

# Financial Management

## Section 17.1

### Basic Accounting Procedures



What are the basic accounting procedures businesses should practice?

#### Objectives

After completing this section, you will be able to:

- **Explain** the finance function of business.
- **Identify** types of daily business transactions.
- **List** the components of payroll.
- **Explain** double-entry accounting procedures.

## Section 17.1 Review

### Check Your Understanding

1. The finance function of business includes what types of activities?  
Answer: The finance function of business includes all activities that involve money.
2. State the accounting equation.  
Answer: The accounting equation is stated as: assets = liabilities + owner's equity
3. What is the first step in recording a transaction?  
Answer: The first step in recording a transaction is to identify which accounts are affected.
4. What are subsidiary ledgers?  
Answer: Individual accounts for customers and vendors are called *subsidiary ledgers*.
5. After transactions are recorded in the journals, where is the information transferred?  
Answer: After transactions are recorded in the journals, the information is transferred to the general ledger and the subsidiary ledgers. By posting to the ledgers, the business can obtain specific information about each account in the business.

## Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

financial planning

Answer: Process of setting financial goals and developing plans to reach them.

revenue

Answer: Earnings that a business received for the goods and services it sells. Also called *income* or *sales*.

expense

Answer: Cost involved in operating a business.

financial management

Answer: Process used to manage the financial resources of a business.

accounting

Answer: System of recording business transactions and analyzing, verifying, and reporting the results.

generally accepted accounting principles (GAAP)

Answer: Rules, standards, and practices businesses follow to record and report financial information.

audit

Answer: Review of the financial statements of a business and the accounting practices that were used to produce them.

business entity

Answer: Organization that exists independently of the owner's personal finances.

fiscal period

Answer: Period of time for which a business summarizes accounting information and prepares financial statements. Also known as *accounting period*.

budget

Answer: Financial plan that reflects anticipated revenue and shows how it will be allocated in the operation of the business.

sales forecast budget

Answer: Projected sales units and revenue dollars for the period.

sales forecast

Answer: Predication of future sales based on past sales.

start-up budget

Answer: Budget created in the planning to help project revenues and expenses until the business is profitable.

operating budget

Answer: Projection of the sales revenue that will be earned and the expenses that will be incurred during a future period of time.

cash budget

Answer: Used to estimate the amount of money coming into and going out of the business.

source document

Answer: Record that proves a business transaction occurred.

sale on account

Answer: Transaction for which cash for the sale is received at a later date.

purchase on account

Answer: Transaction for which merchandise purchased is paid to the vendor at a later date.

merchandise

Answer: Item or items that are bought with the intentions of reselling to a customer.

payroll

Answer: List of all employees working for the business and their earnings, benefits, taxes withheld, and other deductions.

withholding allowance

Answer: Amount of income that is not subject to income taxes.

dependent

Answer: Individual who relies on someone else for financial support.

employee's earnings record

Answer: Individual payroll record maintained for each employee.

payroll register

Answer: Summary of the earnings, payroll deductions, and net pay for all employees recorded for each payroll period.

gross pay

Answer: Amount of income earned before taxes and other deductions are withheld.

account

Answer: Individual record that summarizes information for a single category, such as cash or sales.

chart of accounts

Answer: List of all accounts in the business.

double-entry accounting

Answer: Recording the debit and credit parts of a transaction.

journal

Answer: Form used to record business transactions in chronological order.

journalizing

Answer: Process of recording business transactions in a journal.

ledger

Answer: Group of accounts.

posting

Answer: Transferring information from the journal to the ledger.

## Section 17.2

# Financial Records



### Objectives

After studying this section, you will be able to:

- **State** the importance of financial statements for a business.
- **Explain** why financial statement analysis is performed.

## Section 17.2 Review

### Check Your Understanding

1. When are financial statements completed for a business?

**Answer:** Financial statements are used to report information for the business. They are completed at the end of the accounting cycle.

2. Which financial statement provides the financial condition of the business on a specific date?

**Answer:** The balance sheet gives a snapshot of the financial condition of the business for a specific date.

3. For what purpose does the owner's equity statement serve?

**Answer:** The owner's equity statement summarizes changes in the owner's equity during a fiscal period.

4. List three financial ratios that are calculated from the balance sheet.

**Answer:** By analyzing the balance sheet, a business can determine its working capital, current ratio, and debt ratio.

5. List two financial ratios that are calculated from the income statement.

**Answer:** Two financial ratios that are calculated from the income statement are the net profit ratio and the operating ratio.

### Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

accounting cycle

**Answer:** Sequence of steps businesses follow to record, summarize, and report financial information.

stakeholder

**Answer:** Person with interest in a business.

balance sheet

**Answer:** Reports the assets, liabilities, and owner's equity.

cash flow statement

Answer: Reports how cash moves into and out of a business.

income statement

Answer: Reports the revenue and expenses of a business for a specific time period and shows a net income or net loss.

financial ratio

Answer: Evaluates the overall financial condition of the business by showing the relationships between selected figures on financial statements.

working capital

Answer: Difference between current assets and current liabilities of a business.

current asset

Answer: Cash or any asset that will be exchanged for cash or used within one year.

current liability

Answer: A short-term debt that must be paid within one year.

current ratio

Answer: Shows the relationship of current assets to current liabilities.

debt ratio

Answer: Shows the percentage of dollars owed as compared to assets owned.

net profit ratio

Answer: Illustrates how much profit is generated per dollar of sales.

operating ratio

Answer: Shows the relationship of expenses to sales.

## Section 17.1 Basic Accounting Procedures

- Finance is one of the four functions of business. Financial management is a process used to manage the financial resources of a business. It includes accounting, budgeting, and risk management. Financial planning is the process of setting financial goals and developing plans to reach them.
- A business transaction is any activity that affects the business. All daily business transactions must have a source document to prove it happened. The accounting equation is used to analyze business transactions.
- Businesses use double-entry accounting to record transactions. Every transaction has at least two parts, or two accounts. Transactions are recorded in journals then posted into ledgers.
- An important responsibility of a business is to pay its employees. The regular payroll generates multiple types of financial transactions. These transactions are recorded as the payroll is completed.

## Section 17.2 Financial Records

- Financial statements are important to all the stakeholders in a business. These statements provide information about the financial status of the business. Creating financial statements is one part of the financial management process.
- The information provided in financial statements is used to analyze the performance of the business by calculating financial ratios. Financial statement analysis provides benchmarks for making decisions about the business.

## Review Your Knowledge

1. Explain three core goals of a successful business.

**Answer:** The three core goals of a successful business are pay debts, meaning the business must repay banks and others who have extended loans; provide return for investors, meaning those who have invested in a business expect to get a return on their money; and finance future growth, meaning for a business to continue, money must be available.

2. Describe common budgets used in financial planning.

**Answer:** A sales forecast budget is the projected sales units and revenue dollars for the period; a start-up budget is a budget created in the planning stages for a new business; and operating budget is a projection of the sales revenue that will be earned and the expenses that will be incurred during a future period of time; and a cash budget is used to estimate the amount of money coming into and going out of the business.

3. Explain a cash sale.

**Answer:** A cash sale occurs when customer pays cash or writes a check for a purchase, and the business gives a copy of the sales receipt to the customer and keeps a copy for its records.

4. Describe two components of payroll.

**Answer:** Two important components of payroll are employee records, which is personal information about an employee, and employer records, such as a payroll register.

5. List and describe four special journals used to record transactions.

**Answer:** Four special journals are cash receipts journals, which are used for all receipts of cash; cash payments journals, which are used for all payments of cash; sales journals, which are used for all sales on account transactions; and purchase journals, which are used for all purchased on account transactions.

6. Explain why financial statements are important to a business owner.

**Answer:** Financial statements are used to report information for the business. Investors need to see how their investments are doing. Financial statements give stakeholders, who are the people with interests in the business, updates about the status of the business. Lenders, such as a bank, want to know their loans will be repaid on time.

7. Define financial statement analysis.

**Answer:** *Financial statement analysis* is the process of reviewing information provided in financial statements to analyze the performance of the business.

8. What does the balance sheet show?

**Answer:** The balance sheet shows the financial strength of the business.

9. How is debt ratio calculated?

**Answer:** Debt ratio is calculated by dividing the total liabilities by the total assets.

10. What do profit margin ratios indicate?

**Answer:** *Profit margin ratios* are an important indicator of progress.

## Apply Your Knowledge

1. Pay a visit to the accounting teacher in your school. Ask for examples of each of the basic journals typically used by a business. Create a poster of each with captions on the type of journal and its purpose.

Answer: Student answers will vary. Evaluate each response individually.

2. A net profit ratio illustrates how much profit is generated per dollar of sales. Village Bicycle Shop has a net income of \$62,000 and \$107,000 in sales. Using the formula presented in the chapter, calculate the net profit ratio for Village Bicycle Shop. Explain what the resulting ratio means.

Answer: Student answers will vary. Evaluate each response individually.

3. Acceptable accounting principles dictate that personal records be kept separately from the records of a business. Explain why this is important. What kinds of issues could arise from a business that does not follow this standard?

Answer: Student answers will vary. Evaluate each response individually.

4. Using the balance sheet in Figure 17-7, interpret the nature of the statement. What does it show? Why should an investor analyze the balance sheet of a business? Interpret what the balance sheet reveals about a business.

Answer: Student answers will vary. Evaluate each response individually.

5. Income statements provide important financial information for a business. What is the nature of income statements? Interpret the information that an income statement reveals about a business.

Answer: Student answers will vary. Evaluate each response individually.



## You Do the Math

### Numeric Reasoning

To multiply whole numbers and decimals, place the numbers, called the *factors*, in pairs in a vertical list. When multiplying a percentage, move the decimal two places to the left. To find the number of decimal places needed in the final product, add the number of places in each number. Two decimal places plus three decimal places means the product must have five decimal places.

#### Solve the following problems.

1. Shelia earns \$12 an hour and earns time and a half (1.5×) for hours worked over 40. Last week, Shelia worked a total of 42 hours. What is her gross pay?

Answer:  $\$12 \times 40 = \$480$

$$1.5 \times \$12 = \$18$$

$$42 - 40 = 2$$

$$\$18 \times 2 = \$36$$

$$\$480 + \$36 = \$516$$

2. You live in an area that has a general sales tax rate of 8.5 percent on most purchases. How much sales tax would you pay for the following goods and services from area stores?

A. \$150 three-in-one computer printer

Answer:  $\$150 \times .085 = \$12.75$

B. \$30 box of printer paper

Answer:  $\$30 \times .085 = \$2.55$

C. \$4 package of pens

Answer:  $\$4 \times .085 = \$0.17$

3. A business must pay a 2 percent fee on all credit card transactions. What is the total fee for all of these transactions: \$24.76, \$52.76, and \$29.35?

Answer:  $\$24.76 \times .02 = \$0.50$

$$\$52.76 \times .02 = \$1.06$$

$$\$29.35 \times .02 = \$0.59$$

$$\$0.50 + \$1.06 + \$0.59 = \$2.15$$