



Accounting Basics

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Financial (Accounting) Statements

- Financial or Accounting statements are used for reporting corporate activity.

For Stakeholders



Financial Statements

- The Balance Sheet
- The Income Statement
- Statement of Cash Flows



The Balance Sheet

- The balance sheet is an accountant's snapshot of the firm's accounting value on a particular date, as though the firm stood momentary still.
- The balance sheet states what the firm owns and how it is financed.

The Balance Sheet (Cont.)

$\text{Assets} \equiv \text{Liabilities} + \text{Stockholders' equity}$

The Balance Sheet (example)

| XYZ Corporation | | | | | |
|---|-------------|-------------|---|-------------|-------------|
| Balance Sheet 2006 and 2005 | | | | | |
| Assets | 2006 | 2005 | Liabilities (Debt) and Stockholder's Equity | 2006 | 2005 |
| Current Assets: | | | Current Liabilities: | | |
| Cash and equivalents | 140 | 107 | Accounts payable | 213 | 197 |
| Accounts receivable | 294 | 270 | Notes payable | 50 | 53 |
| Inventories | 269 | 280 | Accrued expenses | 223 | 205 |
| Other | 58 | 50 | Total current liabilities | 486 | 455 |
| Total Current Assets | 761 | 707 | Long-term liabilities: | | |
| | | | Deferred taxes | 117 | 104 |
| Fixed Assets: | | | Long-term debt | 471 | 458 |
| Property, plant, and equipment | 1423 | 1274 | Total Long-term liabilities: | 588 | 562 |
| Less accumulated depreciation | (550) | (460) | | | |
| Net Property, plant, and equipment | 873 | 814 | Stockholders' equity: | | |
| Intangible assets and others | 245 | 221 | Preferred stock | 39 | 39 |
| Total fixed assets | 1118 | 1035 | Common Stock (\$1 par value) | 55 | 32 |
| | | | Capital surplus | 347 | 327 |
| | | | Accumulated retained earnings | 390 | 347 |
| | | | Less treasury stock | (26) | (20) |
| | | | Total equity | 805 | 725 |
| Total Assets | 1879 | 1742 | Total liabilities and stockholders' equity | 1879 | 1742 |



The Income Statement

- The income statement measures performance over a specific period of time, say, a year.
- The accounting definition of income is:
$$\text{Revenue} - \text{Expenses} = \text{Income}$$

The Income Statement (example)

| XYZ Corporation | |
|---|---------|
| Income Statement 2006 | |
| Total operating revenues | 2262 |
| Cost of goods sold | (1,655) |
| Selling, general, and administrative expenses | (327) |
| Depreciation | (90) |
| Operating income | 190 |
| Other income | 29 |
| Earnings before interest and taxes (EBIT) | 219 |
| Interest expense | (49) |
| Pretax income | 170 |
| Taxes (Current: 71, Deferred 13) | (84) |
| Net Income | 86 |
| Retained earnings: | 43 |
| Dividends: | 43 |

Statement of Cash Flows

Uses of Funds

Assets



Liabilities and
Stockholders' Equity

Sources of Funds

Assets



Liabilities and
Stockholders' Equity



Statement of Cash Flows

- The most important item that can be extracted from financial statements is the accounting cash flow of the firm.
- The statement of cash flows helps to explain the changes in accounting cash and equivalents...



Statement of Cash Flows (Cont.)

- The first step in determining the change in cash is to figure out cash flow from operating activities. This is the cash flow that results from the firm's normal activities producing and selling goods and services.
- The second step is to make an adjustment for cash flow from investing activities.
- The final step is to make an adjustment for cash flow from financing activities. Financing activities are the net payments to creditors and owners (excluding interest expense) made during the year.

Statement of Cash Flows (Cont.)

- The three components of the statement of cash flows are:-
 - 1- Cash flow from Operating Activities
 - 2- Cash flow from Investing Activities
 - 3- Cash flow from Financing Activities

Statement of Cash Flows (example)

Statement of Consolidated Cash Flows of XYZ Corporation

XYZ Corporation Statement of Cash Flows 2006

Operations

| | |
|--|------------|
| Net Income | 86 |
| Depreciation | 90 |
| Deferred taxes | 13 |
| Changes in assets and liabilities | |
| Accounts receivable | (24) |
| Inventories | 11 |
| Accounts payable | 16 |
| Accrued expenses | 18 |
| Notes payable | (3) |
| other | (8) |
| Total Cash Flow from Operations | 199 |

Investing Activities

| | |
|--|--------------|
| Acquisition of fixed assets | (198) |
| Sales of fixed assets | 25 |
| Total Cash Flow from Investing Activities | (173) |

Financing Activities

| | |
|--|-----------|
| Retirement of debt | (73) |
| Proceeds of long-term debt | 86 |
| Dividends | (43) |
| Repurchase of stock | (6) |
| Proceeds from new stock issues | 43 |
| Total Cash Flow from Financing Activities | 7 |
| Changes in cash (on the balance sheet) | 33 |

- When analyzing a balance sheet, the financial manager should be aware of three concerns:-
 - 1- Accounting liquidity
 - 2- Debt versus equity
 - 3- Value versus cost

- When analyzing an income statement, the financial manager should keep in mind the followings:-

1- GAAP

2- Noncash items

3- Time and Costs



Some observations (Cash Flow)

- Several types of cash flow are relevant to understanding the financial situation of the firm.
- Net income is not cash flow.
(cash flow is more revealing)