


Monta Vista DECA

# **A Very Brief Guide to Finance**

Important Concepts and Information

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## The Scope of Finance and the Competitive Events

“The science that describes the management of money, banking, credit, investments, and assets.”

– Investopedia definition of Finance

Finance is how the world manages its limited resources when wants and needs are unlimited.

Event	Test	Number of roleplays	Number of participants	Description
Principles of Finance (PFN)	Business Administration Core	1	1	A Principles event with a focus on general business, accounting, and finance topics.
Financial Services Team Decision Making (FTDM)	Finance Cluster	1	2	A team event where you make decisions and analyze financial data for others.
Accounting Applications (ACT)	Finance Cluster	2	1	Focus on decision making and recordkeeping in accounting.
Business Finance (BFS)	Finance Cluster	2	1	New this year, a general finance series event focusing on high-level decision making and analysis.
Finance Operations Research (FOR)	none	0	1-3	2011-2012: Research and develop a plan to create or improve a customer loyalty program for a finance-related company.

## The Nature of Money

Money is a common medium of exchange for goods and services. If you have money, you have a store of value. In the past, money was in the form of objects that actually held value to people, such as salt or gold. Currencies and other forms of exchange were created by banks, and then officially supported by governments. They were backed by precious metals that was somewhere in the world, and so held their value. Eventually, the standard was dropped, and the modern day fiat currency system arose, where money now only has value because the government deems it to be so, and people depend on money all the time. Money is often just a number stored in a computer. For this reason, a lot of trust needs to be put in those who handle money transactions.

## Legal Aspects

Because of the significance of money, many laws have been centered on preventing economic disaster and money-related crimes. Here are some examples:

- The Federal Insurance Deposit Corporation (FDIC) insures \$250,000 per depositor in certain banks in case of bankruptcy or other unforeseen circumstances
- The Securities and Exchange Commission (SEC) regulates all securities markets, which include electronic stock exchanges, mutual funds, and stock options and derivatives
- The Sarbanes-Oxley Act of 2002 sets new standards for companies to prevent accounting fraud that affected major companies like Enron

## Types of Investments

There are many ways that you can put your saved and hard-earned money to good use. You need to overcome the high inflation rates brought on by a fiat currency system. Some ways include investing in banks, the stock market, giving loans, or buying government or corporate bonds. If you want a higher reward, there will be more risk involved.

### The Stock Market

- When you buy a stock, you are essentially obtaining a unit of ownership in a company. People used to buy stocks in order to get a share of a company's annual profits, but now they trade frequently and try to make money off of the daily changing value of the stock and the company as a whole.
- You don't just buy and sell stocks. You are allowed to short-sell stocks you don't even own and buy them back later so that you can make a profit on stocks that decrease in value. Options and derivatives let you go even one step further, by selling or purchasing the rights to buy stock at a certain price in the future, for example. This is all in an effort to decrease risk.

### Banks

- When you invest in a bank, it takes everyone's money and invests it elsewhere, like in real estate development for example. Since it's a low return investment, the risk is very low, and most banks are FDIC-insured.

## Company Finances

### Types of Companies

There are several types of companies that have different laws for how they are taxed.

Company Type	Owners	Taxation/Details
Sole proprietorship	1 individual	Taxes are done with the owner's personal tax return.
Partnership	2+ individuals	Similar to sole proprietorship.
Limited partnership	2+ individuals	There are two types of partners, general (have unlimited liability), and limited (limited liability). Company taxed for generating income, investors are taxed for getting dividends (double taxation).
C corporation	Any number of shareholders	Company taxed for generating income, investors are taxed for getting dividends (double taxation).
S corporation	Maximum 75 shareholders	No double taxation, only shareholders pay taxes,

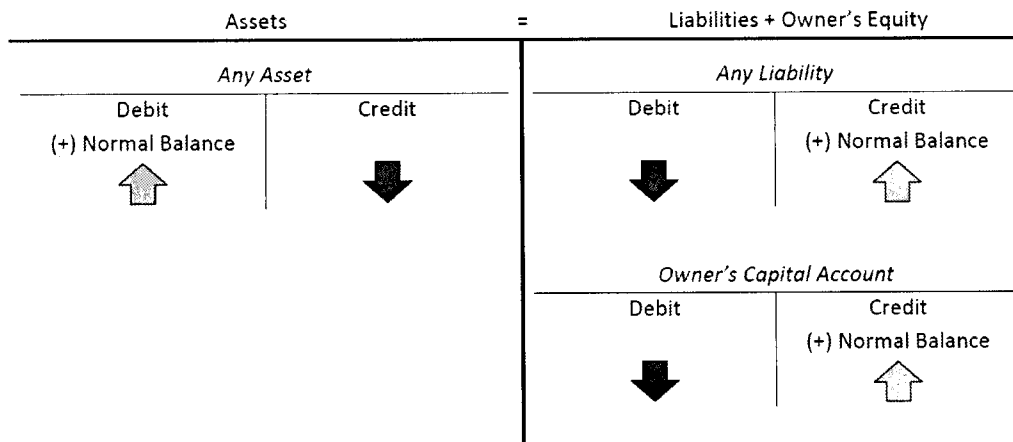
**Limited liability company (LLC)**

1+ members

but there are many, many restrictions. Liability protection, and taxation is done like a proprietorship/partnership.

## Accounting

Accounting is the planning, recording, analyzing, and interpreting of financial information. Within a company there are many accounts, such as accounts receivable, money owed to a business, or things like employee salary. Whenever a transaction occurs, money is debited to one account, and credited to another. This is tracked in a T chart like this (diagram by MVDECA ex-president Japheth Wong):



In any transaction, the basic accounting equation must hold, as seen at the top of the diagram. Accounting has guidelines known as the Generally Accepted Accounting Principles.

Accounting firms are so important they even tally up and verify results for things like the Oscars.

## Financial Statements

A company can present its financial state obtained from its accounting data to the outside in several ways. Here are the most common three.

Type of Financial Statement	Purpose
<b>Cash Flow Statement</b>	Cash flow statements show the flow cash in and out of a business over a period of time. It is important to sustain a decent positive cash balance, otherwise things get very risky.
<b>Balance Sheet</b>	A balance sheet is a snapshot of a company's financial position. It shows where all the money is located in the various accounts
<b>Income Statement (a.k.a. Profit and Loss Statement)</b>	The company prepares this statement to cover how much the revenue, expenses, and overall net profit was for the entire economic year. This is one document investors really look at.

## Calculations

With all the accounting data a company has, they analyze it by calculating key financial ratios to determine how well their company is doing. Some of the things calculated include how fast the inventory gets depleted, a multitude of risk calculations, and estimates of eventual profits. Knowing financial ratios and other calculations is the key to many roleplay performance indicators.

## Resources

### Books

From Japheth Wong's finance notes:

- *Accounting Essentials: Managing by the Numbers* (Jay Jacquet)
- *Century 21 Accounting* (Gilbertson, Lehman, and Ross. Published by Thomson/Southwestern)
- *Crash Course in Accounting and Financial Statement Analysis* (Matan Feldman, Arkady Libman)
- *Finance for Managers* (Harvard Business Essentials – Harvard Business School Press)
- *Financial Analysis: The Next Step* (James O. Gill and Moira Chatton)
- *Financial Intelligence: A Manager's Guide to Knowing What the Numbers Really Mean* (Karen Berman and Joe Knight, with John Case)
- *Understanding Financial Statements: A Primer of Useful Information* (James O. Gill and Moira Chatton)

### Websites

- *Commanding Heights* – <http://www.pbs.org/wgbh/commandingheights/>  
This is a super-long documentary on the formation of the current world economy turning toward capitalism and globalization. You will also see this in your Principles of Business class.
- *The Ascent of Money* – <http://www.pbs.org/wnet/ascentofmoney/>  
This is another super-long documentary about today's financial crisis and the evolution of today's complicated financial system. Try to see the four-hour version.
- Investopedia – <http://www.investopedia.com/>  
Investopedia will define all the finance terms you ever wanted defined.
- The Wall Street Journal – <http://online.wsj.com/home-page>  
If you read about finance every day, some of those articles' knowledge will rub off on you.

Also from Japheth's notes:

- *Century 21 Accounting Companion Site* – <http://www.c21accounting.com/>
- *Financial Ratios* – <http://cpaclass.com/fsa.ratio-01a.htm>