

Undergraduate Diploma in Business Administration

Module 03 Financial Analysis MQF Level 5 (8 ECTS)

Lecture 1

Phase 1: The Accounting Cycle & Building the Statements

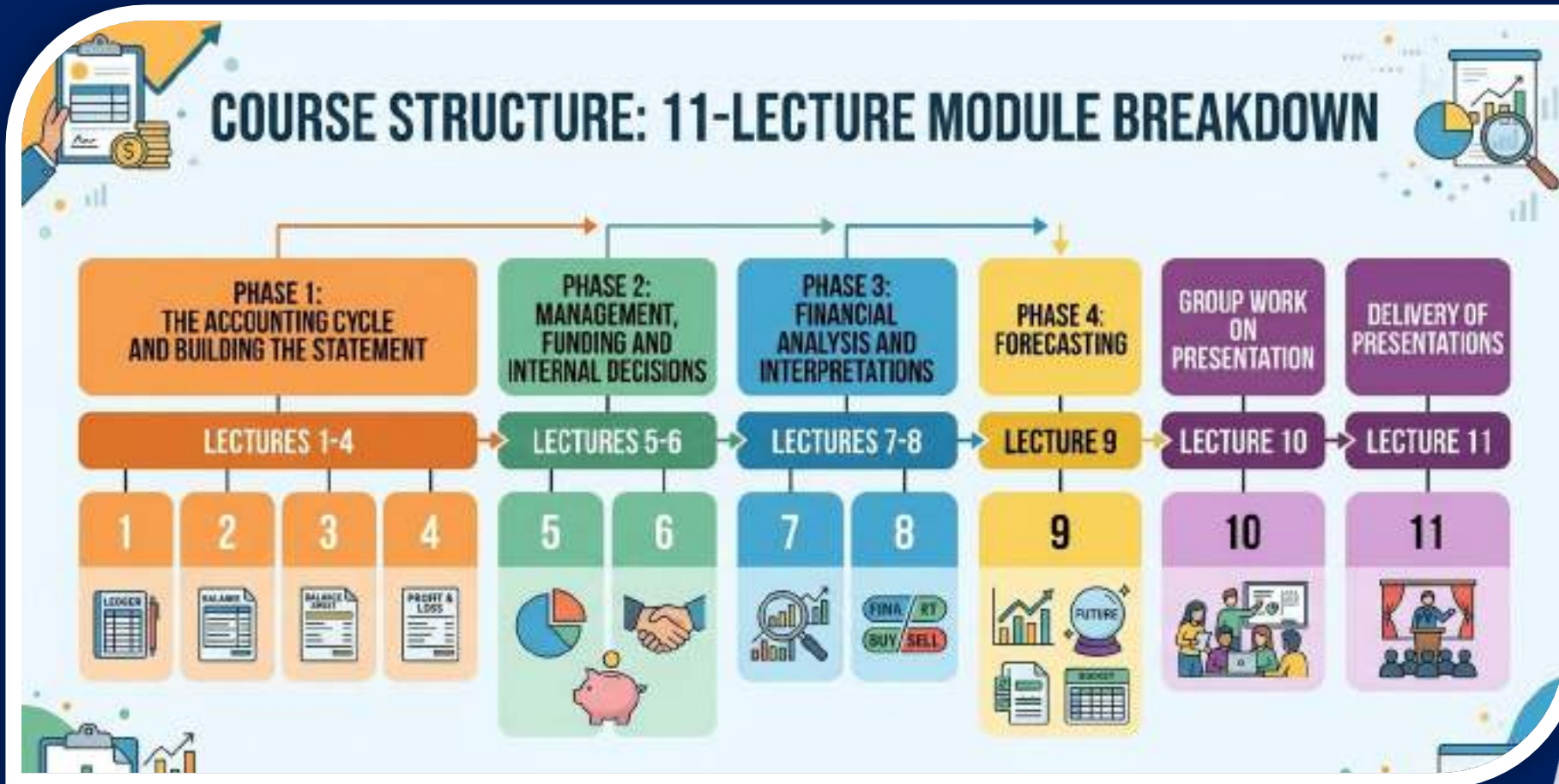


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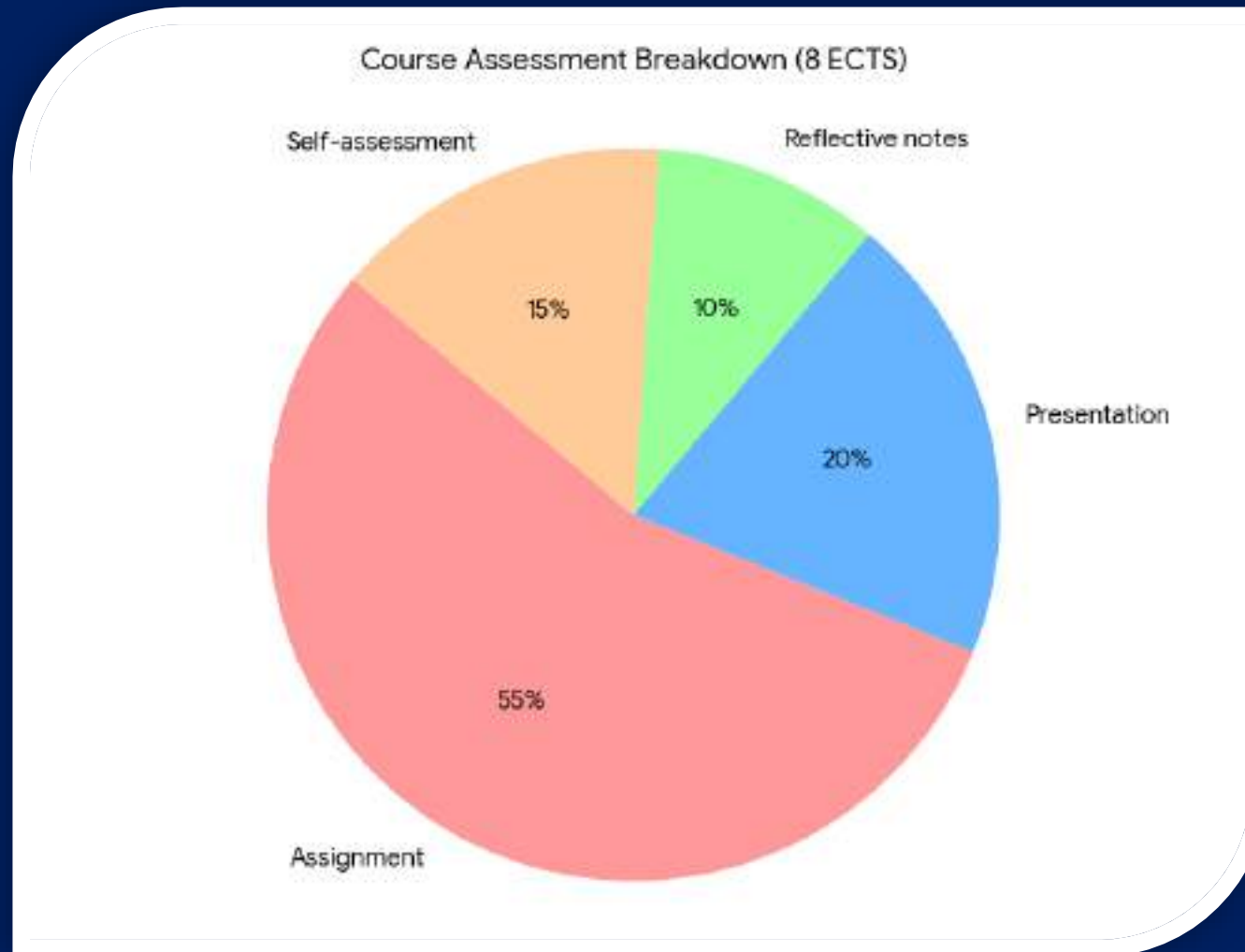
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**Undergraduate Diploma in
Business Administration**

Lectures Breakdown



Course Assessment Breakdown (8 ECTS)



What is accounting?

- **The Primary Definition:** Accounting is the process of recording, classifying, selecting, measuring, interpreting, summarising, and reporting financial data of an organisation.
- **The Main Objective:** Its core purpose is to provide useful financial information to interested parties so they can make informed, objective decisions about a business.
- **Beyond Just Recording:** While it includes writing down day-to-day transactions (which is bookkeeping), accounting is much wider in scope. It is about making sense of those recorded numbers.



What is accounting? Cont..

- **The Output (Financial Statements):** The ultimate result of the accounting process is the production of financial statements. These typically include:
 - The Income Statement (to calculate profit or loss).
 - The Statement of Financial Position / Balance Sheet (to show the overall financial health and value of the business at a specific point in time).
- **Tracking Resources:** It tracks the resources coming into the business, how those resources are being used, and the results achieved by using them.
- **Control and Planning:** By looking at past performance through accounting, managers and owners can control current operations and plan effectively for the future.



The History of Accounting

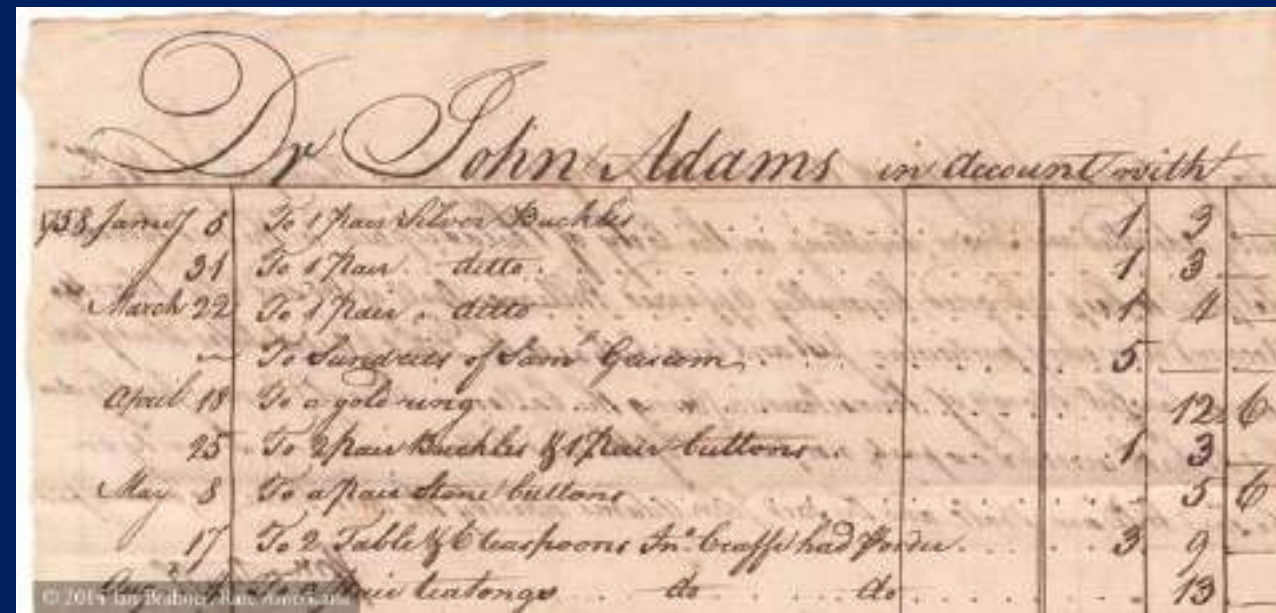
- **Ancient Origins:** The need to record things is as old as civilization itself. Early records date back thousands of years to ancient empires (like Mesopotamia and Egypt), where rulers and merchants needed basic systems to keep track of taxes, wealth, and agricultural stores.
- **The "Father of Accounting":** The turning point for modern accounting happened in Italy during the 15th century. In 1494, an Italian monk and mathematician named Luca Pacioli published a book that detailed the "double-entry" bookkeeping system used by Venetian merchants. This system (where every transaction has a dual effect) is still the foundation of accounting today.



The History of Accounting Cont...

The Industrial Revolution

During the 18th and 19th centuries, the rise of factories and mass manufacturing changed the business landscape. It was no longer just about buying and selling; owners needed to know exactly how much it cost to make their products. This necessity gave birth to **cost accounting and management accounting**.



Dr John Adams in account with				
1753 Jan 8	To 1 pair Silver Buckles	1	3	
31	To 1 pair ditto	1	3	
March 22	To 1 pair ditto	1	4	
	To Surgeons of Sam. Gascon	5		
April 18	To a gold ring	12	6	
25	To 2 pair Buckles & 1 pair buttons	1	3	
May 8	To a pair stone buttons	5	6	
17	To 2 Table & 6 teaspoons In. Croffs had from	3	9	
Aug 2	To a pair leather tongs	13		

The History of Accounting Cont...

The Rise of the Corporation

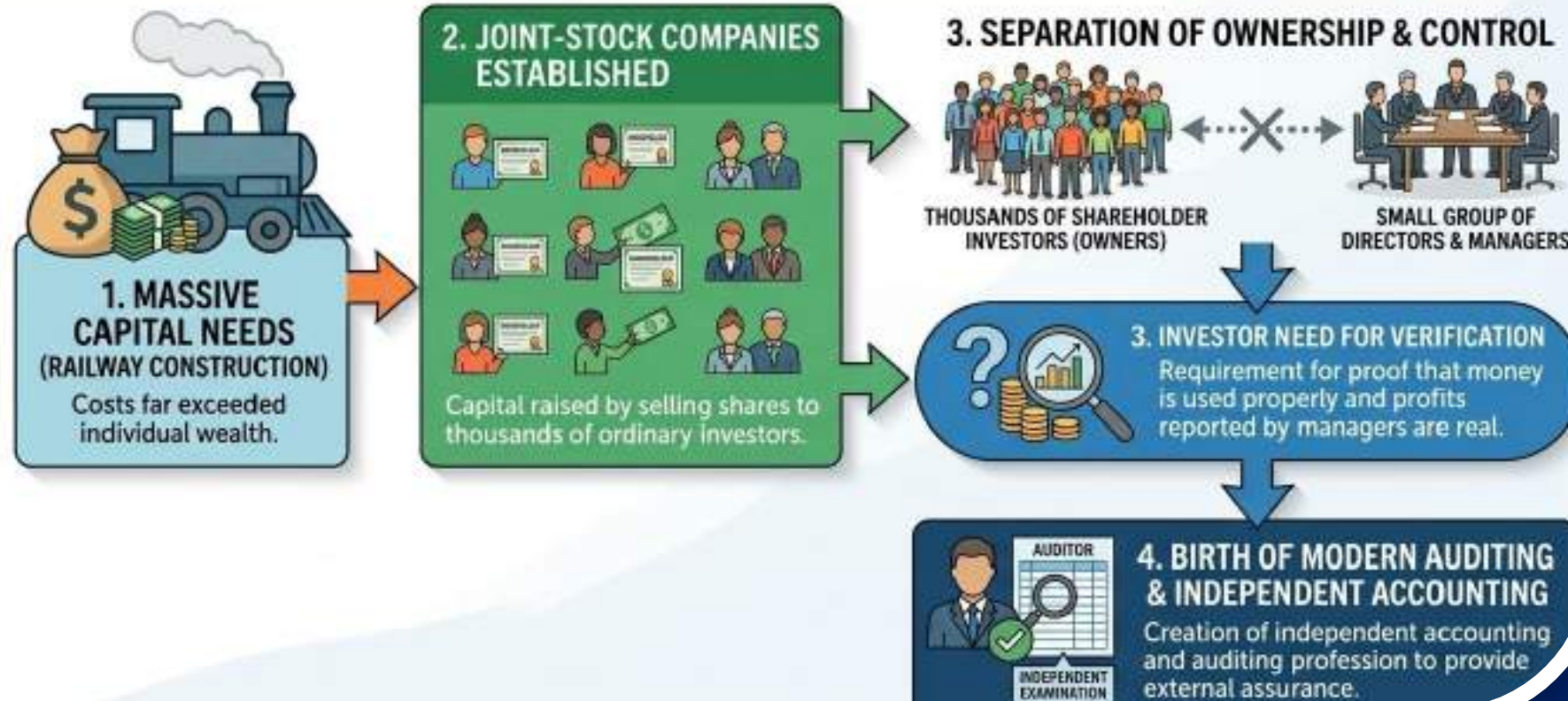
- As businesses grew into massive operations (like the early railway companies), a new business structure emerged: the joint-stock company. This created a major shift because the people who owned the business (the shareholders) were no longer the same people running the day-to-day business (the managers).
 - Key Early Railway Companies:
 - Stockton and Darlington Railway (1825): This is famous for being the world's first public railway to use steam locomotives. It proved that moving heavy freight (like coal) by rail was economically viable.
 - Liverpool and Manchester Railway (1830): This was the first modern, inter-city passenger railway. It was a massive financial success and effectively sparked what became known as "Railway Mania" (a massive investment boom).



The History of Accounting Cont...

The railways changed everything for three reasons:

THE RAILWAY ORIGINS OF MODERN AUDITING.



The History of Accounting Cont...

The Need for Independent Checks (Auditing):

Because the owners were separate from the managers, the owners needed reassurance that the financial reports the managers gave them were actually true. This demand led to the creation of independent, professional accountants (auditors) whose job was to verify the accuracy of the financial statements.



The Objective of Accounting

The 6 Core Objectives of Accounting

-  **Maintain Systematic Records**
 - Permanent, accurate history of all transactions.
-  **Determine Profit or Loss**
 - Compares income vs. expenses to measure success.
-  **Show Financial Position**
 - Tracks what the business owns (assets) vs. owes (liabilities).
-  **Guide Decision-Making**
 - Provides vital, summarized data for managers and investors.
-  **Protect Business Assets**
 - Controls cash, property, and inventory to prevent fraud.
-  **Evaluate Performance**
 - Compares current results against past years or competitors.



Financial Management



Key Objectives of Financial Management

Shareholder Wealth Maximization (Primary Goal)

- Increase long-term company value and owner/shareholder stakes.

Profit Maximization

- Increase revenue and control costs without sacrificing long-term stability.

Ensuring Adequate Liquidity (Short-Term Focus)

- Manage working capital to guarantee enough cash for daily bills and survival.

Proper Utilization of Funds (Long-Term Focus)

- Invest efficiently, distinguishing between operational and capital investments.

Determining Capital Structure

- Find the optimal, cost-effective balance between debt (borrowing) and equity (owners' money).

Financial Control & Evaluation

- Analyse statements and compute ratios to measure health and forecast performance.

While accounting is largely about *recording* and *reporting* the past, financial management is about making strategic decisions for the *future*.

The Accounting Environment



The Accounting Environment



The Accounting Environment



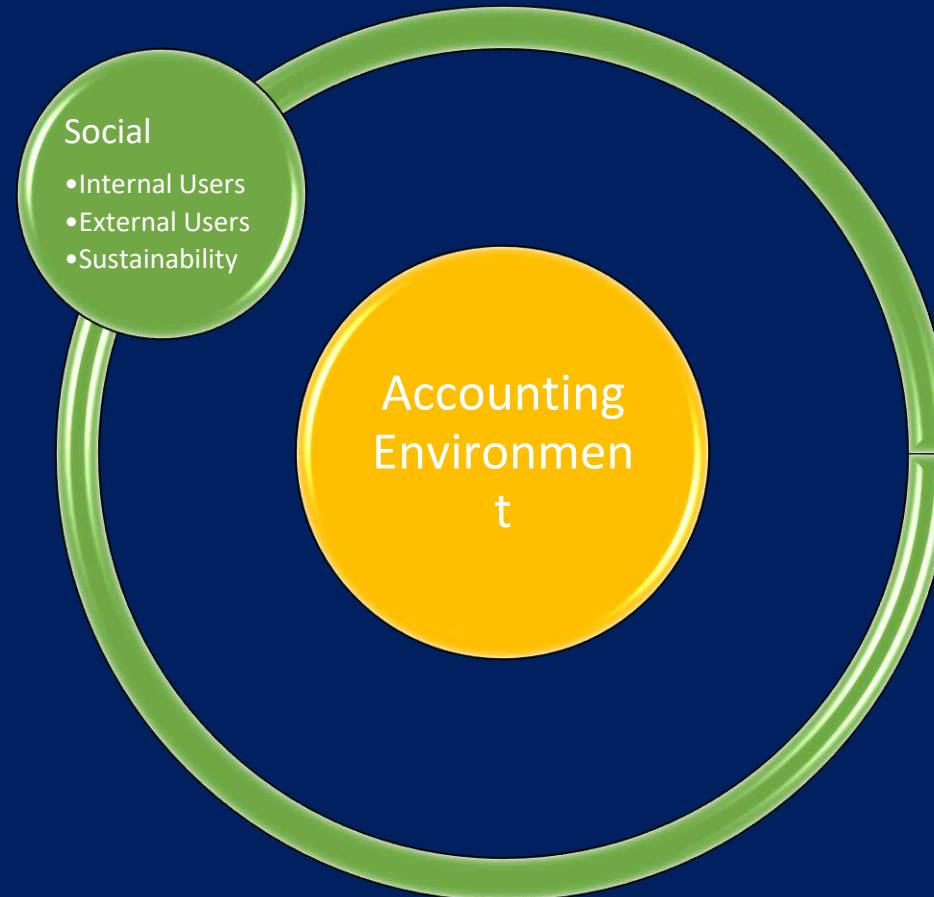
The Accounting Environment



The Accounting Environment



The Accounting Environment



The Core Accounting Principles

Business
Entity

Going
Concern

Money
Measurement

Historical Cost

Dual Aspect

Accrual

Matching

Prudence

Consistency

Materiality

Business Entity Principle

- A business is treated as a completely separate legal and financial entity from its owners.
- Personal expenses of the owner must never be mixed with the business's expenses.



Going Concern Principle

- This is the assumption that the business will continue to operate indefinitely into the future. Because of this, assets are not simply recorded at what they could be sold for tomorrow (liquidation value), but rather at their historical cost.



Money Measurement Principle

- Accounting only records transactions and events that can be expressed in monetary terms. Factors like employee morale or a manager's expertise, while valuable, cannot be objectively measured in money, so they aren't recorded in the financial statements.



Historical Cost Principle

- Assets are typically recorded at their original purchase price, regardless of how their market value might change over time. If a business bought a building for €100,000 ten years ago, it remains recorded at €100,000 (minus depreciation), even if it is now worth double.



Dual Aspect Principle

- This is the foundation of double-entry bookkeeping and the accounting equation. Every single transaction has two effects. If you buy inventory with cash, your inventory goes up, but your cash goes down.



Accrual Principle

- Transactions are recorded when they actually occur, not just when the cash changes hands. If you sell goods on credit in December but don't get paid until January, the revenue is still recorded in December.



Matching Principle

- This goes hand-in-hand with the accrual principle. The expenses incurred to generate a specific amount of revenue must be recorded in the exact same time period as that revenue, so that the profit is calculated accurately.



Prudence Principle

- When making estimates, accountants should always err on the side of caution. If there is a potential loss, it should be recorded immediately. If there is a potential profit, it should not be recorded until it is actually realized. This prevents businesses from overstating their financial health.



Consistency Principle

- Once a business chooses a specific accounting method (like how it calculates depreciation or values inventory), it must stick to that same method year after year. This allows investors and managers to accurately compare financial performance over time.



Materiality Principle

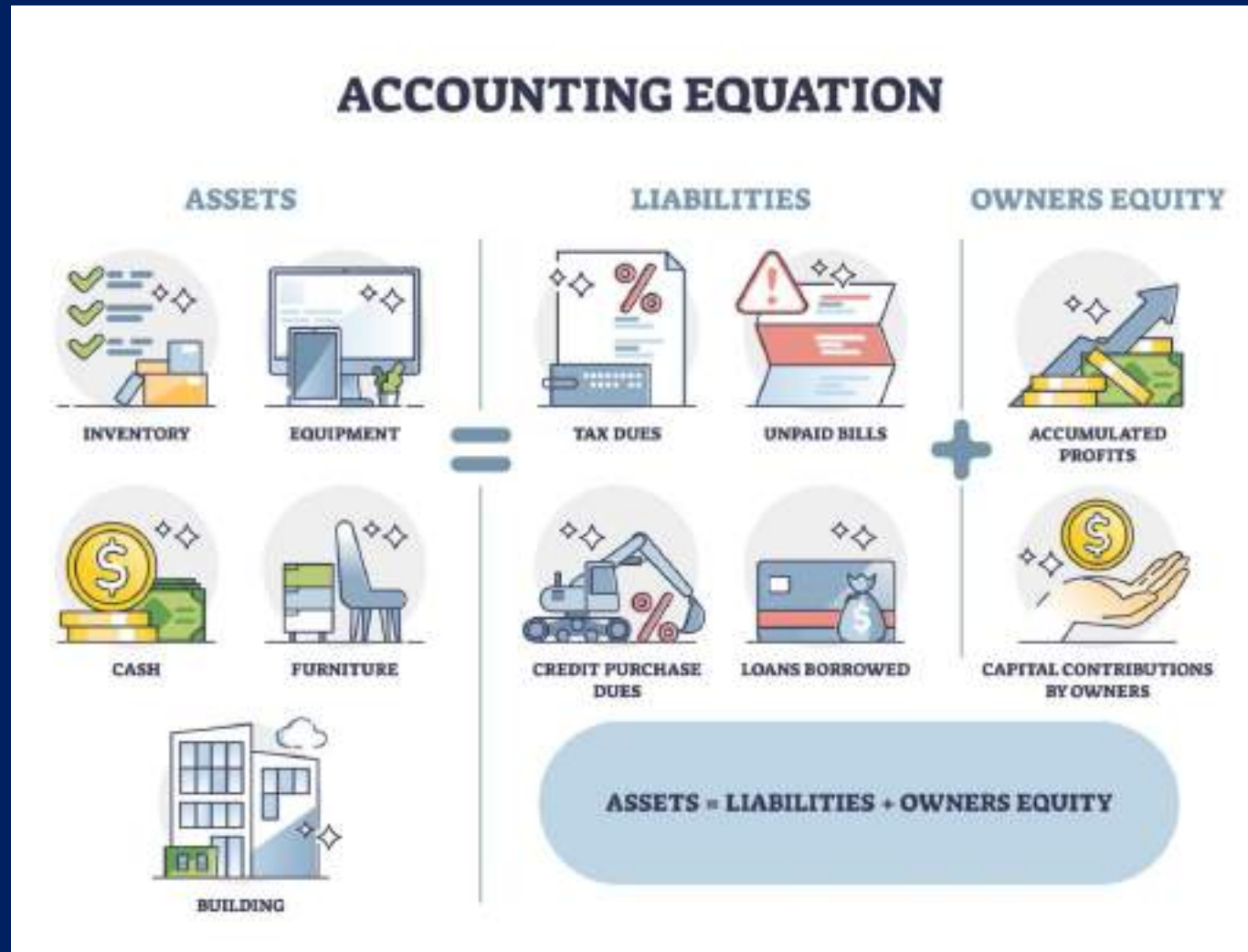
- Strict accounting rules can sometimes be relaxed if an item is so small that it wouldn't influence the decision-making of anyone reading the financial statements. For example, a €5 stapler could theoretically be recorded as an asset and depreciated over five years, but it's simpler and perfectly acceptable (due to materiality) to just record it as a one-time expense.





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The Accounting Equation



The T-Account Structure

- A T-account is a visual representation of a single accounting ledger. It gets its name because it looks exactly like a capital letter "T".

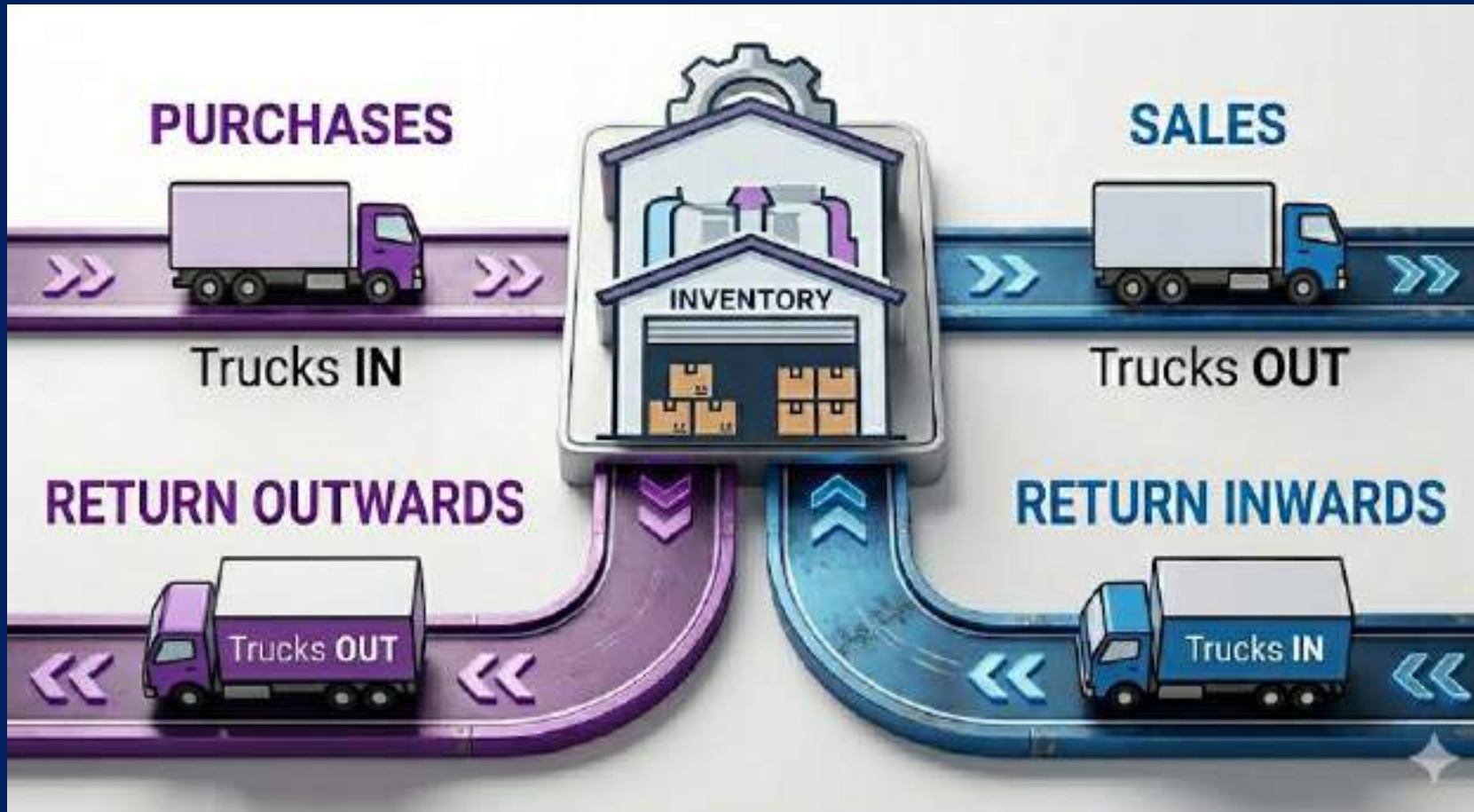
UNDERSTANDING T-ACCOUNTS: DEBITS (+) AND CREDITS (-)

ACCOUNT TITLE (e.g., CASH ACCOUNT)					
DEBIT SIDE (Dr.) (+)			CREDIT SIDE (Cr.) (-)		
Date	Description	Amount (€)	Date	Description	Amount (€)

The Effect of Transactions on the Accounting Equation

Example of transaction	Effect	
Owner pays capital into the Bank	Increase asset (Bank)	Increase Capital
Buy Inventory by cheque	Decrease asset (Bank)	Increase asset (Inventory)
Buy Inventory on credit	Increase asset (Inventory)	Increase liability (Accounts Payable)
Sale of inventory on credit	Decrease asset (Inventory)	Increase asset (Accounts receivables)
Pay creditor	Decrease asset (Bank)	Decrease liability (Accounts payable)
Debtor pays money owing by cheque	Increase assets (Bank)	Decrease asset (Accounts receivable)
Owner takes money out of the business bank account for own use	Decrease asset (Bank)	Decrease Capital

Inventory



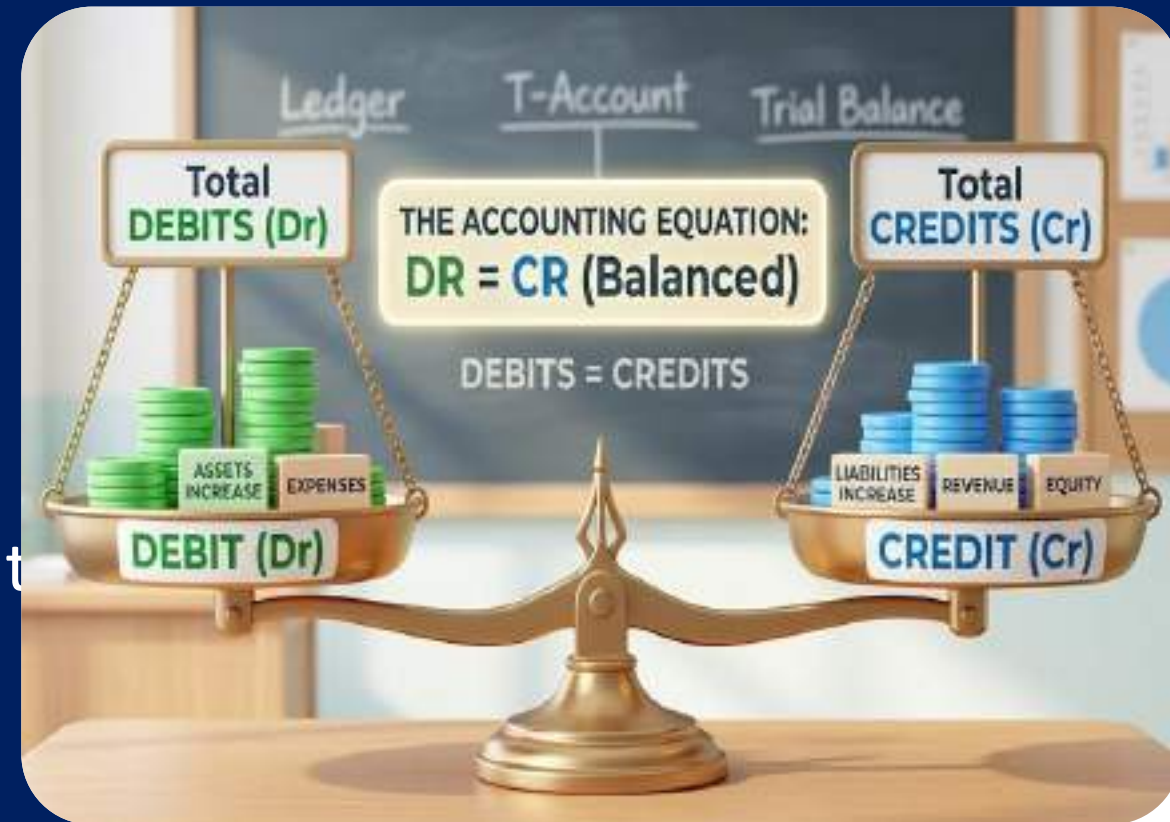
Class exercise:

Business Accounting – Frank Woods - Inventory - 3.5



Balancing off Accounts

- **Balancing off an account** simply means finding the exact value (the "net balance") of an account at the end of a specific period, like a month or a year.
- Because a T-account has two sides—money coming in (Debits) and money going out (Credits)—you need to figure out the difference between the two to know exactly where that account stands before moving into the next month.



This is the easiest and most satisfying scenario in bookkeeping.

ABERDEEN CARS LTD (CREDITOR)					
Debit (Dr) €			Credit (Cr) €		
Jul 29	Bank	9,100	Jul 17	Van	9,100
		9,100			9,100

When you total up the debit (Dr) side and it exactly matches the total of the credit (Cr) side, the account has a zero balance (sometimes referred to as being squared off).

Next two steps

Balance Carried Down

In standard balancing, if one side is heavier, you have to calculate the difference and create a "Balance c/d" (carried down) to make the two sides equal

Balance Brought Down

Then bring it down as a "Balance b/d" (brought down) for the next period. Because a squared-off account already balances perfectly, you skip this step entirely. You simply draw your double lines under the matching totals to show the account is closed for that period.



Example

BANK					
Debit (Dr) €			Credit (Cr) €		
Jul 1	Capital	20,000	Jul 25	B. Brown	1,924
Jul 6	Cash	200	Jul 29	Aberdeen Cars	9,100
			Jul 31	Balance c/d	9,176
		<u>20,200</u>			<u>20,200</u>
BALANCE B/D: € 9,176					

Class exercise:

***Business Accounting – Frank Woods - Inventory -
3.5 – Balancing off***



Class exercise:

Business Accounting – Frank Woods – Balancing off accounts – 6.1





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