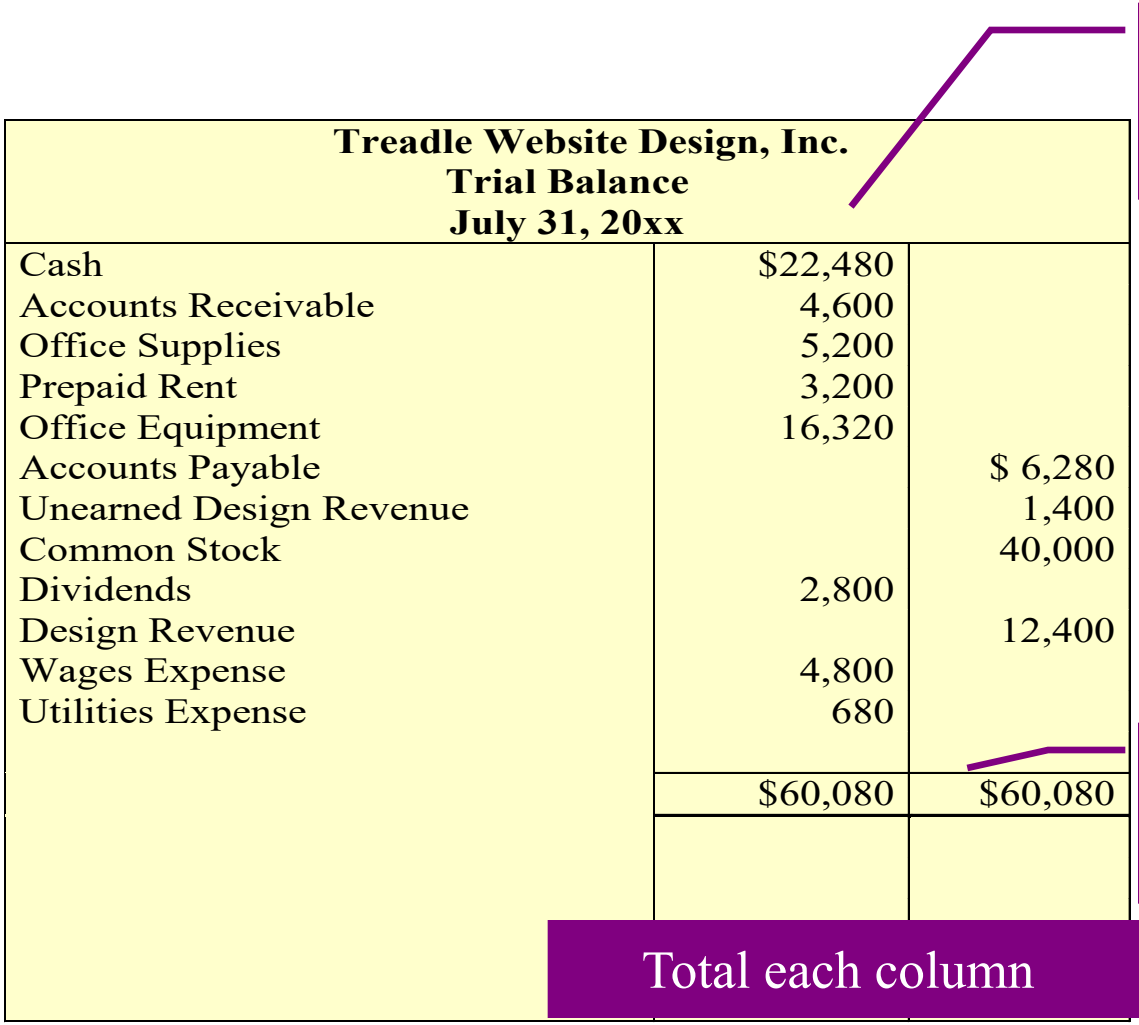
The T Account Illustrated



Analyzing Business Transactions



The Trial Balance



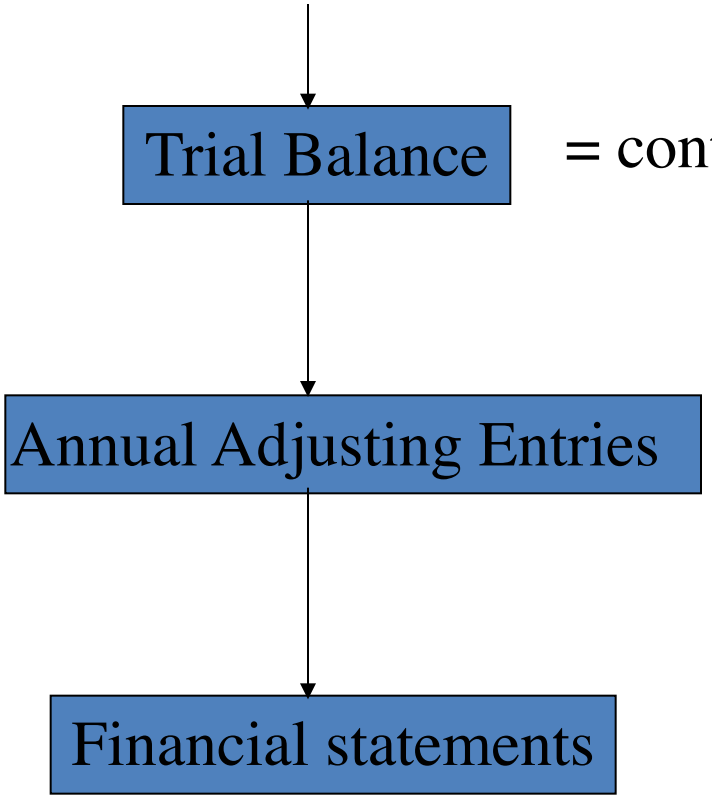
Treadle Website Design, Inc.
Trial Balance
July 31, 20xx

Cash	$22,480	
Accounts Receivable	4,600	
Office Supplies	5,200	
Prepaid Rent	3,200	
Office Equipment	16,320	
Accounts Payable		$ 6,280
Unearned Design Revenue		1,400
Common Stock		40,000
Dividends	2,800	
Design Revenue		12,400
Wages Expense	4,800	
Utilities Expense	680	
	$60,080	$60,080

Finding Trial Balance Errors

If the debit and credit totals are not equal, look for one or more of these errors:

- ✓ A debit was entered as a credit, or vice versa
- ✓ The balance of an account was computed incorrectly
- ✓ An error was made in carrying the account balance to the trial balance
- ✓ The trial balance was summed incorrectly

Analyzing Business Transactions

- Prepaid epxenses/assets
- Depreciation
- Unearned Revenues
- Receivables
- Payables