



Your Financial Statements

- The basic financial statements
 - Balance Sheet
 - Income Statement
 - Statement of Cash Flows
 - Statement of Equity

The Balance Sheet

- A single moment in time of your financial position
- Assets
 - What you own (have a claim)
- Liabilities
 - What you owe (others have a claim on you)
- Equity
 - What you have put into the company (plus income not taken out)

- $\text{Assets} = \text{Liabilities} + \text{Equity}$

Balance Sheet - Continued

- Order of Balance Sheet
- Current Assets
 - Cash – or will be cash within one year
 - Cash, Accounts Receivable, Inventory, Short-term loans, etc.
- Fixed Assets
 - Have a life exceeding one year
 - Depreciate over the life
 - Buildings, Vehicles, Machinery, Computers, Furniture, etc.
- Other assets
 - Have a value, but will not become cash within one year
 - Patents, copyrights, Goodwill, Long-term loans, Deposits

Balance Sheet - Continued

- Order of Balance Sheet – Continued
- Current Liabilities
 - Will use cash within one year
 - Accounts Payable, Payroll taxes payable, Wages payable, Other accrued expenses, Current portion of debt
- Long-term Liabilities
 - Will use cash past one year from now
 - Notes Payable



Balance Sheet - Continued

- Equity
 - Stock
 - Additional Paid-In Capital
 - Less: Distributions to owners
 - Retained Earnings
 - All of the accumulated profits

The Income Statement

- Records activity over a period of time
- Sales
- Cost of Sales
 - All raw materials that go into product (CGS), plus (perhaps) other expenses attributable to cost of production
- $\text{Sales} - \text{Cost of Sales} = \text{Gross Profit}$
- General and Administrative Expenses
 - Overhead / Fixed Costs
 - Rent, Utilities, Salaries, Benefits, Professional Fees, Office expenses, etc.
- Other Income and expenses
 - Not related to the primary business
- $\text{Gross Profit} - \text{G/A} \pm \text{Other income/expense} = \text{Net Income}$

Statement of Cash Flows

- Transactions that affect the cash over a period of time
- Three sections – Cash provided/(used) by: Operating Activities, Investing Activities, and Financing Activities
- Cash provided/(used) by operating activities
 - Starts with Net Income and adjust for non-cash income-producing (or using) operating activities
- Cash Provided/(Used) by Investing Activities
 - Purchases (and sales) of fixed assets
- Cash Provided/Used by Financing Activities
 - Loans received, Payments made on loans
- Reconciliation



Statement of Equity

- Simply a reconciliation over time of Equity portion of Balance Sheet
 - Usually just Net Income
 - Can include distributions (dividends)

Financial Statement Analysis

■ Balance Sheet

- Cash – look at increasing/decreasing cash
- Accounts Receivable / Payable
 - Look for significant differences between periods
 - Look at A/R Aging if it seems high for slow paying customers
- Look for unusual items, like employee loans to make sure they are being paid
- Note any big differences

Financial Statement Analysis – Cont'd

- Income Statement
 - Sales – look for increases/decreases
 - Gross Profit percentage – look for differences in the percentage
 - All expenses – look for large fluctuations in expenses as a percentage of sales
- Cash Flow Statement
 - Cash flow from Operating Activities

Financial Statement Analysis – Cont'd

- Ratios
- Liquidity Indicators
 - Current Ratio
 - $\text{Current Assets} / \text{Current Liabilities}$
 - Measures ability to pay liabilities as they come due
 - Quick Ratio
 - $\text{Cash} + \text{Marketable Securities} + \text{A/R} / \text{Current Liabilities}$
 - Harsher test of ability to pay current liabilities
- Leverage Indicators
 - Debt Ratio
 - $\text{Total Liabilities} / \text{Total Assets}$
 - Shows % of assets financed by debt to others
 - Debt to Equity Ratio
 - $\text{Total Debt} / \text{Total Equity}$
 - Capital provided by outsiders rather than by the owners

Financial Statement Analysis – Cont'd

- Ratios – Cont'd
- Efficiency Indicators
 - Days Sales in Receivables
 - $(\text{Accounts Receivable} / \text{Sales}) \times 360$
 - Determines average number of days that A/R is outstanding
 - Inventory Turnover
 - $\text{Cost of Goods Sold} / \text{Average Inventory}$
 - How many times inventory turns over in a year
- Profitability Indicators
 - Return on Assets
 - $\text{Net Income} / \text{Average Assets}$
 - Measures effective use of assets
 - Return on Equity
 - $\text{Net Income} / \text{Average Equity}$
 - Measures effective use of owner capital