## What is Accounting

The process of recording, classifying, summarizing, and interpreting of financial events and transactions to provide management and other interested parties the information they need to make good decisions.

<table>
<thead>
<tr>
<th>Managerial Accounting</th>
<th>Financial Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INTERNAL ONLY</strong></td>
<td><strong>INTERNAL &amp; EXTERNAL</strong></td>
</tr>
<tr>
<td>Provides information to management to allow them to make the day-to-day decisions to run the operation and achieve the goals of the company. These include reports on the cost of production, marketing, forecasting...</td>
<td>Provides information to those outside the corporation to allow them to make informed decisions. <em>Do I invest in this company?</em> <em>Will the company be able to repay a loan?</em> <em>What does the company owe the IRS?</em></td>
</tr>
</tbody>
</table>

### Who are the users of Accounting Information

Governments (IRS) & Regulators → Owners → Creditors → Suppliers → Analysts → Management

**Governments** require tax returns, quarterly reports and more, **Owners** like to see the income statement and cash flow to determine profitability, **Creditors** and **Suppliers** look at the balance sheet to make sure the company can repay their debt, **Analysts** use all statements to advise investors, and **Management** uses information to make decisions, forecast future sales, expenses and much more.

### Types of Specialization

Managerial Accountants → Auditors → Tax Accountants → Governmental & Not-For-Profit

### Financial Statements

Income Statement → Balance Sheet → Statement of Cash Flows

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>Balance Sheet</th>
<th>Statement of Cash Flows</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues:</strong></td>
<td><strong>Assets</strong></td>
<td><strong>Operating:</strong></td>
</tr>
<tr>
<td>Fees Earned</td>
<td>Cash</td>
<td>operating revenues and expenses</td>
</tr>
<tr>
<td>Sales</td>
<td>Accounts receivable</td>
<td>+ <strong>Investing:</strong></td>
</tr>
<tr>
<td>-<strong>Expenses</strong></td>
<td>Inventory</td>
<td>how are we investing in our productive assets (Property, Plant, and Equipment)</td>
</tr>
<tr>
<td>Rent</td>
<td>= Liabilities</td>
<td>+ <strong>Financing:</strong></td>
</tr>
<tr>
<td>Utilities</td>
<td>Accounts payable</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>Bonds Payable</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Mortgages Payable</td>
<td></td>
</tr>
<tr>
<td></td>
<td>+ Owner’s Equity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Common Stock</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Retained Earnings</td>
<td></td>
</tr>
<tr>
<td><strong>=Net Income</strong></td>
<td><strong>Assets</strong> = Liab + OE</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>THE EQUATION MUST BALANCE</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Operating:**

**Investing:**

**Financing:**

-how are we financing our business (Equity → Stock, Debt, Bonds, Mortgages, etc.)

=Increase(Decrease in Cash)

+Cash at beginning of year

=Cash at end of year
John Company
Income Statement
For the Year Ended Dec 31, 2012

<table>
<thead>
<tr>
<th>Revenue:</th>
<th>20,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fees Earned</td>
<td></td>
</tr>
<tr>
<td>Expenses:</td>
<td>4,350</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>1,500</td>
</tr>
<tr>
<td>Wages Expense</td>
<td>2,500</td>
</tr>
<tr>
<td>Utilities Expense</td>
<td>350</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>15,650</td>
</tr>
</tbody>
</table>

Assets:
- Cash: 18,100
- Accounts receivable: 6,250
- Total Assets: 24,350

Liabilities:
- Accounts payable: 4,230

Owner’s Equity:
- Common Stock: 1,670
- Retained Earnings: 18,450
- Owner’s equity: 24,350

Operating Activities:
- Net Income: 15,650
- Depreciation: 5,700
- Gain on Investment: (2,000)
- Net Cash Flows from Operating activities: 20,350

Investing Activities:
- ±Cash received/paid for Property, Plant, Equip: (15,750)
- Net Cash Used for Investing Activities: (15,750)

Financing Activities:
- Cash received/Paid for Stocks, Bonds, Mortgage: 2,000
- Less cash paid for Dividends: (2750)
- Net Cash Used for Financing Activities: (750)
- Increase(decrease) in cash: 3,850
- Cash at beginning of Year: 14,300
- Cash at end of Year: 18,100

**Analyzing Financial Performance using Ratios**

Ratio Analysis: The assessment of a firm’s financial condition using calculations and interpretations of financial ratios developed from the firm’s financial statements.

**Liquidity Ratios**

**Current Ratio**

\[
\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{Cash} + \text{A/R}}{\text{A/P}} = \frac{18,100 + 6,250}{4,230} = \frac{24,350}{6:1}
\]

This ratio tells us that John Co., is able to pay all of its current liabilities 6 times. The average is 2:1 so this is great.

**Acid Test Ratio**

\[
\frac{\text{Cash & Cash equivalents}}{\text{Current Liabilities}} = \frac{\text{Cash & Cash equivalents are those accounts that can be converted to cash today. Only Cash, Accounts Receivable, and Marketable Securities}}{\text{Current Liabilities}}
\]

This ratio shows us the John Co., had $0.18 in debt for every dollar in equity.

**Debt to owners’ equity ratio**

\[
\frac{\text{Total Liabilities}}{\text{Owner’s Equity}} = \frac{\text{A/P}}{\text{Owner’s equity}} = \frac{4,230}{24,350} = \frac{.1737}{.18}
\]

This ratio shows us the John Co., had $0.18 in debt for every dollar in equity.

**Profitability (Performance) Ratios**

**Return on sales**

\[
\frac{\text{Net Income}}{\text{Net sales}} = \frac{\text{Net Income}}{\text{Total Revenue}} = \frac{15,650}{20,000} = .7825 = .78
\]

For every dollar of sales, the company keeps $0.78 before paying out dividends.

**Return on Equity**

\[
\frac{\text{Net Income}}{\text{Net Sales}} = \frac{\text{Net Income}}{\text{Total Revenue}} = \frac{15,650}{20,000} = .7825 = .78
\]

For every $1 the owners put into John Co. they earn $.78.