

Financials

Lecture 3

Financials: Objectives

To develop an understanding of financial statements to serve as a basis for all analysis of business situations.

Outline

- Financial Information
- Financial Statements
- Accounting Principles
- Ratio Analyses

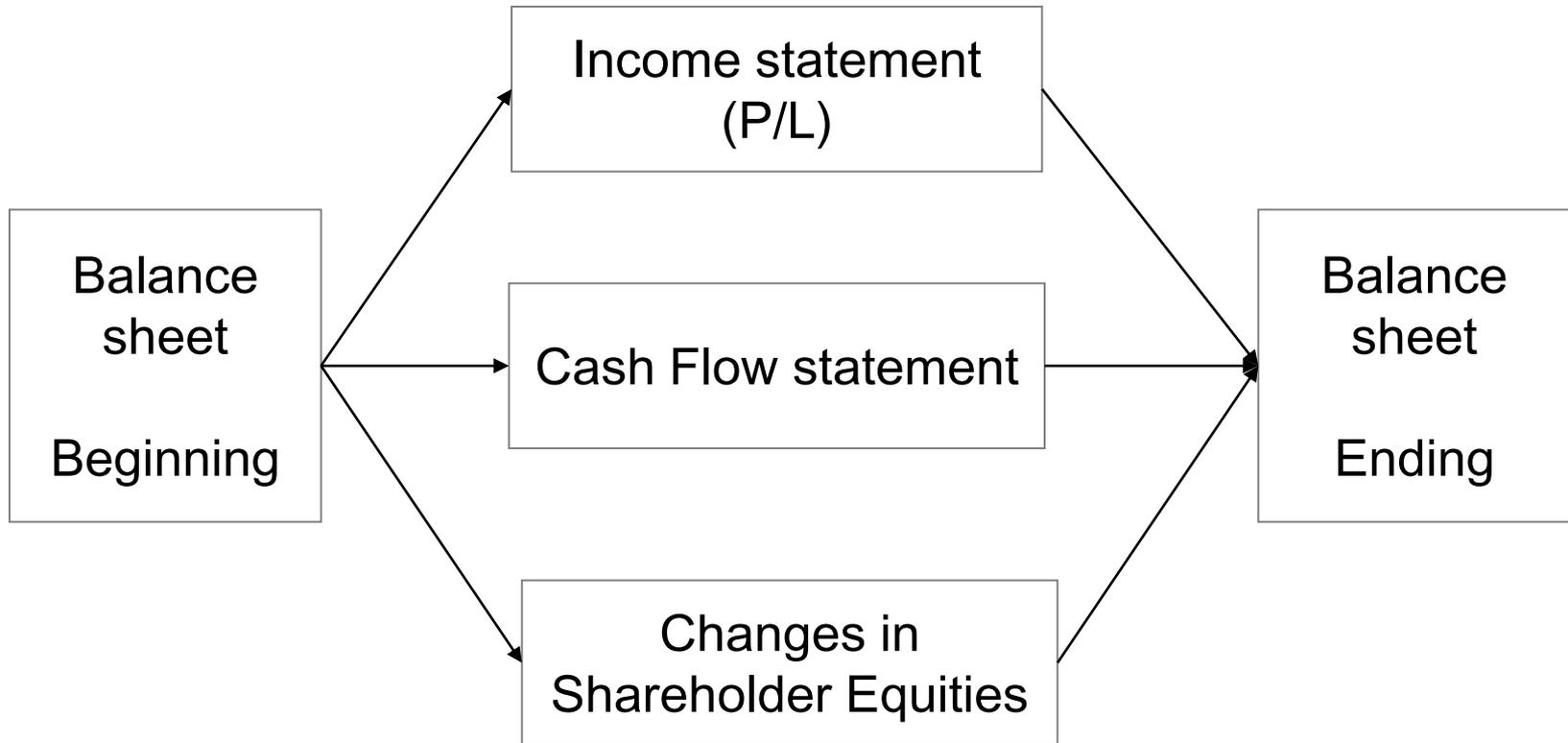
Need for Financial Information

- Control
- Coordination
- Planning

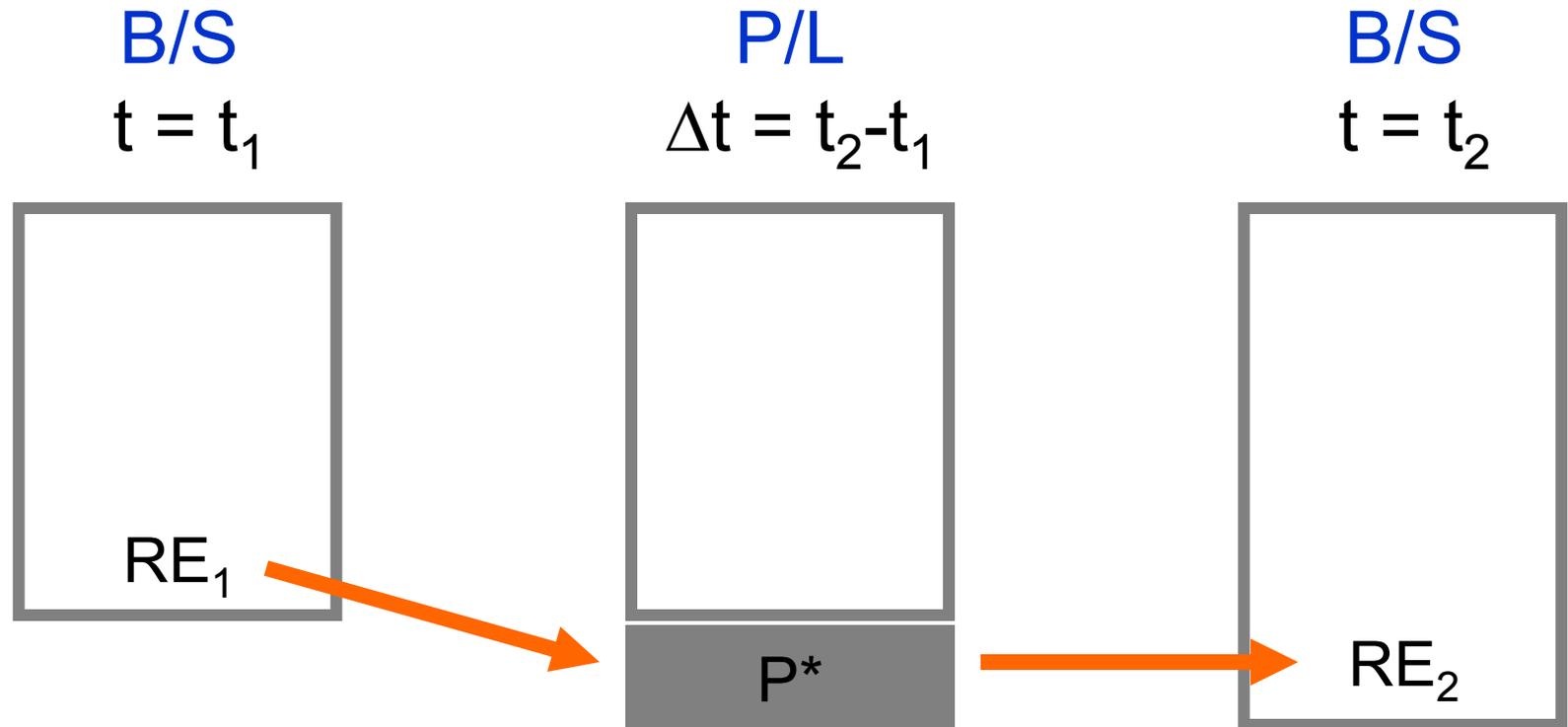
Financial Information

- Financial Perspective
- Customer Perspective
- Internal Business Process Perspective
- Learning and Growth Perspective

Financial statements

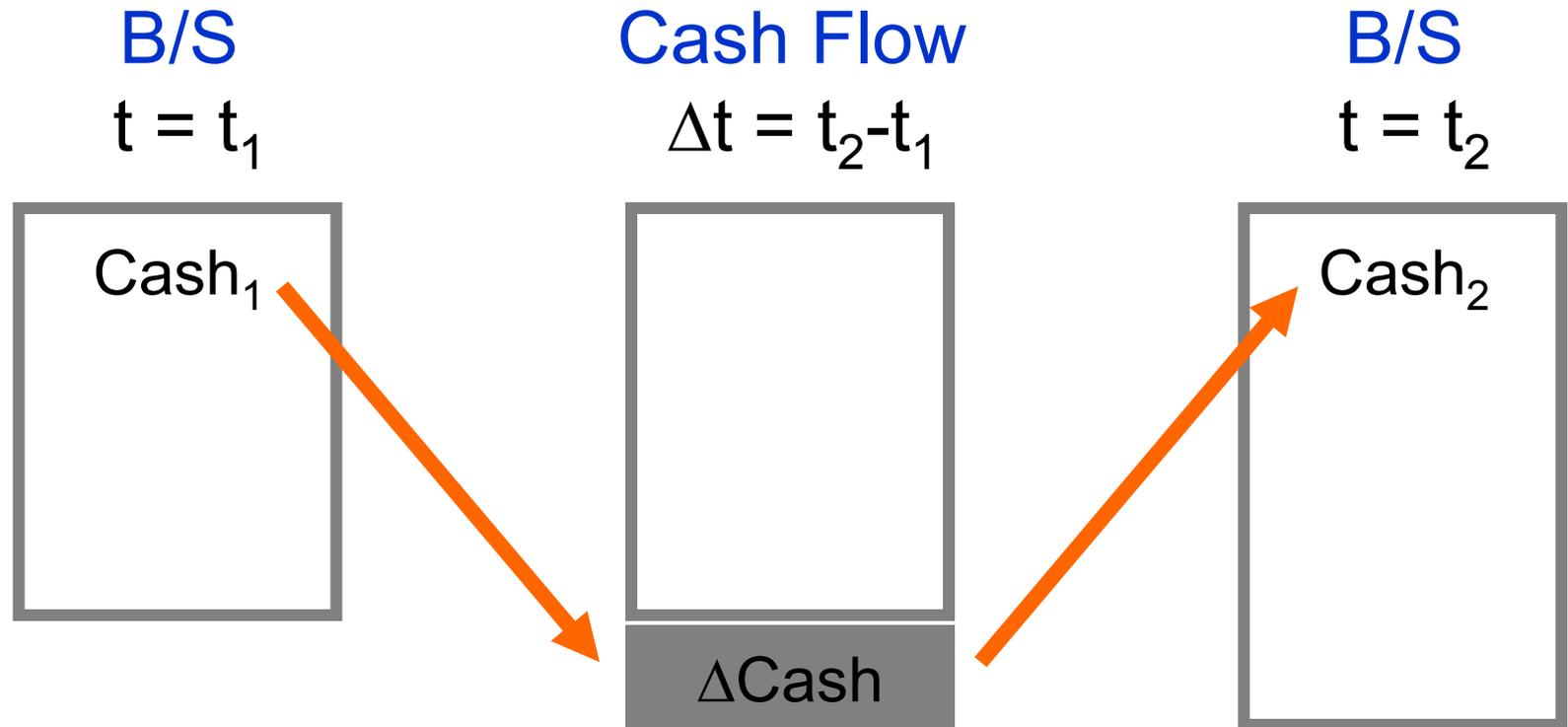


Relationship of Financial Statements



$$RE_1 + P^* = RE_2$$

Relationship of Financial Statements



$$\text{Cash}_1 + \Delta\text{Cash} = \text{Cash}_2$$

Accounting

Luca Pacioli, 15th century monk

- Typical Accounting Period: 1 yr
- Double Entry Bookkeeping

Accounting Concepts

- Measurement unit: \$
- Double entry concept
- Cost (not value)
- Conservatism
- Going concern
- Period
- Realization
- Matching (Accrual)
- Consistency
- Materiality

Bookkeeping

- Chart of accounts
- T-account

Journal Entry*

Chronological record of accounting transactions showing:

- The names of accounts that are to be debited or credited
- The amounts of the debits and credits
- Any useful supplementary information about the transaction

* Anthony, R.N. and Reece, J., "Accounting: Text and Cases, 6th ed.", Irwin

The Chart of Accounts

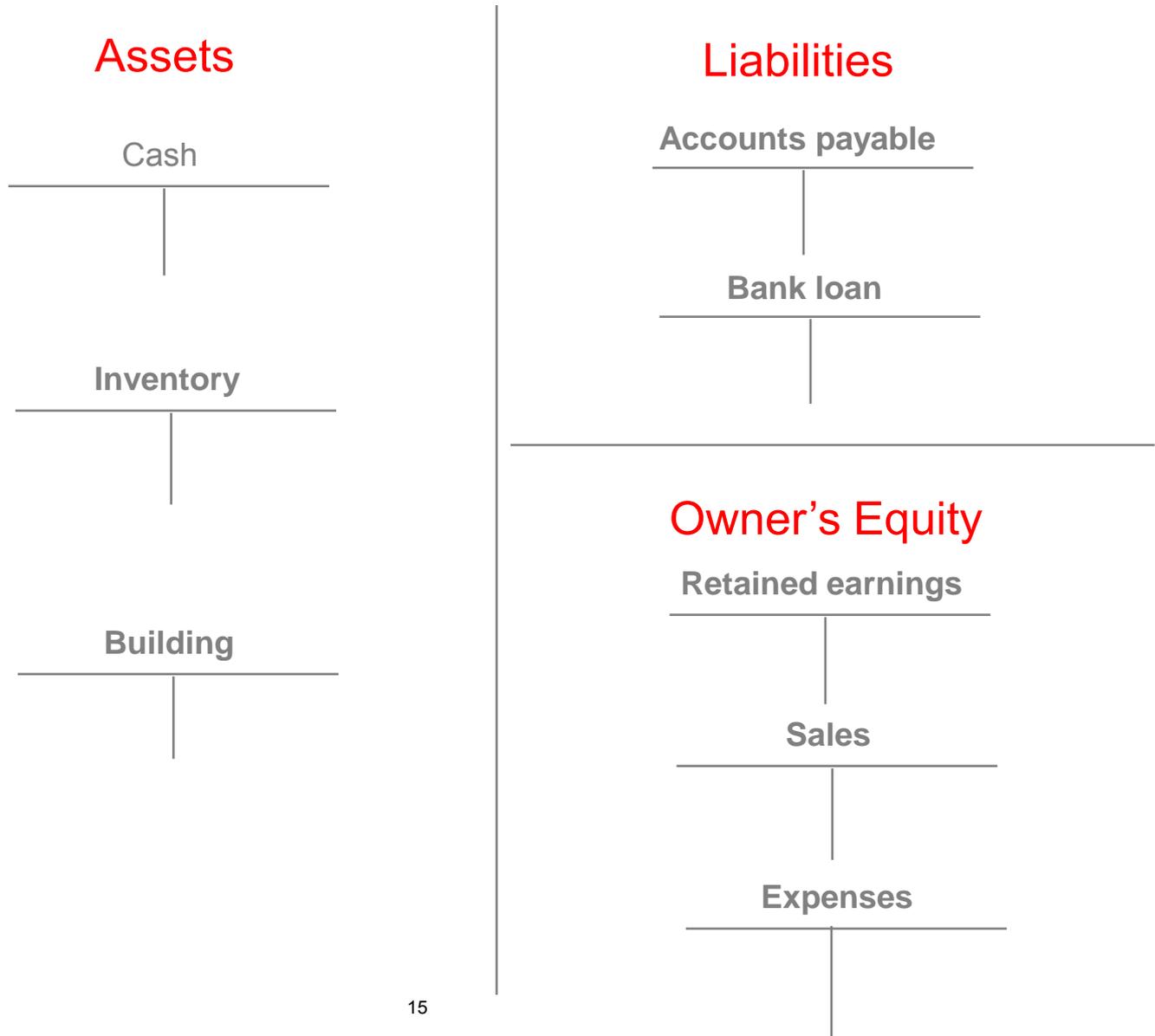
(multi-layered)

1000	Current Assets
1100	Cash
1110	Cash, Bank 1
1111	Cash, Bank 1, Account 1
5000	Property
5100	Land
5110	Land, US
5111	Land, US, MA

T Account

Account	
debit	credit
+ / -	- / +

Business Account



Debit and Credit

Assets = Liabilities + Equity

Cash	
(d)	(c)
+	-

A / P	
(d)	(c)
-	+

R / E	
(d)	(c)
-	+

Revenue	
(d)	(c)
	+

Expense	
(d)	(c)
+	

Accounting Record Example

Starting Balance

King's Shoe Store, Inc. Starting Balance 1-Jan-00		
	Accounts with Debit Balances	Accounts with Credit Balances
Cash (A)	30,000	
Account Receivable (A)	63,000	
Raw Materials Inventory (A)	10,000	
Work-in-Process Inventory (A)	10,000	
Merchandise Inventory (A)	175,000	
Land (A)	100,000	
Building and Equipment (A)	525,000	
Accumulated Depreciation (XA)		85,000
Accounts Payable (L)		135,000
Bonds Payable (L)		100,000
Common Stock (SE)		250,000
Additional Paid-in Capital (SE)		200,000
Retained Earnings (SE)		143,000
Total	913,000	913,000
(A) Asset (XA) Contra Account		
(L) Liability		
(SE) Shareholders' Equity		

Transactions - 1

- (1) The firm purchases shoe-making equipment in cash costing \$10,000

- (2) The firm sells merchandise during the year 2000 at a total selling price of \$625,000. It receives \$225,000 immediately, with the remainder sold on account

- (3.1) The firm purchases raw materials costing \$25,000 on account

- (3.2) The firm issues raw materials costing \$20,000 to producing department

- (3.3) Shoes completed and transferred to the finished goods storeroom have a manufacturing cost of \$10,000

- (3.4) The cost of merchandise sold during the year 2000 is \$90,000

- (4) The firm pays salaries in cash of \$110,000 for employee services received during the year 2000

- (5) The firm collects cash of \$325,000 from customers who had purchased on account

Transactions - 2

- (6) The firm makes payments of \$70,000 to merchandise supplies for purchases on account

- (7) The firm issues common stock of \$50,000 for cash on January 28, 2000.

- (8) The firm pays a premium of \$1,500 on January 1, 2000 for a three-year property and liability insurance policy

(1) The firm purchases shoe-making equipment in cash costing \$10,000

Transaction Number	Accounts	Debit	Credit
1	Building and Equipment (A)	10,000	
	Cash (A)		10,000

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A)			Account Payable (L)			Retained Earnings (SE)	
Bal. 1/1	30,000		135,000	Bal. 1/1		123,000	Bal. 1/1
	10,000 (1)		135,000	Bal. 12/31		123,000	Bal. 12/31
Bal. 12/31	20,000						
Account Receivable (A)			Dividends Payable (L)			Sales Revenue (SE)	
Bal. 1/1	63,000		-	Bal. 1/1		-	Bal. 1/1
Bal. 12/31	63,000		-	Bal. 12/31		-	Bal. 12/31
Merchandise Inventory (A)						Cost of Goods Sold (SE)	
Bal. 1/1	175,000				Bal. 1/1	-	
Bal. 12/31	175,000				Bal. 12/31	-	
Prepaid Insurance (A)						Salary Expense (SE)	
Bal. 1/1	-				Bal. 1/1	-	
Bal. 12/31	-				Bal. 12/31	-	
Building and Equipment (A)							
Bal. 1/1	525,000						
(1)	10,000						
Bal. 12/31	535,000						

(2) The firm sells merchandise during the year 2000 at a total selling price of \$625,000. It receives \$225,000 immediately, with the remainder sold on account

Transaction Number	Accounts	Debit	Credit
2	Cash (A)	225,000	
	Account Receivable (A)	400,000	
	Sales Revenue (SE)		625,000

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A)			Account Payable (L)			Retained Earnings (SE)	
Bal. 1/1	30,000		135,000	Bal. 1/1		123,000	Bal. 1/1
(2)	225,000						
	10,000	(1)	135,000	Bal. 12/31		123,000	Bal. 12/31
Bal. 12/31	245,000						
Account Receivable (A)						Sales Revenue (SE)	
Bal. 1/1	63,000					-	Bal. 1/1
(2)	400,000					625,000	(2)
Bal. 12/31	463,000					625,000	Bal. 12/31
Merchandise Inventory (A)						Cost of Goods Sold (SE)	
Bal. 1/1	175,000					-	
Bal. 12/31	175,000					-	
Prepaid Insurance (A)						Salary Expense (SE)	
Bal. 1/1	-					-	
Bal. 12/31	-					-	
Building and Equipment (A)							
Bal. 1/1	525,000						
(1)	10,000						
Bal. 12/31	535,000						

(3.1) The firm purchases raw materials costing \$25,000 on account

Transaction Number	Accounts	Debit	Credit
3.1	Raw Materials Inventory (A)	25,000	
	Accounts Payable (L)		25,000

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A) Bal. 1/1 30,000 (2) 225,000 10,000 (1) Bal. 12/31 <u>245,000</u>			Account Payable (L) 135,000 Bal. 1/1 25,000 (3.1) 160,000 Bal. 12/31			Common Stock (SE) 250,000 Bal. 1/1 250,000 Bal. 12/31	
Account Receivable (A) Bal. 1/1 63,000 (2) 400,000 Bal. 12/31 <u>463,000</u>						Retained Earnings (SE) 123,000 Bal. 1/1 123,000 Bal. 12/31	
Merchandise Inventory (A) Bal. 1/1 175,000 Bal. 12/31 <u>175,000</u>						Sales Revenue (SE) - Bal. 1/1 625,000 (2) 625,000 Bal. 12/31	
Building and Equipment (A) Bal. 1/1 525,000 (1) 10,000 Bal. 12/31 <u>535,000</u>						Cost of Goods Sold (SE) Bal. 1/1 - Bal. 12/31 <u>-</u>	
Raw Materials Inventory (A) Bal. 1/1 10,000 (3.1) 25,000 Bal. 12/31 <u>35,000</u>						Salary Expense (SE) Bal. 1/1 - Bal. 12/31 <u>-</u>	

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