

# **Understanding Financial Statements**



# Accounting is The Language of Business

Describe the firm and its operations as the language of business

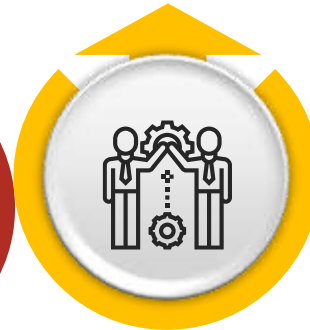
Manager needs to interpret financial statement to communicate with stakeholders



Visual representation of the firm



Manager needs to know how to "speak business"



Members of the firm determine the bonus by looking the firm's financial performance



# An Overview of The Firm's Financial Statements:

## Basic Financial Statements



### Income Statement

- The revenues the firm has earned
- The expenses it has incurred to earn those revenues
- The profit it has earned over a specific period



### Balance Sheet

- The firm's assets
- Liabilities (the company's debts)
- Stockholders equity



### Cash Flow Statement

- Reports cash received
- Reports cash spent by the firm




### Statement of Shareholders' Equity

- Activities in the firm's common stock accounts
- Activities in the firm's preferred stock accounts
- Retains earning account
- Changes in stake holders equity


# Why Study Financial Statements

## Financial Statement Analysis

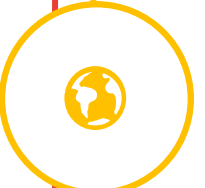


Assess the financial condition of firm being analyzed

## Financial Statement Analysis

- 
- Control firm's operation
  - Determines executives bonuses
  - Analyzing loan

## Financial Forecasting and Planning

- 
- Forecasting firm operation : revenue, profit, cash flow ect
  - Planning : Revenue vs Cost, Investment, Dividend, etc

# What are the Accounting Principles Used to Prepare Financial Statements? (1)

01

## The Revenue Recognition Principle



1. Its goods and services were exchanged for their cash or account receivable (credit sales that have not yet been collected)
2. The firm completed what it had to do be entitled to the cash

*Revenue should be reported in a particular income statement*

# What are the Accounting Principles Used to Prepare Financial Statements? (2)

02

## Matching Principle

1. Determines the revenues
2. Accountants determines the expenses: Expenses follow the revenues

*What costs or expenses can be attributed to a specific period revenues*

# What are the Accounting Principles Used to Prepare Financial Statements? (3)

03

## The Historical Cost Principle



Most Assets and liabilities are reported in the financial statements on the basis of the price of the firm paid to acquire them → Historical cost

*Determines the dollar values the firm reports on the balance sheet*

# Income Statement

A Profit and loss statement :  
Measures the amount of profits generated by a firm over a given time period

$$\text{Revenues (Sales) - Expenses = Profits}$$

- ◆ Revenue represent the sales for the period
- ◆ Profits are the difference between the firm's revenue and all the expenses it incurred in order to generate those revenues for the period





# Income Statement HJ Boswell, Inc

Income Statement (\$ millions, except per share data) for the Year Ended December 31, 2016

Sales		\$2,700.00	
Cost of goods sold		(2,025.00)	
Gross profit		\$ 675.00	
Operating expenses:			
Selling expense	\$(90.00)		
General and administrative expense	(67.50)		
Depreciation and amortization expense	(135.00)		
Total operating expenses		(292.50)	
Net operating income (EBIT, or earnings before interest and taxes)		\$ 382.50	Income from operating activities
Interest expense		(67.50)	Cost of debt financing
Earnings before taxes		\$ 315.00	
Income taxes		(110.25)	Cost of corporate income taxes
Net income		\$ 204.75	Income resulting from operating and financing activities
Additional information:			
Dividends paid to stockholders during 2016		\$ 45.00	
Number of common shares outstanding		90.00	
Earnings per share (EPS)		\$ 2.28	
Dividends per share		\$ 0.50	

## Earning Per Share

$$= \frac{\text{Net Income}}{\text{Outstanding Share}}$$

$$= \$ 204,75 \text{ million} / 90 \text{ million}$$

$$= \$ 2,28 \text{ per share}$$

## Deividends Per Share

$$= \frac{\text{Dividends}}{\text{Outstanding Share}}$$

$$= \$ 45 \text{ million} / 90 \text{ million}$$

$$= \$ 0,5 \text{ per share}$$

# Balance Sheet

Snapshot of the firm's financial position  
on a specific date

**Total Assets = Total Liabilities +  
Total Shareholder's Equity**

- ◆ Total Assets : Resources owned by the firm
- ◆ Total liabilities : Total amount of money the firm owes its creditors ( including the firm's banks and suppliers)
- ◆ Total Shareholder's Equity :their book value of their investment in the firm → shares and the accumulation of past earnings from the firm's operation



## TOTAL ASSETS

### Current Assets :

- Cash
- Accounts Receivable
- Inventory
- Other Current Assets

+

### Long-term (fixed) Assets :

- Net Plant and Equipment
- Other Long-term Assets

=

TOTAL ASSETS

Net Working  
Capital



Current  
Assets –  
Current  
Liabilities

## TOTAL LIABILITIES + STOCKHOLDER'S EQUITY

### Current Liabilities :

- Accounts Payable
- Short-term debt (notes payable)
- Other Current Liabilities

+

### Long-term Liabilities :

- Long-term Debt

+

### Stockholder's Equity :

- Common Stock-Par Value
- Paid-in Capital
- Retained Earnings

=

TOTAL LIABILITIES AND  
EQUITY

# Balance Sheet HJ Boswell, Inc

Balance Sheets (\$ millions), December 31, 2015 and 2016

Assets			Liabilities and Stockholders' Equity		
	2015	2016		2015	2016
Cash	\$ 94.50	\$ 90.00	Accounts payable	\$ 184.50	\$ 189.00
Accounts receivable	139.50	162.00	Accrued expenses	45.00	45.00
Inventory	229.50	378.00	Short-term notes	<u>63.00</u>	<u>54.00</u>
Other current assets	<u>13.50</u>	<u>13.50</u>	Total current liabilities	\$ 292.50	\$ 288.00
Total current assets	\$ 477.00	\$ 643.50	Long-term debt	<u>720.00</u>	<u>771.75</u>
Gross plant and equipment	1,669.50	1,845.00	Total liabilities	\$1,012.50	\$1,059.75
Less accumulated depreciation	<u>(382.50)</u>	<u>(517.50)</u>	Common stockholders' equity		
Net plant and equipment	<u>\$1,287.00</u>	<u>\$1,327.50</u>	Common stock-par value	45.00	45.00
Total assets	<u>\$1,764.00</u>	<u>\$1,971.00</u>	Paid-in capital	324.00	324.00
			Retained earnings	<u>382.50</u>	<u>542.25</u>
			Total common stockholders' equity	\$ <u>751.50</u>	\$ <u>911.25</u>
			Total liabilities and stockholders' equity	<u>\$1,764.00</u>	<u>\$1,971.00</u>

Thank  
you

