

# WEEK 1

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## Four Financial Statements:

1. **Balance Sheet (B/S):** Statement of financial position *Snapshot (what is right now not what's going to happen) such as Jan 31*
  - a. Things on a B/S
    - i. Company Name
    - ii. Balance Sheet
    - iii. As at Dec. 31, 2011
    - iv. (in thousands)
    - v. Split into three: Assets, liabilities, equity
    - vi. L hand side differs from R hand side
      - 1) L is Assets or sources/stuff you're controlling incl. past transactions, control, goodwill, future benefit, measurable
      - 2) R is Obligations which are broken into two parts: creditors (liability/debt e.g. Loans, bonds, debts) and owners (equity e.g. shares)
      - 3) Assets = Liability + Equity AKA both sides must balance!
    - vii. List all your accounts (most liquid items at the top and less at the bottom; divide into current and noncurrent)
      - 1) Current assets: exchanged, used, or due within operating cycle
        - a) Money "Cash"
        - b) Money owned to you "Accounts Receivable" (A/R)
        - c) Merchandise for sale "Inventory"
        - d) Merchandise to use in business operations "Supplies"
        - e) Prepaid services "Prepaid Expenses" (<-assets, doesn't come into income statement wtf?!)
      - 2) Non current assets
        - a) Equipment
        - b) Buildings, land
        - c) Long term investments
        - d) Patents, license, copyright
        - e) Goodwill (can only be recognized if you sell the company; good reputation essentially and super hard to quantify)
      - 3) Current liabilities (if these obligations are due within current operating cycle)
        - a) Negative cash (N.B. Negative amounts go in brackets but negative liabilities can be moved to assets and negative assets to liabilities.)
        - b) Line of credit/demand loan (very liquid)
        - c) Amounts due to regular suppliers e.g. Inventory purchase, utilities, rent "Accounts Payable" (A/P)
        - d) Unfulfilled business sales "Deferred Revenue" or "Unearned revenue" (<- doesn't belong under the income section)
        - e) "Income taxes payable" paid to CRA
        - f) "GST/PST/HST due" paid to gov't
        - g) "Dividends payable" paid to owners
        - h) "Current portion of long-term debt" paid to creditors
      - 4) Noncurrent liabilities (stuff not due within current cycle)
        - a) Mortgage payable
        - b) Bank loans
        - c) Bonds
        - d) Leases
        - e) Pension liability (problem is inflation occurs)
        - f) Restoration fees such as during environment involved businesses "Contingencies"
      - 5) Equity
        - a) Share capital
        - b) Accumulated profit or retained earnings
    - b. Ratios on a B/S (comparing sections)
      - i. Liquidity (good measure for a bank; under liability)
        - 1) Working capital = Current assets - current liabilities; if > 0 = good thing!
        - 2) WC ratio = Current assets / current liabilities; if > 1 = good thing!
          - a) This ratio allows you to compare between companies
      - ii. Solvency (long-term liquidity; under equity)
        - 1) Guaranteed return to debt providers "interest"
        - 2) Not guaranteed return "dividends" <- usually issued under pressure
      - iii. Liability is riskier due to the exposure to credit risk created by interest rate fluctuations
      - iv. Liabilities/Equity = Debt equity ratio (leverage)
        - 1) If internal rate of return > the interest rate then borrow like crazy
        - 2) If interest rate > internal rate of return then get rid of those debts
    - c. Made at the beginning and the end of a period
  2. **Income statement (I/S):** Statement of financial performance *Period such as Jan 1-Jan 31*
    - a. Uses accrual accounting method (for any sizable company)
      - i. Revenues: cash and noncash inflows from sale/provision of goods/services e.g. Credit sale
      - ii. Expenses: cash and noncash outflows incurred in the sale/provision of goods/services e.g. Depreciation, warranty expense, pension expense, bad debts <- these are all estimates
      - iii. Cash accounting doesn't include noncash inflows and outflows; accrual accounting does so by estimating certain inflows and outflows
      - iv. Revenues - Expenses = Profit -> Earnings per share
      - v. Profit + Retained earnings -> B/S "Articulation of B/S occurs through I/S"
        - 1) If you change something on the B/S, I/S won't change but if you change the I/S, B/S will change
      - vi. No single number represents profit; profit number is very subjective
    - b. Income statement consists of:
      - i. Sales, sales returns, sale discounts... Or "Revenues"
      - ii. - Cost related to inventory or "Costs of goods sold"
      - iii. = "Gross margin"
      - iv. - Costs related to operations, research and development, selling, administrative, wages or "Operating costs"
      - v. = Inflows/outflows related to financing/sale or disposal of asset; interest expense or "Operating income"

- vi. - Non-operating inflows/outflows
- vii. = Income from continuing operations/ earnings before income tax
- viii. - Income tax expense: current and future income tax expense/ income as per accounting (CICA) versus income as per taxation (CRA)
- ix. = Net earnings/(loss) < -EPS
- x. Gross Margin = sales - COGS
- xi. Gross margin percentage = Gross margin/sales x 100%
- xii. Mark up = (sales - COGS)/COGS x 100%

B/S and I/S connected by:  $R/E_{\text{BEGIN}} + N/I = R/E_{\text{END}}$  where R/E=retained earnings and N/I=net income