

Overview – ACCOUNTING

1. FINANCIAL ACCOUNTING
2. MANAGEMENT ACCOUNTING

What is Accounting?

What Is Accounting?

- **Accounting**
 - a comprehensive system for collecting, analyzing, and communicating financial information
- **Bookkeeping**
 - recording accounting transactions
- **Accounting Information System (AIS)**
 - organized procedure for identifying, measuring, recording, and retaining financial information

Users of Accounting Information

Business managers

Employees and unions

Investors and creditors

Taxing authorities

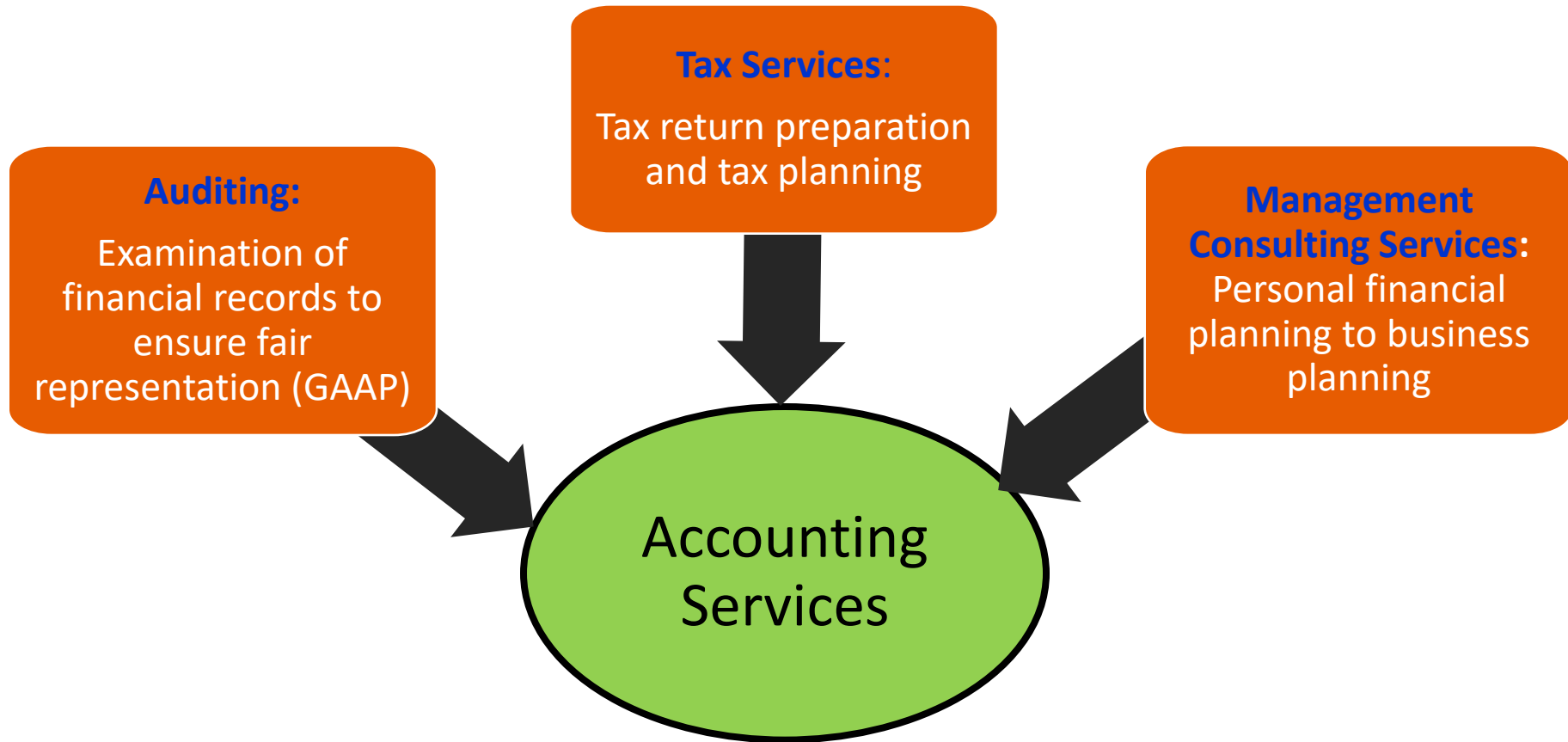
Government regulatory agencies

Accountants

Private Accountants

- ☐ hired as salaried employees
- ☐ duties cover day-to-day accounting needs
- ☐ small business may have just one
- ☐ large business may have area specialists (i.e. budgeting, taxation, accounts payable etc.)

Accounting Jobs



Accountant or Controller?

Professional Accountants

chartered accountants (CA)
certified general accountants (CGA)
certified management accountants (CMA)



Unification

Chartered Professional Accountant (CPA)

Accountant or Controller?

Controller

- head of the AIS
- ensures that the accounting system provides the reports and statements needed for planning, controlling and decision-making
- activities may need different types of accounting specialists



Christian Delbert/Fotolia



International Accounting (IFRS)

- **International Accounting Standards Board (IASB)**

- ❖ members in over 80 countries
- ❖ goal is to eliminate differences in financial reporting from country to country
- ❖ IASB statements include an income statement, balance sheet and a statement of cash flows

The Accounting Cycle

1.
Analyze
transaction
documents
(e.g.,
sales slips,
travel
expenses,
payments to
employees,
and so on)



2.
Record
transactions
in a journal



3.
Transfer
entries
from the
journal
to a ledger



4.
Do a trial
balance



5.
Prepare
financial
statements
(i.e., income
statement,
balance
sheet,
and
statement
of cash
flows)



6.
Analyze
the financial
statements
(e.g., using
ratio analysis)

The Accounting Equation

- **Asset**

- ☐ anything of economic value owned by a firm or individual

- **Liability**

- ☐ any debt owed by a firm or an individual to others

- **Owners' Equity**

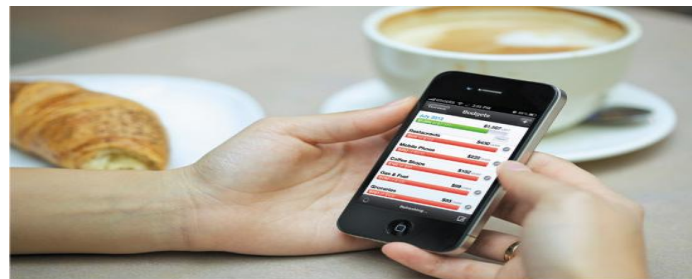
- ☐ any positive difference between a firm's assets and liabilities



^
^
^ The inventory at this car dealership is part of the company's assets. The cars constitute an economic resource because the firm will benefit financially as it sells them. After they are sold and at the end of the company's accounting period, the dealership will convert the cost of the cars as expenses and show them as costs of goods sold.

Alex Segre/Alamy

The Accounting Equation



⌘ Thanks to smartphones, financial information is now much more accessible wherever you might be located.

Types of Accounting

Accounting Two main Categories

- **Financial Accounting**

- ☐ keeps external parties informed about the firm's financial condition
- ☐ statements structured according to GAAP requirements

- **Managerial Accounting**

- ☐ directed at internal parties (managers)
- ☐ provides information to facilitate planning, forecasting, and decision-making

Financial Statement Analysis (FSA)

A) FINANCIAL INFORMATION ANALYSIS

- 1) Balance Sheet
- 2) Income Statement
- 3) Cash Flow Statement
- 4) Financial Ratios
 - ✓ *Trends*
 - ✓ *Industry Norms*
 - ✓ *Economic Cycles & Moods*

B) COMPETITIVE / INDUSTRY ANALYSIS

A) ΑΝΑΛΥΣΗ ΟΙΚΟΝΟΜΙΚΩΝ ΠΛΗΡΟΦΟΡΙΩΝ

1) Ισολογισμός

2) Κατάσταση Αποτελεσμάτων

3) Κατάσταση Ταμειακών Ροών

4) Οικονομικοί Δείκτες

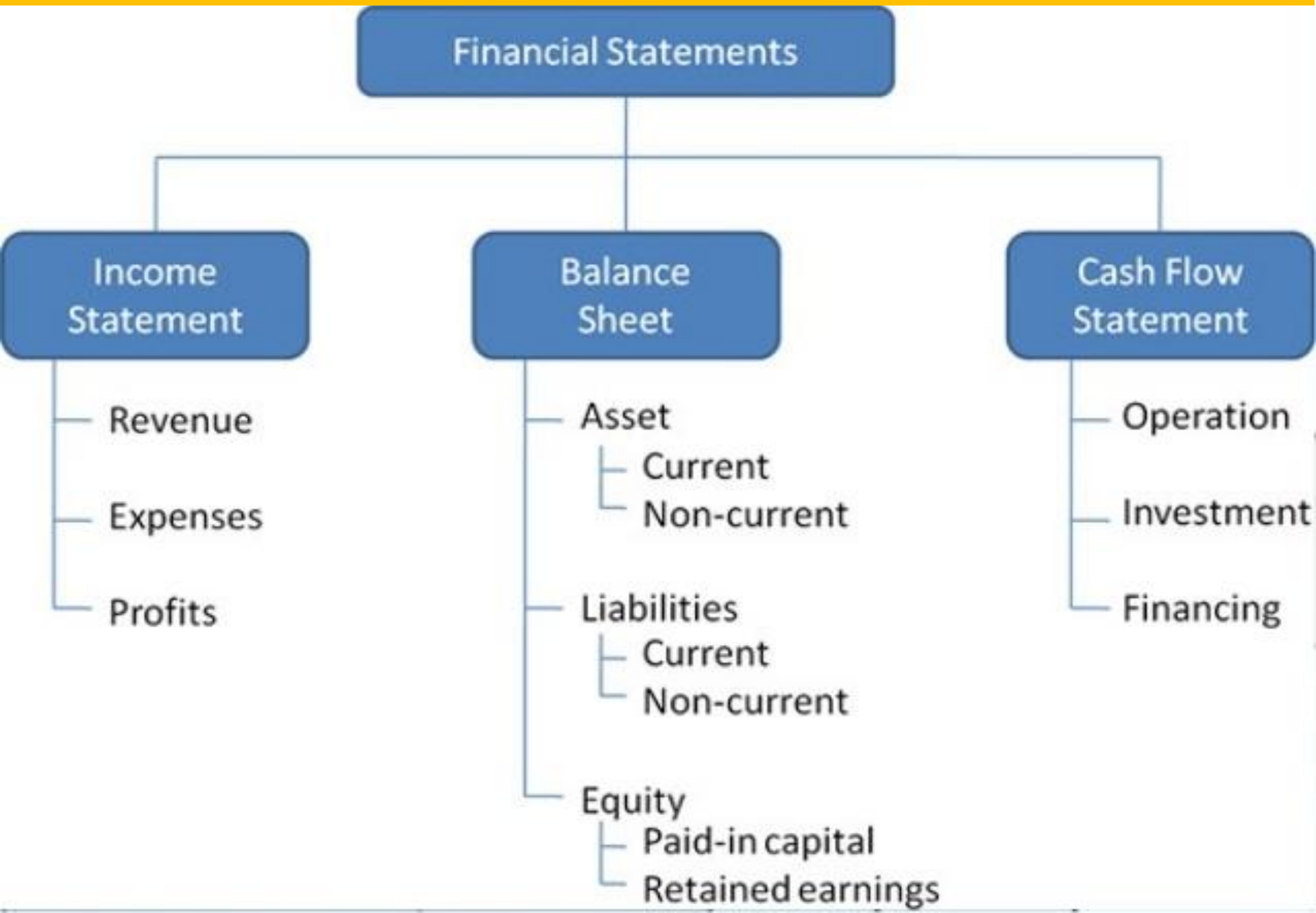
a) Τάσεις

b) Κλαδοδείκτες

c) Οικονομικοί Κύκλοι & Διαθέσεις

B) ΑΝΤΑΓΩΝΙΣΤΙΚΗ / ΚΛΑΔΙΚΗ ΑΝΑΛΥΣΗ

Let's Examine the Three ... Accounts / Financial Statements



Three Accounts / Statements ... to Analyze

Income statement (INRmn)

Fiscal year ending	03/13
Operating income	82,793
EBITDA	21,626
Other income	2,158
Depreciation	2,952
EBIT	20,832
Interest	276
Net extra ordinary items	398
PBT (reported)	20,954
Total taxes	5,443
PAT (reported)	15,511
(+) Share in assoc. earnings	(62)
Less: Minority interest	-
Prior period items	-
Net income (reported)	15,449
Aventus net income	15,449
Aventus dil. shares (mn)	802.9
Aventus EPS (INR)	18.7

Cash flow statement (INRmn)

Net profit + Depreciation	18,401
Deferred tax	0
Working capital changes	-6,480
Less: Other income	2,158
Cash flow from operations	9,763
Capital expenditure	-6,972
Others	-10,478
Cash flow from investing	-17,451
Equity raised	0
Change in borrowings	9,379
Dividends paid (incl. tax)	-3
Others	-1,163
Cash flow from financing	8,213
Net change in cash	526

Balance sheet (INRmn)

Fiscal year ending	03/13
Net worth	90,187
Minority interest	-
Total debt	9,671
Deferred tax liability	2,805
Total liabilities	102,663
Net block	36,100
CWIP	3,778
Goodwill	-
Investments	25,324
Cash	1,430
Inventories	23,871
Debtors	16,688
Loans and advances	9,387
less: Current liabilities	11,091
less: Provisions	2,824
Net working capital	37,461
Total assets	102,663

Source: Bloomberg, Aventus Research

Financial Statement Analysis (FSA)

- Financial statements reflect the activity and financial condition of a company

Balance Sheets

Income
Statements

Statements of
Cash Flow



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^ A financial report is an integral component of the financial accounting system.

Damir Karan/E+/Getty Images

Three Accounts / Statements ... to Analyze

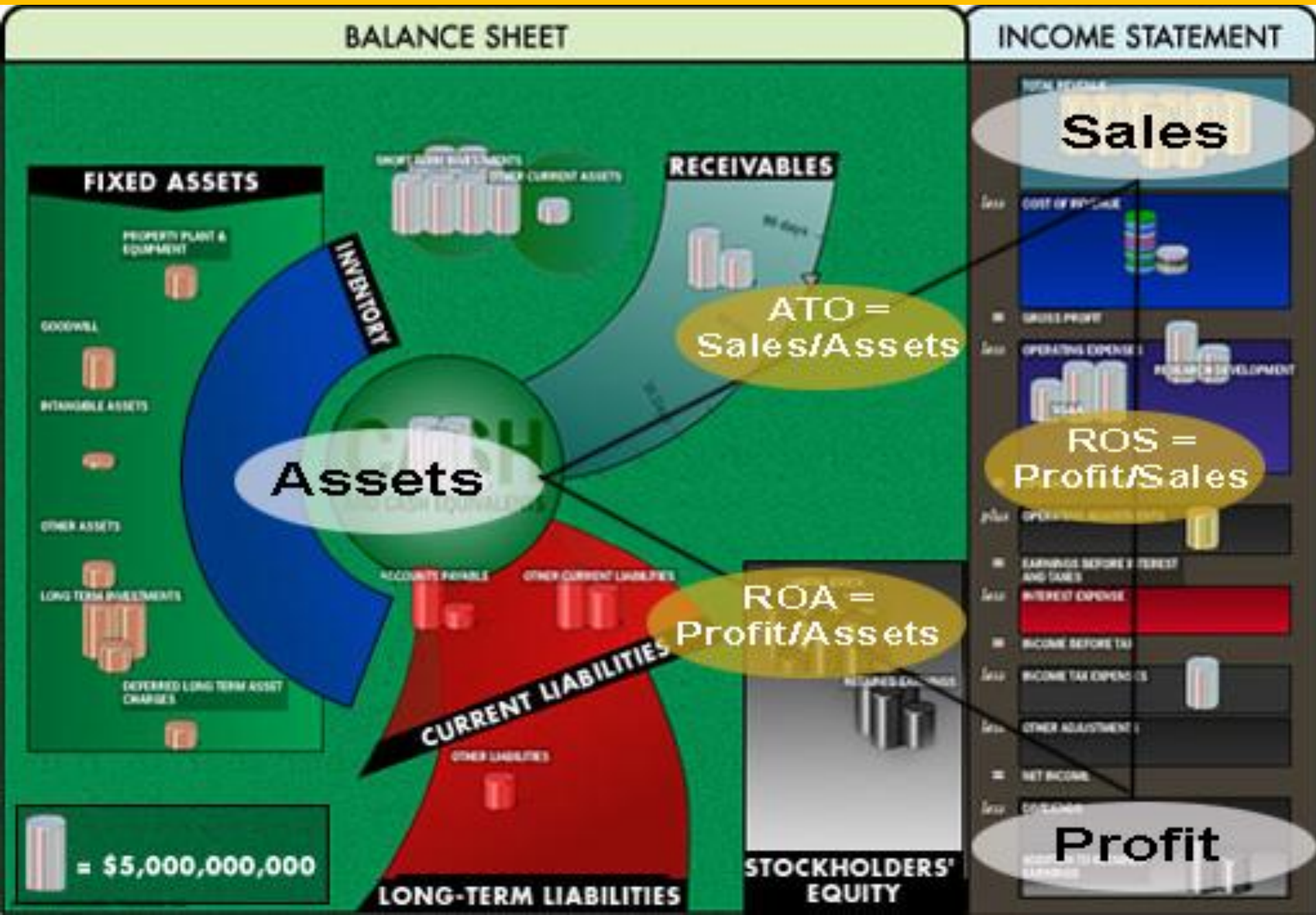
● Three basic statements:

- Balance sheet
- Income statement
- Statement of cash flows

● Why we need statements:

- Evaluating financial health of a company (ratio analysis)
- Evaluating separate projects and business as a whole
 - Discounted Cash Flow (DCF) methods (need the *projected* cash flows)
 - Using comparables (various ratios) (need usually last income statement and balance sheet)

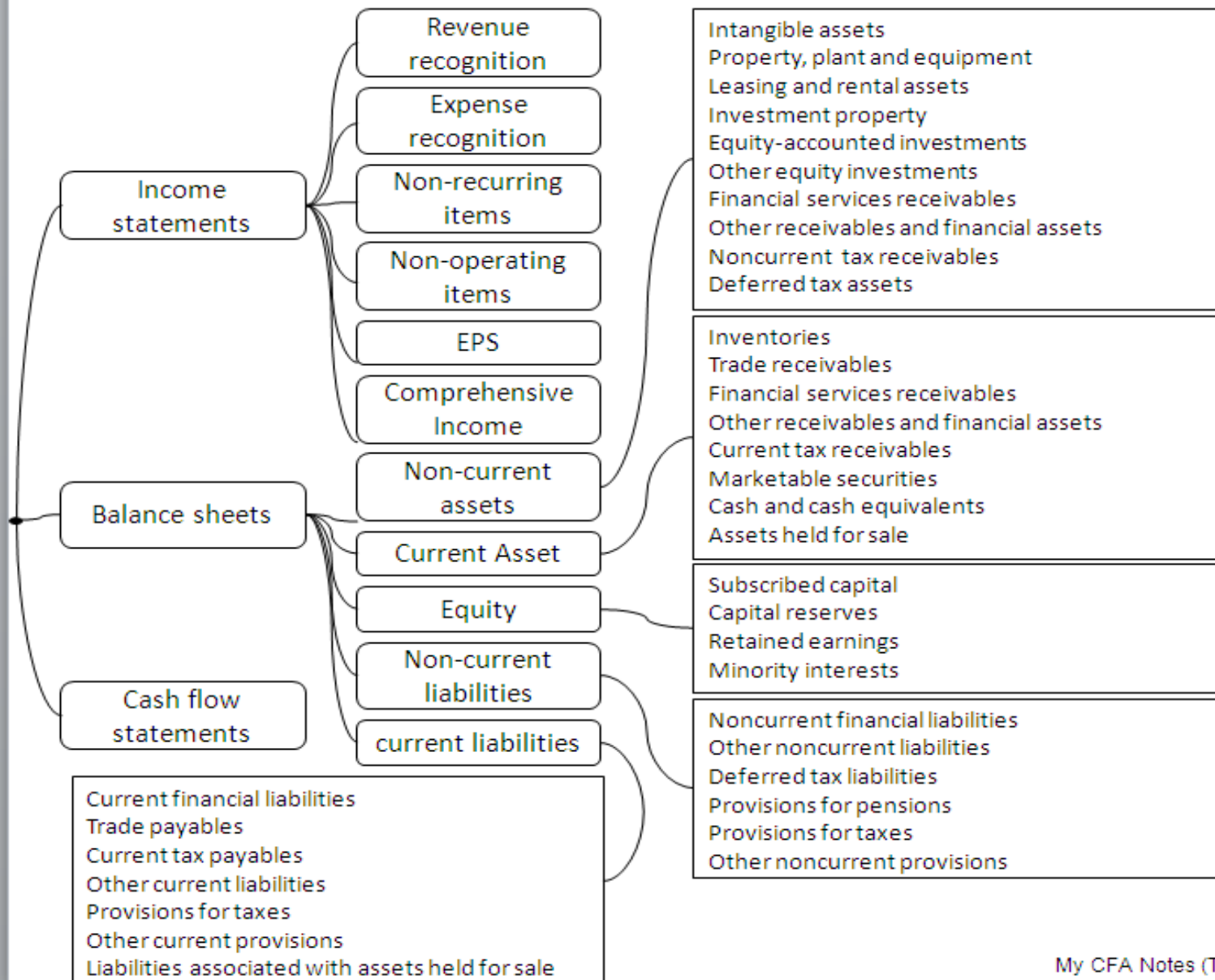
Three Accounts / Statements ... to Analyze



Financial Statement Analysis (FSA)

Finance statements analysis

Financial statements analysis



Why Analyze?

- 
1. Analysis of the funds needs of the firm.
 2. Analysis of the financial condition and profitability of the firm.
 3. Analysis of the business risk of the firm.

Business risk relates to the risk inherent in the operations of the firm.

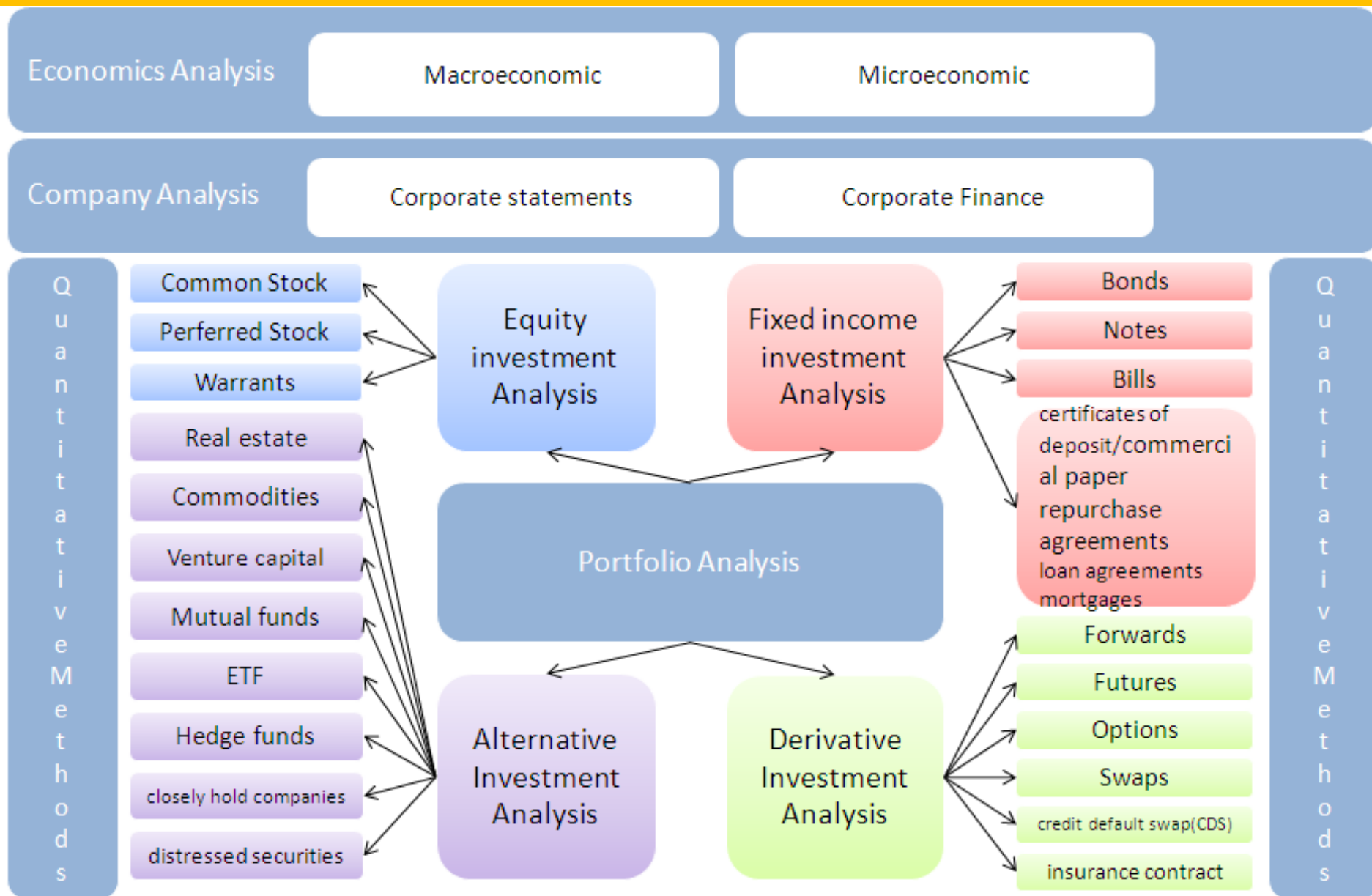
Examples:

Volatility in sales

Volatility in costs

Proximity to break-even point

Financial Analysis Framework



Double-Entry Bookkeeping System

- ❑ all transactions are entered in two ways, showing how they impact assets and liabilities
- ❑ the accounting equation is always kept in balance

Revenue Recognition and Matching

- **Revenue Recognition**

- ❑ is the formal recording and reporting of revenues in financial statements once the earnings cycle is completed

- **Matching**

- ❑ expenses will be matched with revenues to show net income for an accounting period

Budget

- **Budget**

- a detailed financial plan of estimated receipts and expenditures for a future period
- ☐ an internal financial statement
- ☐ usually one year
- ☐ requires input from other departments
- ☐ compares actual vs. budget to signal problems

1) Balance Sheet

Balance Sheet

- Balance Sheets
 - provide detailed information about the accounting equation factors
 - *assets*
 - *liabilities*
 - *owner's equity*
 - show a firm's financial **condition at one point in time**

Current Assets

- **Cash** and assets that can be converted into cash within the year
- **Accounts receivable**
 - amounts owed to the firm by customers
- **Inventory**
 - cost of merchandise acquired for sale but not yet sold
- **Prepaid expenses**
 - supplies on hand and rent (other bills) paid for coming period



^^
At the end of its accounting period, this pharmaceuticals company will subtract the cost of making the goods that it sells from the revenues it receives from sales. The difference will be its gross profit (or gross margin).

Balance Sheet

Fixed Assets: have a long-term use or value

- **Land**
- **Buildings**
- **Machinery**
- **Depreciation:**
 - distributing the cost of a major asset over its lifetime, deducted yearly

Balance Sheet

- **Intangible Assets:** non-physical assets with economic value (difficult to calculate)
 - ✓ *patents*
 - ✓ *trademarks*
 - ✓ *franchise fees*
 - ✓ *copyrights*
- **Goodwill:** the amount paid for an existing business beyond the value of its other assets

Balance Sheet

Liabilities and Owner's Equity

Current liabilities

- debts owed by the firm that must be repaid within one year (i.e. accounts payable)

Long-term liabilities

- debts owed by the firm and due in more than one year

Owners' equity

- owners' holdings in the firm

Example of a Balance Sheet



Perfect Posters, Inc.
555 Riverview, Toronto, Ontario

Perfect Posters, Inc.
Balance Sheet
As of December 31, 2015

Assets

Current Assets:			
Cash		\$7 050	
Marketable securities.		2 300	
Accounts receivable.	\$26 210		
Less: Allowance of doubtful accounts.	(650)	25 560	
Merchandise inventory.		21 250	
Prepaid expenses		1 050	
Total current assets			\$57 210
Fixed Assets:			
Land		18 000	
Building	65 000		
Less: Accumulated depreciation	(22 500)	42 500	
Equipment	72 195		
Less: Accumulated depreciation	(24 815)	47 380	
Total fixed assets			107 880
Intangible Assets:			
Patents	7 100		
Trademarks	900		
Total intangible assets			8 000
Total assets			\$173 090

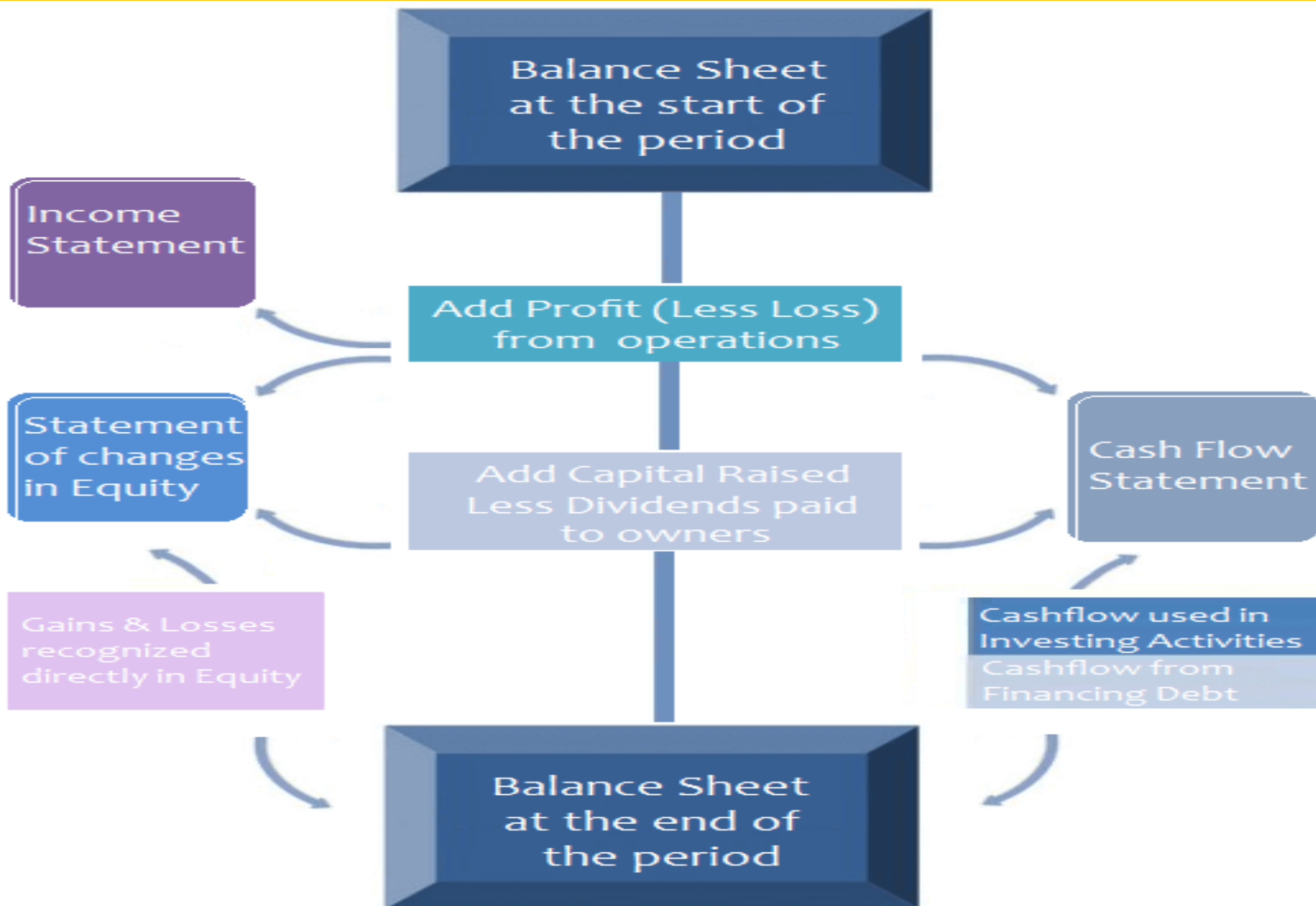
Liabilities and Owners' Equity

Current liabilities:			
Accounts payable.		\$16 315	
Wages payable.		3 700	
Taxes payable.		1 920	
Total current liabilities			\$21 935
Long-term liabilities:			
Notes payable, 8% due 2018		10 000	
Bonds payable, 9% due 2020		30 000	
Total long-term liabilities			40 000
Total liabilities			\$61 935
Owners' Equity:			
Common stock, \$5 par		40 000	
Additional paid-in capital		15 000	
Retained earnings		56 155	
Total owners' equity			111 155
Total liabilities and owners' equity			\$173 090

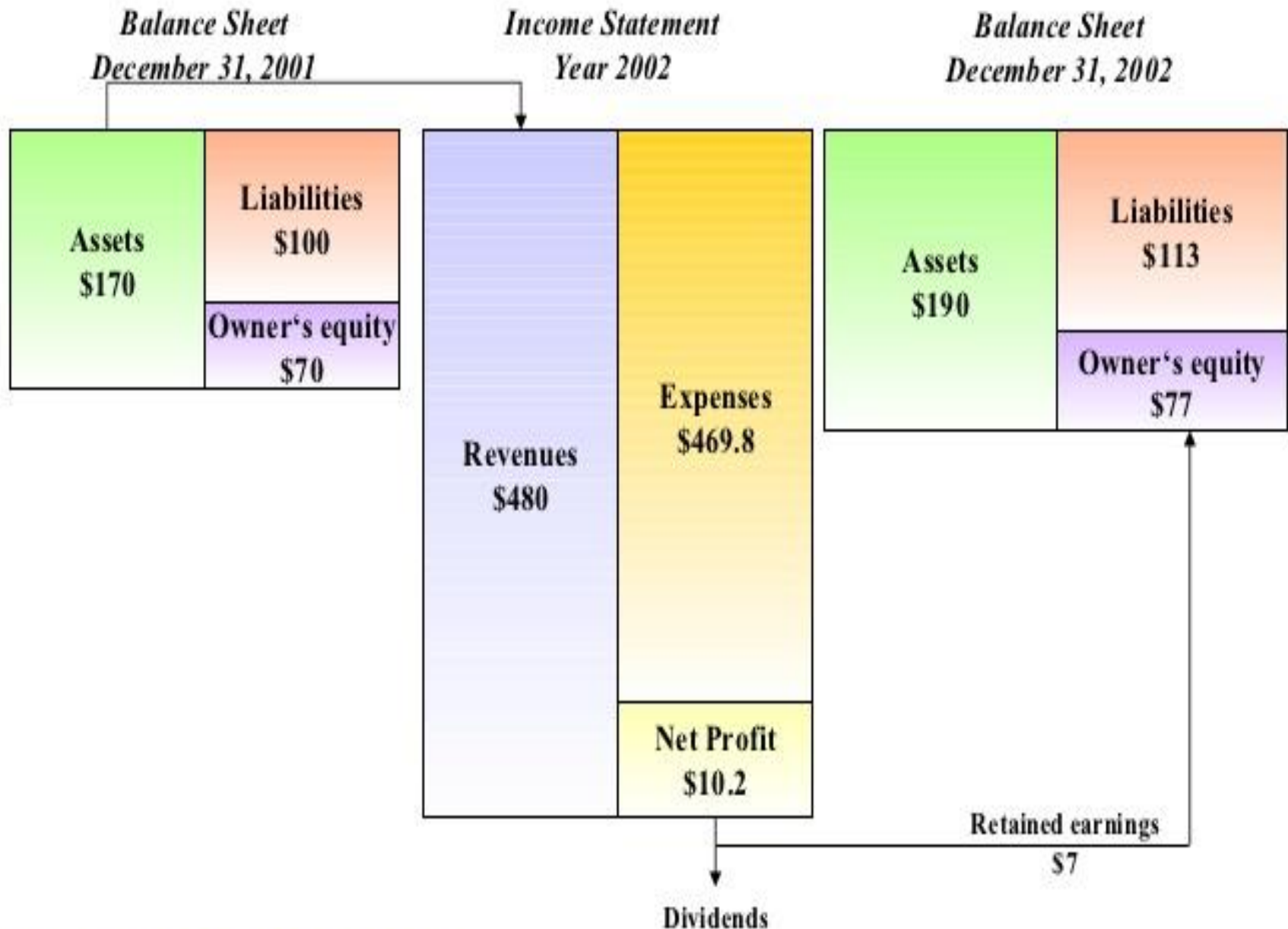
FIGURE 11.2 Perfect Posters' balance sheet

This balance sheet shows clearly that the firm's total assets equal its total liabilities and owners' equity.

Balance Sheet



The Link between Balance Sheet & Income Statement



2) Income Statement

Income Statement

➤ Income Statement

- ☐ sometimes called a profit-and-loss statement
- ☐ description of revenues and expenses that shows the firm's annual profit or loss

$$\text{revenues} - \text{expenses} = \text{profit (or loss)}$$

Income Statement

Example of an Income Statement

Perfect Posters, Inc. 555 Riverview, Toronto, Ontario			
Perfect Posters, Inc. Income Statement Year ended December 31, 2015			
Revenues (gross sales)			\$256 425
Costs of goods sold:			
Merchandise inventory, January 1, 2015	\$22 380		
Merchandise purchases during year.	<u>103 635</u>		
Goods available for sale.		<u>\$126 015</u>	
Less: Merchandise inventory, December 31, 2015		<u>21 250</u>	
Cost of goods sold			<u>104 765</u>
Gross profit			151 660
Operating expenses:			
Selling and repackaging expenses:			
Salaries and wages	49 750		
Advertising	6 380		
Depreciation—warehouse and repackaging equipment.	3 350		
Total selling and repackaging expenses		59 480	
Administrative expenses:			
Salaries and wages	55 100		
Supplies	4 150		
Utilities	3 800		
Depreciation—office equipment	3 420		
Interest expense	2 900		
Miscellaneous expenses	<u>1 835</u>		
Total administration expenses.		<u>71 205</u>	
Total operating expenses.			130 685
Operating income (income before taxes). . .			20 975
Income taxes.			<u>8 390</u>
Net income.			\$12 585

FIGURE 11.3 Perfect Posters' income statement

The final entry on the income statement, the bottom line, reports the firm's profit or loss.

Case: Income Statement Analysis

The College Shop

Comparative Income Statement
Years Ended December 31, 20×7 and 20×6
[Using vertical percentage analysis
showing each item as a % of sales]

	<u>12/31/20×7</u>		<u>12/31/20×6</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Sales	\$600,000	100	\$500,000	100
Less Cost of goods sold	<u>387,000</u>	<u>64</u>	<u>275,000</u>	<u>55</u>
Gross profit	213,000	36	225,000	45
Less Operating expenses	<u>180,000</u>	<u>30</u>	<u>175,000</u>	<u>35</u>
Operating income	33,000	6	50,000	10
Less Interest	10,000	2	10,000	2
Less Income taxes	<u>5,000</u>	<u>1</u>	<u>10,000</u>	<u>2</u>
Net income	<u><u>\$18,000</u></u>	<u><u>3%</u></u>	<u><u>\$30,000</u></u>	<u><u>6%</u></u>

3) Cash Flows

Cash Flows

Statement of Cash Flows

Operations

cash flows from buying and selling of goods and services



Investments

cash flows from investment activities

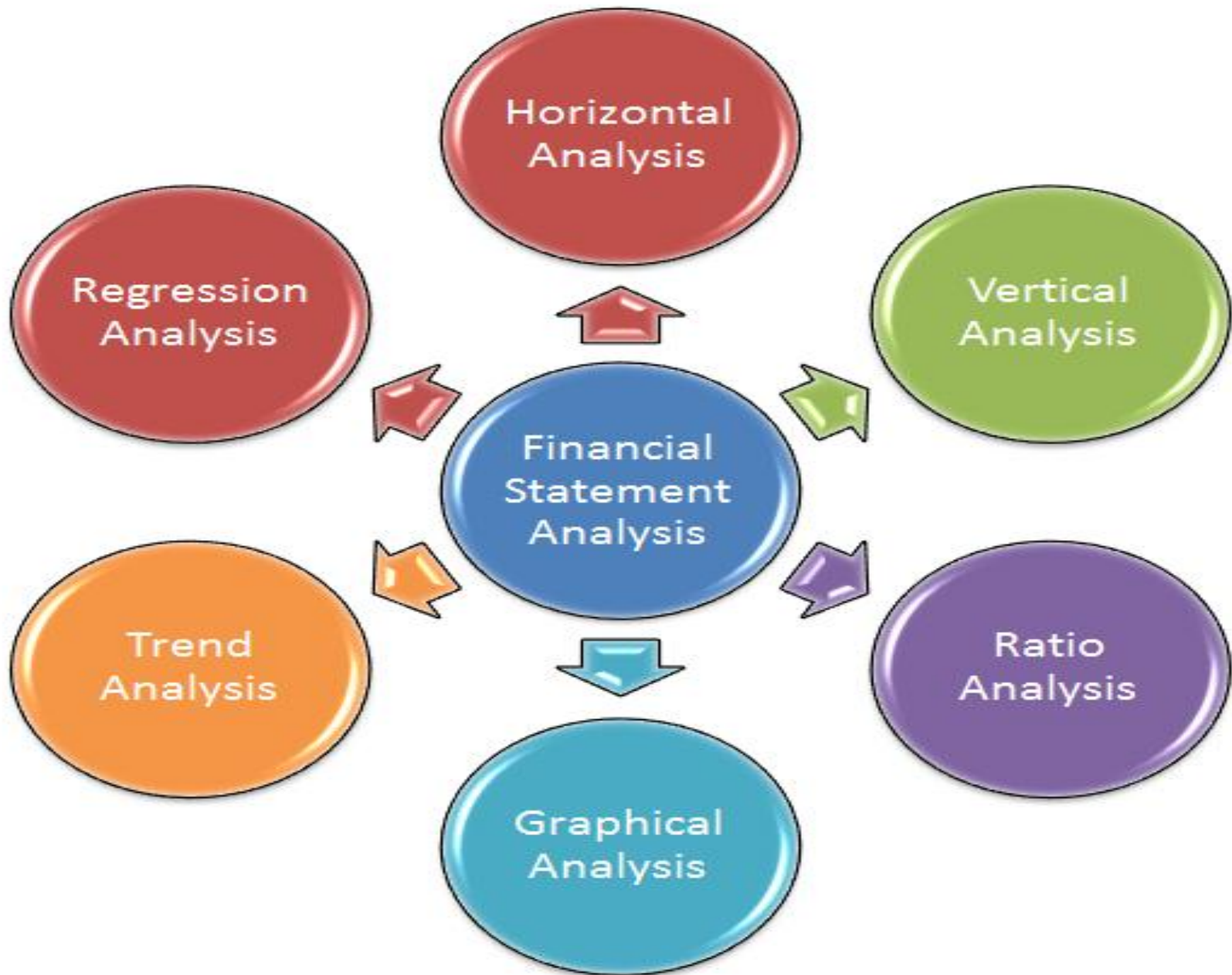


Financing

cash flows from financing activities

Types of Analysis

Types of Analysis



Types of Analysis

Vertical Analysis

Shows relationship of each item to a base amount on financial statements

Income statement (each item expressed as percentage of net sales)

Balance sheet (each item expressed as percentage of total assets)

Horizontal and Trend Analysis

Compares two financial statements to determine dollar and percentage changes

Compute dollar changes and percentage changes

Ratio Analysis

Puts numbers in perspective with other numbers

Helps control for different sizes of firms

Ratios provide meaningful relationships between individual values in the financial statements



Ratio Analysis

Analyzing Financial Statements

Ratios

Solvency
Ratios

short term and long
term, estimate of risk

Profitability
Ratios

measure potential earnings

Activity
Ratios

reflect management's
use of assets

Analyzing Financial Statements

Solvency Ratios

Short Term

- current ratio (current assets/current liabilities)

Long Term

- debt to equity ratio (debt/owner's equity)
 - leverage

Analyzing Financial Statements

Profitability Ratios

Return on Equity

- $\text{net income} / \text{total owner's equity}$

Return on Sales

- $\text{net income} / \text{sales revenue}$

Earnings per Share

- $\text{net income} / \text{number of common shares outstanding}$



Analyzing Financial Statements

Activity Ratios

Inventory turnover ratio

- $\text{cost of goods sold} / \text{average inventory}$
- indicates how quickly inventory is produced and sold



<<< The inventory turnover ratio measures the average number of times that a store sells and restocks its inventory in one year. The higher the ratio, the more products get sold and the more revenue comes in. Zara had a 28.56 inventory turnover ratio in 2015—far superior to the industry average.¹⁶

Bjanka Kadic/Alamy

Bringing Ethics into the Accounting Equation

Accounting Ethics help maintain public confidence in

business institutions

financial markets

the accounting profession



Without ethics, all accounting tools would be meaningless

usefulness depends, on their honest application

Evolving Role of The Modern Accountant

The following issues are contributing to the additional roles of the modern accountant:

- *Fewer restrictions from physical and geographic boundaries*
- *Social-media-driven changes in relationships and the way business is conducted*
- *Need for the accountant to be an effective communicator*
- *Project management in the accountant's expanded role*

Sources

- 1) Copyright © 2021-2026 Visual Capitalist, All rights reserved.
- 2) Wikipedia
- 3) References at Slides

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