Workshop I: Financial Accounting

Dina Model
Rachel Nabatian
SEC Regulations

- GAAP – FASB
- Filings
  - Annual filings – 10K
  - Quarterly filings – 10Q
  - Major events – 8K
- Three kinds of financial statements
  - Balance sheet
  - Income statement
  - Statement of cash flows
The Balance Sheet

- Financial position at a moment in time
- Master Equation
  - Assets = Liabilities + Shareholders Equity
- Assets – anything of value, both current and future, that the company owns
- Liabilities – anything it owes to others
- Equity – anything that is owed
<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>50</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>15</td>
</tr>
<tr>
<td>Inventory</td>
<td>15</td>
</tr>
<tr>
<td>PPE</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>50</td>
</tr>
<tr>
<td>Long Term Debt</td>
<td>10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Stock</td>
<td>40</td>
</tr>
<tr>
<td><strong>Total L + E</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
Income Statement

- Shows revenues and expenses over a period of time
- Revenues – amount of money company gets from selling its products
- Expenses – costs of a company to earn revenue
  - COGS
  - SG&A
  - Depreciation
**Sample – Income Statement for the Year Ended 12/31/08**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1,000</td>
</tr>
<tr>
<td>COGS</td>
<td>500</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>500</td>
</tr>
<tr>
<td>Depreciation Expense</td>
<td>20</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>30</td>
</tr>
<tr>
<td><strong>Operating Income/EBIT</strong></td>
<td>450</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>50</td>
</tr>
<tr>
<td><strong>Income Before Taxes</strong></td>
<td>400</td>
</tr>
<tr>
<td>Taxes</td>
<td>100</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>300</td>
</tr>
</tbody>
</table>
Cash vs Accrual Accounting

- Income earned over a period does not necessarily reflect the cash received.

- Example: Company sells $50 on credit and $100 in cash during the first year. The firm recognizes $150 of revenues but only receives $100 in cash.
  - Cash based accounting = $100
  - Accrual based accounting = $150

- Depreciation expense
Statement of Cash Flows

- Can be constructed from balance sheet and income statement
- Cash flow from operations – movement of cash from everyday business transactions
- Cash flow from investing – cash changes in long term and fixed asset purchases
- Cash flow from financing – cash movement from raising capital from debt, equity, or other exotic means

CASH IS KING!!!
**Sample – CF for the Year Ended 12/31/08**

CF From Operations

- Net Income: 300
- Depreciation: 20
- Increase in A/R: (5)
- Decrease in A/P: (10)

Net Cash from Operating: 305

CF From Investing

- Purchase of PPE: (500)
- Sale of PPE: 100

Net Cash from Investing: (400)

CF From Financing

- Borrowing from Banks: 100

Net Cash from Financing: 100

*Net Increase (Decrease) in Cash*: 5
Quick Tips When Looking at CFS

- Quality of income – compare NI with CFO, the closer they are, the higher quality of their earnings
- Is CFO high enough to cover CFI?
- Is CFO positive?
- What phase of the business cycle is the company in?
Business Cycles

INTRO | GROWTH | MATURITY | DECLINE

Cash Flow

CF From Operations
CF From Financing
CF From Investing
Questions?