

Chapter 1

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• The constraints of accounting information

- Timeliness
 - Old information quickly loses its relevance to users
 - Up to date information is important in decision-making
 - e.g. Public companies produce financial statements quarterly and annually (sometimes might not be timely enough)
- Balance between benefit and cost
 - The benefits from information should exceed the cost of producing it
 - e.g. cost of weekly statement vs. benefits
- Balance between qualitative characteristics
 - Provide information that is useful for decision-making.
 - e.g. when a used equipment is about to be sold, should the estimated price or the original price be reported

• Business Activities

- Financing
 - Obtaining funds (cash) [to start and expands operations, replaces old buildings and equipment]
 - Obtained from **creditors and investors (external), and profits made (internal)**.
 - Creditors:
 - expect to be repaid (interest) on a timely basis
 - e.g. banks offer short-term and long-term loans, suppliers who provide goods and services expect to be paid for those products later
 - Investors:
 - Expect the companies can generate profits, they earn profits by receiving **dividends** or by selling their shares to another investor (gain or loss)
 - Profit:
 - Not paid out to shareholders in dividends (**retained earnings**)
 - e.g. H&M expand only when it has sufficient internally generated funds

Dividends:

Payments of funds from the company to the shareholders

Typical financing activities

Borrowing money
Repaying loans
Issuing shares
Repurchasing shares
Paying dividends on shares

- Investing
 - Invest the funds to accomplish goals, short-termly and long-termly
 - Short-term investments (e.g. purchase of raw materials and inventories)
 - Related to the **day-to-day operations** are considered **operating activities**
 - Long-term investments
 - The **purchase of property, plant, and equipment** that can be used to produce goods and services for sale
 - **Investments in the shares of other companies** (can be short-/long-term)

Typical investing activities

Purchase of property, plant, and equipment
Sale of property, plant, and equipment
Purchase of the shares of other companies
Sale of the shares of other companies

- Operating
 - All activities associated with developing, producing, marketing, and selling the company's products and/or service.

Day-to-day ongoing activities are generally classified as operations.

Typical operating activities

Sales to customers
Collections of amounts owed by costumers
Purchases of inventory
Payments of amounts owed to suppliers
Payments of expenses such as wages, rent, and interest
Payments of taxes owed to the government

• Typical Types of information in an annual report (H&M annual report)

- Corporate Profile
 - Important to know that kind of business a company is in to assess its risk level

e.g. risk level of oil company and grocery store

(H&M 2009) clothing industry, 1,988 stores, some of which are **franchises**, located in 35 markets, mainly in Europe, extensive operations, stores in highly populated areas.

o **Message to Shareholders**

From a senior executive is an important part

(H&M 2009) overview of past events, insights into future plans, value of designer collections, social and environmental responsibility, challenges the company faces

o **Management Discussion and Analysis**

Required of all publicly traded companies in Canada and the United States.

Overview of the previous year, discussion of the risks facing the company, information about future plans, comments on the company and its operating results

Information in the section: significant events and about sales, profits, and cash flow

o **Board of Directors and Management**

List of the company's board of directors and senior management

o **Financial section**

Components of the Financial Section
Statement of the management's responsibility
Auditors' report
Financial statements:
 Statement of comprehensive income
 Statement of financial position
 Statement of changes in equity Statement of cash flows
 Notes to the financial statements
 Statement on corporate government

▪ **Statement of comprehensive income**

Also known as the **income statement**, the **statement of earnings**, or the **statement of profit or loss**

It describes the results of the operating activities from the beginning to the end of the current period. The results of those activities add up to the **Net earning** (net income or net profit/net loss) **amount** [or "bottom line"]

The statement is a report of the company's operating performance, measures the inflow of revenues and outflow of expense from the shareholders' perspective [so sometimes call **Flow Statement**]

There may be a delay in recognizing some expenditures as expenses - expense treatment: **depreciation**

(H&M 2009) **Group income statement (consolidated)**

H&M [parent company], H&M Hennes & Mauritz GBC AB [subsidiary company]

1 DECEMBER - 30 NOVEMBER	2009	2008
Revenue		
Sales including VAT	118,697	104,041
Sales excluding VAT, Note 3, 4	101,393	88,532
Cost of goods sold, Note 6, 8	-38,919	-34,064
GROSS PROFIT	62,474	54,468
Expenses		
Selling expenses, Note 6, 8	-38,224	-32,185
Administrative expenses, Note 6, 8, 9	-2,606	-2,145
OPERATING PROFIT	21,644	20,138
Interest income	467	1,060
Interest expense	-8	-8
PROFIT AFTER FINANCIAL ITEMS	22,103	21,190
Tax, Note 10	-5,719	-5,896
PROFIT FOR THE YEAR	16,384	15,294
	An increase in profit	
All profit is assignable to the parent company H & M Hennes & Mauritz AB's shareholders.		
Earnings per share, SEK*	Basic earning per share = $\frac{\text{net income}}{\text{number of common shares}}$	
Number of shares	19.80	18.48
	827,536,000	827,536,000

Net earning: income less expenses

Income (revenue) - money or resources flow into the company

Expenses - money or resources flow out of the company to enable the inflow of income (losses are part of expenses)

Depreciation:

The expense taken each period that is based on the usage of a long-lived asset, such as equipment. Depreciation is the process that uses a systematic and rational method to allocate a portion of the cost of a long-lived asset to each of the years of its useful life.

VAT : value add taxes

The sales value excluding VAT is used in subsequent calculations

COMMON STATEMENT OF EARNINGS ITEMS	
Sales Revenues	The total amount of sales of goods and/or services for the period.
Other Income	Various types of revenues or income to the company other than sales, including interest income.
Cost of Goods Sold	The cost of the units of inventory that were sold during the period.
Selling, General, and Administrative Expense	The total amount of other expenses (e.g., salaries, rent) during the period that do not fit into any other category.
Depreciation Expense	The allocation of part of the cost of long-lived items such as equipment.
Interest Expense	The amount of interest incurred on the company's debt during the period.
Income Tax Expense (Provision for Taxes)	The taxes levied on the company's profits during the period.

▪ **Statement of Financial Position [Balance Sheet]**

Presents the company's financial status at a particular point in time (beginning/end points)

30 NOVEMBER	2009	2008
ASSETS		
Classified balance sheet [with current & non-current assets]		
FIXED ASSETS (Long-term assets)		
Intangible fixed assets		
Brands, Note 11	396	443
Customer relations, Note 11	110	123
Leasehold rights, Note 11	744	659
Goodwill, Note 11	424	431
	1,674	1,656
Tangible fixed assets		
Buildings and land, Note 12	492	480
Equipment, tools, fixtures and fittings, Note 12	14,319	11,961
	14,811	12,441
Long-term receivables	551	476
Deferred tax receivables, Note 10	1,246	1,299
TOTAL FIXED ASSETS	18,282	15,872
CURRENT ASSETS		
inventories		
Stock-in-trade	10,240	8,500
Current receivables		
Accounts receivable	1,990	1,991
Other receivables	889	1,206
Prepaid expenses, Note 13	937	948
	3,816	4,145
Short-term investments, Note 14	3,001	-
Liquid funds, Note 15	19,024	22,726
TOTAL CURRENT ASSETS	36,081	35,371
TOTAL ASSETS	54,363	51,243

30 NOVEMBER	2009	2008
EQUITY AND LIABILITIES		
EQUITY		
Share capital, Note 17	207	207
Reserves	1,514	1,410
Retained earnings	22,508	20,039
Profit for the year	16,384	15,294
TOTAL EQUITY	40,613	36,950
Long-term liabilities*		
Provisions for pensions, Note 18	254	228
Deferred tax liabilities, Note 10	2,038	1,818
Other provisions, Note 19	368	368
	2,660	2,414
Current liabilities**		
Accounts payable	3,667	3,658
Tax liabilities	439	1,279
Other liabilities	2,531	3,255
Accrued expenses and prepaid income, Note 21	4,453	3,687
	11,090	11,879
TOTAL LIABILITIES	13,750	14,293
TOTAL EQUITY AND LIABILITIES	54,363	51,243
Pledged assets and contingent liabilities	-	-

* Only provisions for pensions are interest-bearing.
 ** No current liabilities are interest-bearing.

Formatting:

European - long-term assets, current assets, equity, long-term liability, current liability
Canadian - current assets, long-term assets (in liquidity order), current liability, long-term liability, equity

Assets:

- A resource controlled by an entity
- The entity expects future economic benefits from the use or sale of the resource
- The event that gave the entity control of the resource has already happened

COMMON BALANCE SHEET ASSETS

Cash	The amount of currency that the company has, including amounts in bank accounts.
Short-Term (Temporary) Investments	Short-term investments in securities of other companies, such as treasury bills, shares, and bonds.
Accounts Receivable	Amounts owed to the company that result from credit sales to customers.
Inventory	Goods held for resale to customers.
Prepaid Expenses	Expenses related to items that have been paid for but have not yet been used. An example is insurance that is paid in advance.
Capital Assets	Land, buildings, equipment, vehicles, and intangibles that the company uses over the long term. Fixed assets are investments in physical assets such as land, buildings, and equipment. Intangibles are investments in assets without physical substance such as patents, trademarks, and goodwill.

operating cycle: the time period between the initial investment of cash in products or services and the return of cash from the sale of the product or service [most company have several operating cycle in a year]

Current assets: asset will be turned into cash or be consumed in the next year or operating cycle

Liability:

- Any type of borrowing from persons or banks for improving a business or personal income that is payable during short or long time
- A duty or responsibility to others that entails settlement by future transfer or use of assets, provision of services, or other transaction yielding an economic benefit, at a specified or determinable date, on occurrence of a specified event, or on demand
- A duty or responsibility that obligates the entity to another, leaving it little or no discretion to avoid settlement
- A transaction or event obligating the entity that has already occurred

The shareholders' Equity:

Basic accounting equation:

Asset = Liabilities + Shareholders' Equity [reflects balance sheet]

Shareholders' Equity = Asset - Liabilities [net assets]

COMMON BALANCE SHEET "SHAREHOLDERS' EQUITY ACCOUNTS"

Share Capital	Represents the shares that the company has issued, usually stated at an amount equal to what investors originally paid for the shares. This can be referred to as capital stock. Shares can be of different types, with different rights and privileges attached to each type.
Retained Earnings (Capital stock)	The company's earnings (as measured on the Income Statement) that have been kept (retained) and not paid out in the form of dividends.

Change in retained earnings:

Change in Retained Earnings = Net Income - Dividends

COMMON BALANCE SHEET LIABILITIES

Bank Indebtedness	Amounts owed to the bank on short-term credit.
Accounts Payable	Amounts owed to suppliers from the purchase of goods on credit.
Notes Payable	Amounts owed to a creditor (bank or supplier) that are represented by a formal agreement called a note (sometimes called a promissory note). Notes payable often have an interest component, whereas accounts payable usually do not.
Dividends Payable	Amounts owed to shareholders for dividends that are declared by the board of directors.
Accrued Liabilities	Amounts owed to others based on expenses that have been incurred by the company but are not yet due, such as interest expense and warranty expense.
Income Taxes Payable	Amounts owed to taxing authorities.
Long-Term Debt	Amounts owed to creditors over periods longer than one year.
Deferred Tax Liabilities	Amounts representing probable future taxes the company will have to pay.

▪ **Statement of Cash Flows**

A flow statement measures inflows and outflows of cash and highly liquid assets and liabilities called "cash equivalent" during a specific time period.

1 DECEMBER - 30 NOVEMBER	2009	2008
Profit after financial items*	22,103	21,190
Provision for pensions	26	72
Depreciation	2,830	2,202
Tax paid	-6,468	-5,940
Cash flow from current operations before changes in working capital	18,491	17,524
Cash flow from changes in working capital		
Current receivables	-71	-1,343
Stock-in-trade	-1,740	-183
Current liabilities	1,293	1,968
CASH FLOW FROM CURRENT OPERATIONS	17,973	17,966
Investment activities		
Investments in leasehold rights	-180	-446
Investments in/sale of buildings and land	-25	-23
Investments in fixed assets	-5,481	-4,724
Adjustment of consideration/acquisition of subsidiaries	7	-555
Change in short-term investments, 4-12 months	-3,001	4,900
Other investments	-75	-242
CASH FLOW FROM INVESTMENT ACTIVITIES	-8,755	-1,090
Financing activities		
Dividend	-12,825	-11,584
CASH FLOW FROM FINANCING ACTIVITIES	-12,825	-11,584
CASH FLOW FOR THE YEAR	-3,607	5,292
Liquid funds at beginning of financial year	22,726	16,064
Cash flow for the year	-3,607	5,292
Exchange rate effect	-95	1,370
Liquid funds at end of financial year**	19,024	22,726

Cash flow from operating activities:

Inflows and outflows of cash related to the company's sale of goods and services
The number is adjusted, including account receivable and payable
It is essential to have a positive cash flow from operations

Cash flow from investing activities:

Generally involve the purchase and sale of long-term assets such as property, plant, and equipment, and investments in other companies.

Cash flow from financing activities:

Issuance and repurchase of shares
The issuance and repayment of debt

* Interest paid for the Group amounts to SEK 8 m (8). Received interest for the Group amounts to SEK 466 m (1,070).

** Liquid funds and short-term investments at the end of the financial year amounted to SEK 22,025 m (22,726).

SUMMARY OF FINANCIAL STATEMENTS

Statement of Earnings	Measures the operating performance of a company over a period of time.
Statement of Financial Position	Measures the resources controlled by a company (assets) and the claims on those resources (liability and equity holders) at a given point in time.
Statement of Cash Flows	Measures the change in cash flow through operating, financing, and investing activities over a period of time.

▪ **Notes to the Financial Statements**

Provide more detail information of the items

- Segmented information
Information
- Statement of management's responsibility [Canadian requirement]
The management states that it is responsible for the contents of the annual report
Discusses the steps it has taken to ensure the safekeeping of the company's assets and assures shareholders that it is operating in an ethical and responsible way
- Independent auditors' report
To have an external evaluation of the financial statements, the shareholders hire independent auditors to express an opinion about the fairness of the presentation of the company's results and the conformity to accounting standards.

AUDITORS' REPORT

To the Annual General Meeting of H & M Hennes & Mauritz AB (publ) Corporate identity number 556042-7220

We have audited the annual accounts, consolidated accounts, accounting records and the administration of the Board of Directors and the Managing Director of H & M Hennes & Mauritz AB for the financial year 1 December 2008 to 30 November 2009. The company's annual accounts and consolidated accounts are included in this document on pages 4–31. These accounts, the administration of the company and compliance with the Annual Accounts Act in the preparation of the annual report and the application of IFRS international accounting standards, as adopted by the EU, and of the Annual Accounts Act to the consolidated accounts are the responsibility of the Board of Directors and the Managing Director. Our responsibility is to express an opinion on the annual accounts, the consolidated accounts and the administration based on our audit.

Our audit was conducted in accordance with generally accepted auditing standards in Sweden. This means that we planned and performed the audit in order to obtain a high, but not absolute, degree of assurance that the annual accounts and consolidated accounts are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and their application by the Board and the Managing Director and evaluating the significant assessments made by the Board and the Managing Director in preparing

the annual accounts and consolidated accounts, as well as assessing the overall presentation of information in the annual accounts and the consolidated accounts. As a basis for our opinion concerning discharge from liability, we examined significant decisions, actions taken and circumstances in the company to be able to determine the liability, if any, to the company of any Board member or the Managing Director. We also examined whether any Board member or the Managing Director has, in any other way, acted in contravention of the Companies Act, the Annual Accounts Act or the Articles of Association. We believe that our audit provides a reasonable basis for our opinion set out below.

The annual report has been prepared in accordance with the Annual Accounts Act and gives a true and fair view of the company's and the Group's earnings and financial position in accordance with generally accepted accounting principles in Sweden.

The consolidated accounts have been compiled in accordance with IFRS international accounting standards, as adopted by the EU, and the Annual Accounts Act and give a true and fair view of the Group's earnings and financial position. The administration report is consistent with the other section of the annual accounts and the consolidated accounts.

We recommend to the Annual General Meeting that the income statement and balance sheet of the parent company and the Group be adopted, that the profit for the parent company be dealt with in accordance with the proposal in the administration report and that the members of the Board of Directors and the Managing Director be discharged from liability for the financial year.

Stockholm, 28 January 2010

Ernst & Young AB