Workshop II: Financial Accounting

Agenda

- Qualitative Factors
- SEC Regulations
- Balance Sheet
- Income Statement
- Cash vs. Accrual Accounting
- Statement of Cash Flows
Qualitative Factors

• What analysts look for when predicting a stock’s price?
• Industry characteristics
  ▪ Players, Growth, Development
• Company Strategy
• “Price, service, quality choose 1!”
• Recent Developments

SEC Regulations

• GAAP
• The SEC requires all publicly traded companies within the US to publish three kinds of financial statements
  ▪ Balance Sheet
  ▪ Income Statement
  ▪ Statement of Cash Flows
• Annual Filings – 10K
  ▪ Audited
• Quarterly Filings – 10Q
  ▪ Un–audited
The Balance Sheet

- Shows a company’s financial position in an instance of time
- Asset: Anything of value
- Liability: Anything that is owed
- Equity: Anything that is owned

Assets = Liability + Equity

T-Account

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owners Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$xxx</td>
<td>$xxx</td>
<td>$xxx</td>
</tr>
<tr>
<td>DEBIT</td>
<td>CREDIT</td>
<td></td>
</tr>
</tbody>
</table>
Jared Starts his own Bakery
He Uses $100,000 of his personal savings and borrows $100,000 from the bank

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owners Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$200,000 (Cash)</td>
<td>$100,000 (Notes Payable)</td>
<td>$100,000 (Contributed Capital)</td>
</tr>
</tbody>
</table>

Balance Sheet Example Cont.

Assets:
Cash $200,000
Total Assets: $200,000

Liabilities:
Notes Payable $100,000

Owners Equity:
$100,000

Liabilities and Equity: $200,000
Balance Sheet Example Cont.

- Jared buys a Store for $150,000

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owners Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$50,000 (Cash)</td>
<td>$100,000 (Notes Payable)</td>
<td>$100,000 (Contributed Capital)</td>
</tr>
<tr>
<td>$150,000 (Property Plant &amp; Equipment)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Assets:**
- Cash $50,000
- PP&E $150,000

**Total Assets:** $200,000

**Liabilities:**
- Notes Payable $100,000

**Owners Equity:** $100,000

**Liabilities and Equity:** $200,000
### Balance Sheet Example Cont.

- Jared buys cake mix for $30,000

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owners Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20,000 (Cash)</td>
<td>$100,000 (Notes Payable)</td>
<td>$100,000 (Contributed Capital)</td>
</tr>
<tr>
<td>30,000 (Inventories)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>150,000 (PP&amp;E)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Assets:
- Cash: $20,000
- Inventory: $30,000
- PP&E: $150,000

Total Assets: $200,000

#### Liabilities:
- Notes Payable: $100,000

#### Owners Equity:
- $100,000

Liabilities and Equity: $200,000
### Balance Sheet Example Cont.

- Jared pays $10,000 of his loan with cash

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owners Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000 (Cash)</td>
<td>$90,000 (Notes Payable)</td>
<td>$100,000 (Contributed Capital)</td>
</tr>
<tr>
<td>30,000 (Inventories)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>150,000 (Property Plant &amp; Equipment)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Balance Sheet Example Cont.

#### Assets:
- Cash $10,000
- Inventory $30,000
- PP&E $150,000
- **Total Assets:** $190,000

#### Liabilities:
- Notes Payable $90,000

#### Owners Equity:
- **$100,000**

#### Liabilities and Equity:
- **$190,000**
### Income Statement Example

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>(Cake Sales)</td>
</tr>
<tr>
<td>- Cost of Goods Sold</td>
<td>(Cost of Cake Mix)</td>
</tr>
<tr>
<td>= Gross Profit</td>
<td></td>
</tr>
<tr>
<td>- Research and Development Experiment</td>
<td>(Ingredient)</td>
</tr>
<tr>
<td>- Depreciation and Amortization</td>
<td>(PPE expensed over life)</td>
</tr>
<tr>
<td>- Selling and General Administrative</td>
<td>(Marketing, Salaries)</td>
</tr>
<tr>
<td>- Other operating expenses expenses</td>
<td>(Misc Catering)</td>
</tr>
<tr>
<td>= Earnings Before Interest and Taxes (EBIT)</td>
<td></td>
</tr>
<tr>
<td>- Interest Expense</td>
<td>(Cost of debt)</td>
</tr>
<tr>
<td>- Taxes</td>
<td></td>
</tr>
<tr>
<td>= Net Income</td>
<td></td>
</tr>
</tbody>
</table>

### Cash vs. Accrual Accounting

- The income earned during a period does not necessarily reflect the cash received
- Cash is any asset that can be accepted as a form of payment

- Example: Jared’s company sells $50,000 on credit and $100,000 in cash during the first year. The firm recognizes $150,000 of earnings and receives $100,000 in cash
- Cash Based Accounting = Jared made $100,000
- Accrual Based Accounting = Jared made $150,000
### Balance Sheet Example Extended

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owners Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000 + $100,000 (Cash)</td>
<td>$90,000 (Notes Payable)</td>
<td></td>
</tr>
<tr>
<td>50,000 (Accounts Receivable)</td>
<td></td>
<td>$150,000 (Retained Earnings)</td>
</tr>
<tr>
<td>30,000 (Inventories)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$150,000 (Property Plant &amp; Equipment)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Income Statement Example Extended

- Revenues $150,000
- Cost of Goods Sold = Gross Profit
- Research and Development
- Depreciation and Amortization
- Selling and General Administrative
- Other operating expenses
- Earnings Before Interest and Taxes
- Interest Expense
- Taxes
- Net Income
### Depreciation Example

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owners Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20,000 + $100,000 (Cash)</td>
<td>$100,000 (Notes Payable)</td>
<td>$100,000 (Contributed Capital)</td>
</tr>
<tr>
<td>$150,000 – 30,000</td>
<td></td>
<td>$150,000 -30,000 (Retained Earnings)</td>
</tr>
<tr>
<td>(Accounts Receivable)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30,000 (Inventories)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$150,000 – 30,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Property Plant &amp; Equipment)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Depreciation Example Cont.

- Revenues $150,000
- Cost of Goods Sold
- Gross Profit
- Research and Development
- Depreciation and Amortization $30,000
- Selling and General Administrative
- Other operating expenses
- Earnings Before Interest and Taxes
- Interest Expense
- Taxes
- Net Income
Statement of Cash Flows

- Cash flows from operations—everyday business transactions
- Cash flows from investing—long term and fixed asset purchases
- Cash flows from financing—raising capital through debt, equity, or other exotic means

Cash is King!!!