



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.)

Assets \equiv Liabilities + 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:		
Fixed Assets:			Deferred taxes	117	104
Property, plant, and equipment	1423	1274	Long-term debt	471	458
Less accumulated depreciation	(550)	(460)	Total Long-term liabilities:	588	562
Net Property, plant, and equipment	873	814			
Intangible assets and others	245	221	Stockholders' equity:		
Total fixed assets	1118	1035	Preferred stock	39	39
			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:
$$\text{Revenue} - \text{Expenses} \equiv \text{Income}$$





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

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- 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

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- 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)