Wall Street Journal, December 7, 1971

General Motors Corporation [on December 6, 1971] named Richard C. Gerstenberg, a tough-minded financial man, as its chairman and chief executive officer. The main reason Mr. Gerstenberg got the job, it's believed, is his strong financial background, making him the man of the hour when GM is increasingly worried about its profit margins and its ability to finance its growth internally.

The biggest surprise in the executive reorganization was the naming of T.A. Murphy [another finance man] to the powerful post of vice chairman. Observers expressed some surprise that none of the top assignments given out was to an executive whose career had been in sales or manufacturing.

Why?

Part of the real world

Requisite for high-level management

Beneficial to managers at all levels

Well-founded skepticism

Power

Whence Cometh?

- **Bookkeeping - Ancient**
- **Budget - 5 A.D.**
  Roman Emperor Augustus
- **Accounting - 13th Century**
  double-entry, Luca Pacioli, Italy, 1494
- **Accounting Profession - 1700s**
  England + Italy, certification
- **Auditing - late 1700s**
  during Industrial Revolution
- **Finance - 20th Century**

Terms

ACCOUNTING

keeping transactions in accounts and reporting results

BUDGET

financial document estimating future performance

FINANCE

"the art of providing the terms of payment"

Organization

CHIEF EXECUTIVE OFFICER

CHIEF FINANCIAL OFFICER

CONTROLLER
"inside"

accounting system
budgeting system
capital budget

TREASURER
"outside"

raising capital
credit policies

Accounting

(per Riggs)

Definition:

Accounting is the process of observing, measuring, recording, classifying, and summarizing the changes in an entity, expressed in monetary terms, and interpreting the resulting information

Limitations:

Historical
Monetary
Internal
Estimation

Role of Accounting

A service function providing useful information

Fundamental Equation of Accounting

A = L + OE

Assets = Liabilities + Owners' Equities

<u>Owner's Equity</u>

also known as
Net Worth

<u>Increase</u>

additional investment
retained earnings

<u>Decrease</u>

capital withdrawal
operating loss

Owner's Equity is NOT market value.

INCREASING (DECREASING) OWNER (STOCKHOLDER) EQUITY

ADDITION OR WITHDRAWAL OF CAPITAL INVESTMENT

ASSETS	*LIABILITIES* *OWNER EQUITIES*

- **SELL STOCK, CONTRIBUTE CAPITAL**

+ **ASSETS (INCREASE CASH)**
+ **EQUITIES (INCREASE INVESTMENT BY OWNERS)**

- **BUY STOCK BACK, WITHDRAW CAPITAL, PAY DIVIDENDS**

\- **CASH**
\- **EQUITIES**

INCREASING (DECREASING) OWNER (STOCKHOLDER) EQUITY

EARNINGS OR LOSSES FROM OPERATIONS

ASSETS	*LIABILITIES*
	OWNER EQUITIES

- **REVENUES > EXPENSES**

+ ASSETS
+ EQUITIES

- **REVENUES < EXPENSES**

- ASSETS
- EQUITIES

Valuation Methods

TIME-ADJUSTED

MARKET

COST

Valuation Criteria

Currently Relevant

value reflective of the present situation

Feasible

ability to quantify monetary value

Cost-Effective

expense for processes to obtain value

Timely

acquire value as quickly as possible

Bias-Free

avoid bias of individual identifying value

Repeatable

two or more people generate same value

Verifiable

need for documentation and evidence

Comparison of Methods

	Time-Adjusted	Market	Cost
Relevant	good	good	poor
Feasible	okay	good	good
Effective	poor	okay	good
Timely	good	okay	good
Bias-Free	okay	okay	okay
Repeatable	okay	okay	good
Verifiable	good	good	good

page 14, #1.4: **How do the following individuals interact with (provide information to *and* get information from) the accounting system?**

b) The project manager in design engineering

"provide information to" might include reporting travel expenses; reporting hours on a particular project

"get information from" might include reports on total expenditures for a project

d) The sales engineer who calls on customers

"provide information to" might include billable hours for the customer; invoices for things purchased

"get information from" might include status report on customer's account

i) The manager of warehousing and shipping

"provide information to" might include paperwork associated with items received

"get information from" might include paperwork associated with items to be shipped

<u>page 16, #1.12</u>: **How difficult would it be to measure, in monetary terms, the following transactions?**

b) The exchange of a parcel of land owned by the company for a 15-year lease in a newly-constructed facility

Not too difficult; there would have been some agreed-upon value for the transaction; probably the rough equivalent of the market value of the land; this would be a negotiated value

f) The negotiation of a ten-year license on a product developed by the company to another company that agrees to pay 4 percent royalty on all sales of the product

Difficult; an estimated value would involve estimating sales in the future, together with an estimate of the price basis of the product in the future

page 42, #2.25: **Identify each of the following as an asset, a liability, or owners' equity (from the point of view of the company):**

b) Vacation leave for employees, earned by them but not yet taken

Liability

e) A loan by the bank to the company

Liability

j) Deposit paid to an equipment supplier for specialized equipment to be delivered each year

Asset

q) Earnings of the company during the first six months of this year when no dividends have been paid

Equity

<u>page 43, #2.26</u>: Provide ONE example of transactions that would:

a) Decrease an asset and decrease a liability

***Expend some cash (decreases a current asset)
to Pay off a loan (decreases a liability)***

b) Increase owners' equity and increase and asset

***Make a profit and retain the earnings (increases equity)
and Invest it in Treasury Bills (adds or increases asset)***

c) Increase one asset and decrease another

***Use some raw materials (decreases raw materials inventory asset)
and Create some product (increases finished goods inventory asset)***