



Accounting Fundamentals

Course Instructor - Scott



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Chief Content Officer

About Scott...

Scott is a CFI founder and the company's Chief Content Officer. Now based in Vancouver, Scott spent a significant portion of his career in London, New York, and Hong Kong. Scott has a passion for teaching, with over 25 years of experience designing and delivering learning solutions for firms in the financial services sector - particularly in the areas of commercial banking, investment banking, capital markets, and asset management. Some of the companies he has worked with over his career include Bank of America Merrill Lynch, BCI, Credit Suisse, Deutsche Bank, HSBC, ING, JP Morgan, Royal Bank of Scotland, and TD Bank, to name but a few.

Learning Objectives



Understand the role and importance of the financial statements.



Define various financial statement terms



Explore the format of the income statement, balance sheet, and cash flow statement.



Record financial statement transactions.



Understand how transactions move through the financial statements.

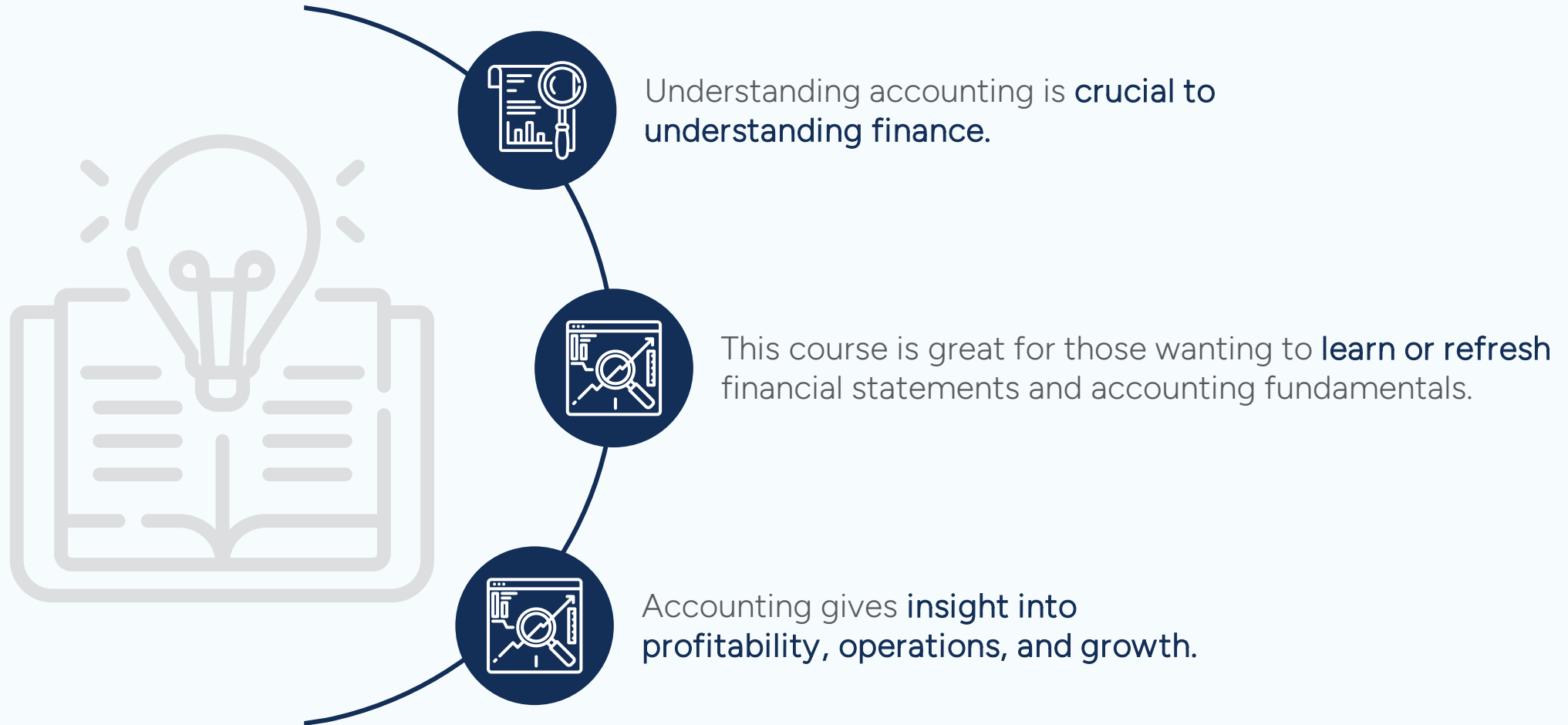


Prepare simple financial statements.

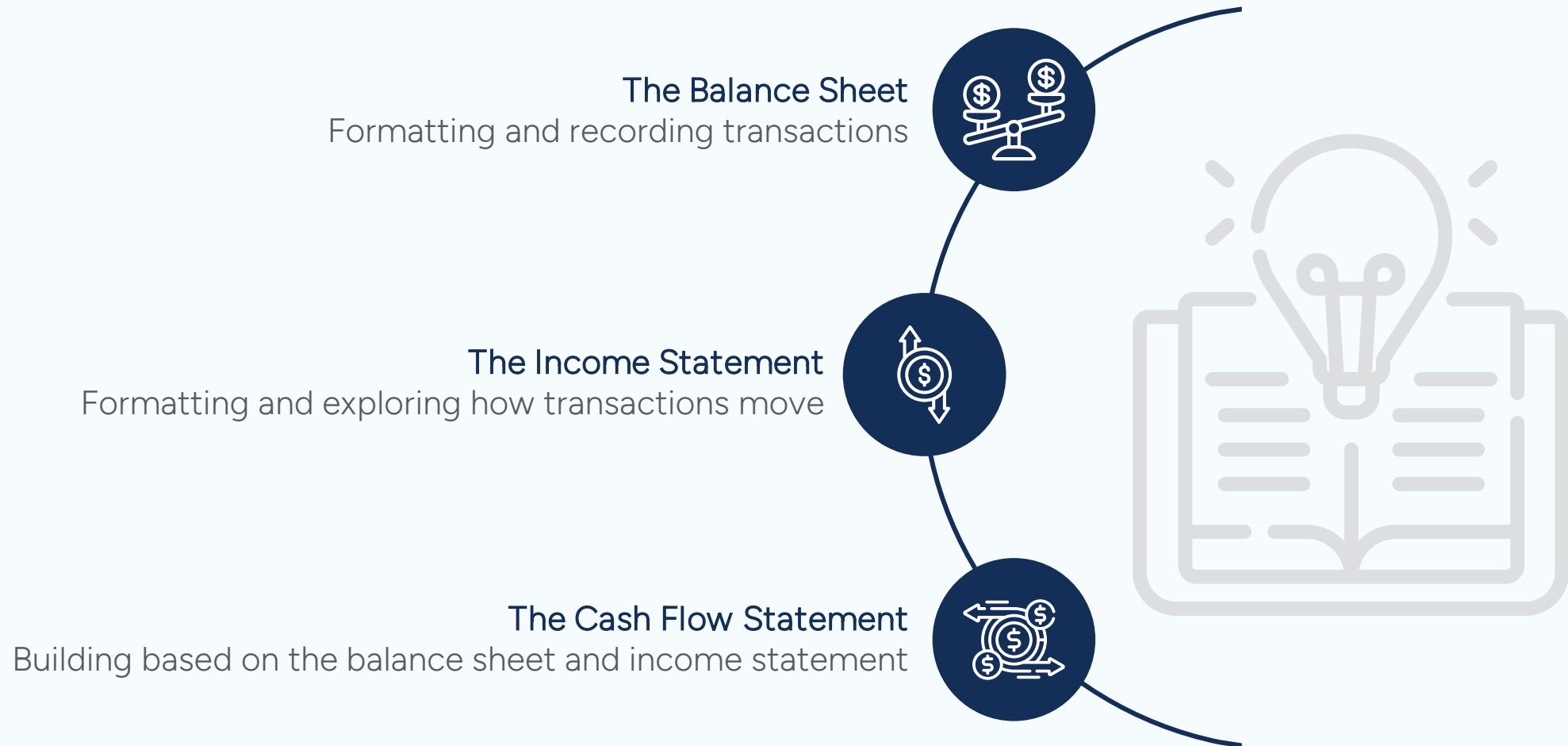
Course Introduction

Understanding the Fundamentals of Accounting

Importance of Accounting and Financial Statements



Importance of Accounting and Financial Statements



Importance of Accounting and Financial Statements



- 1 Watch a video lesson
- 2 Practice with exercises and case studies
- 3 Test your knowledge

The Language of Business



- 1 Watch a video lesson
- 2 Practice with exercises and case studies
- 3 Test your knowledge



- ✓ Explore foundations underpinning accounting
- ✓ Understand the accounting equation

The Language of Business

Financial statements are a method of communicating the **financial health and viability of an organization** to internal and external stakeholders.



Accounting is sometimes referred to as the **language of business**. Throughout the life of a corporation, the accounting processes **identify, track, and record** all financial transactions.



Common accounting terms include **accounts, debits, credits, journal entries, and the general ledger**.

Each of these contributes to the creation of an organization's financial statements.



Financial Statements are a tool used to **communicate the financial performance** of all organizations and businesses.

One of the key tasks for financial analysts is the ability to review financial statements.

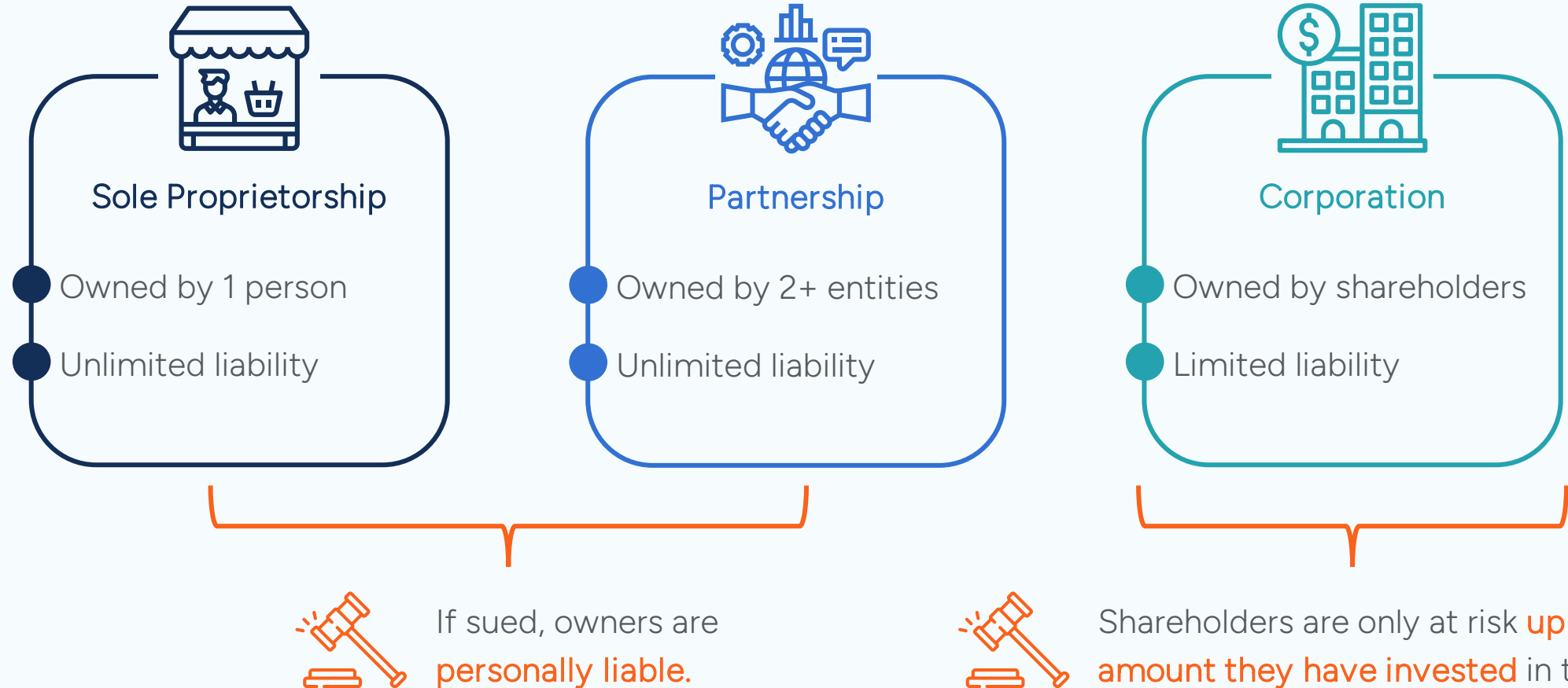
Different Types of Organizations

Organizations come in **all shapes and sizes** and can have a **range of purposes**.



For-Profit Organizations

For-profit businesses can be structured in **three** ways.



Financial Statements

The financial statements are a record of the financial activities of a business.



Income Statement

Revenues

Expenses

Profit or loss



Balance Sheet

Assets

Liabilities

Equity



Statement of Cash Flows

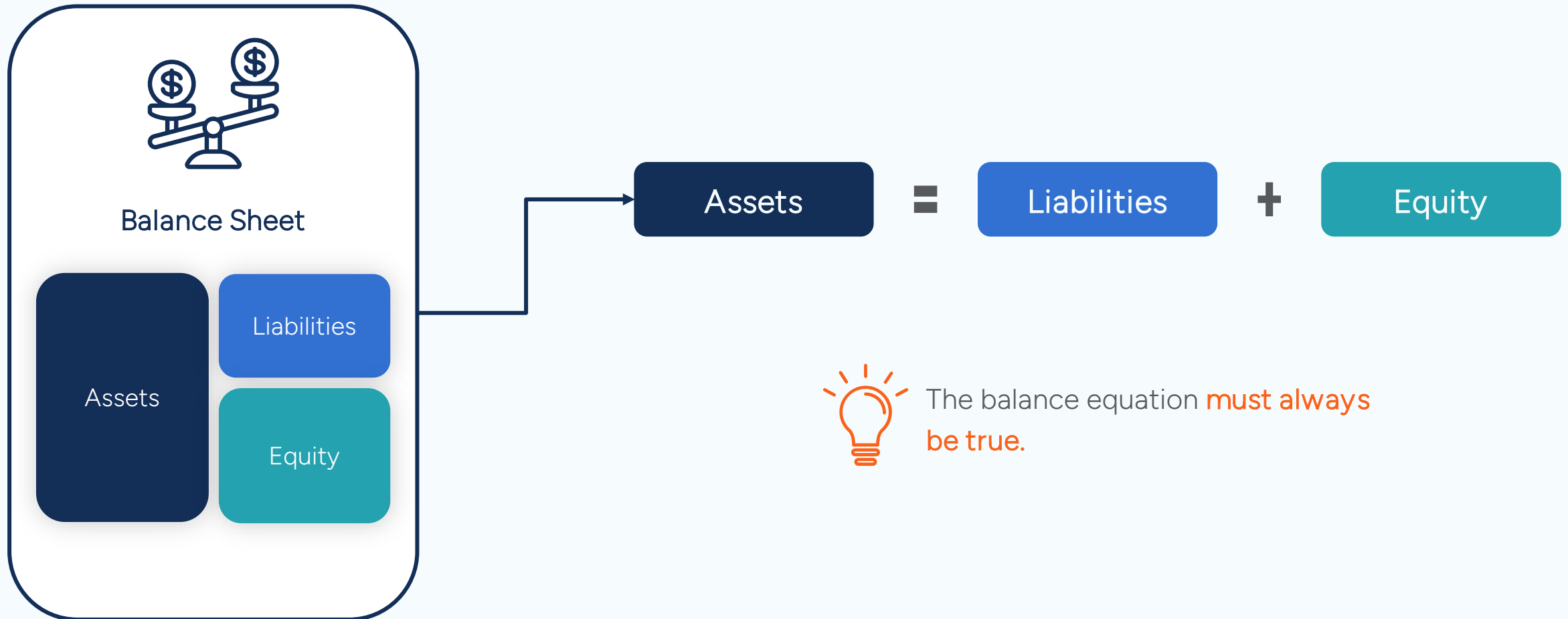
Operating

Investing

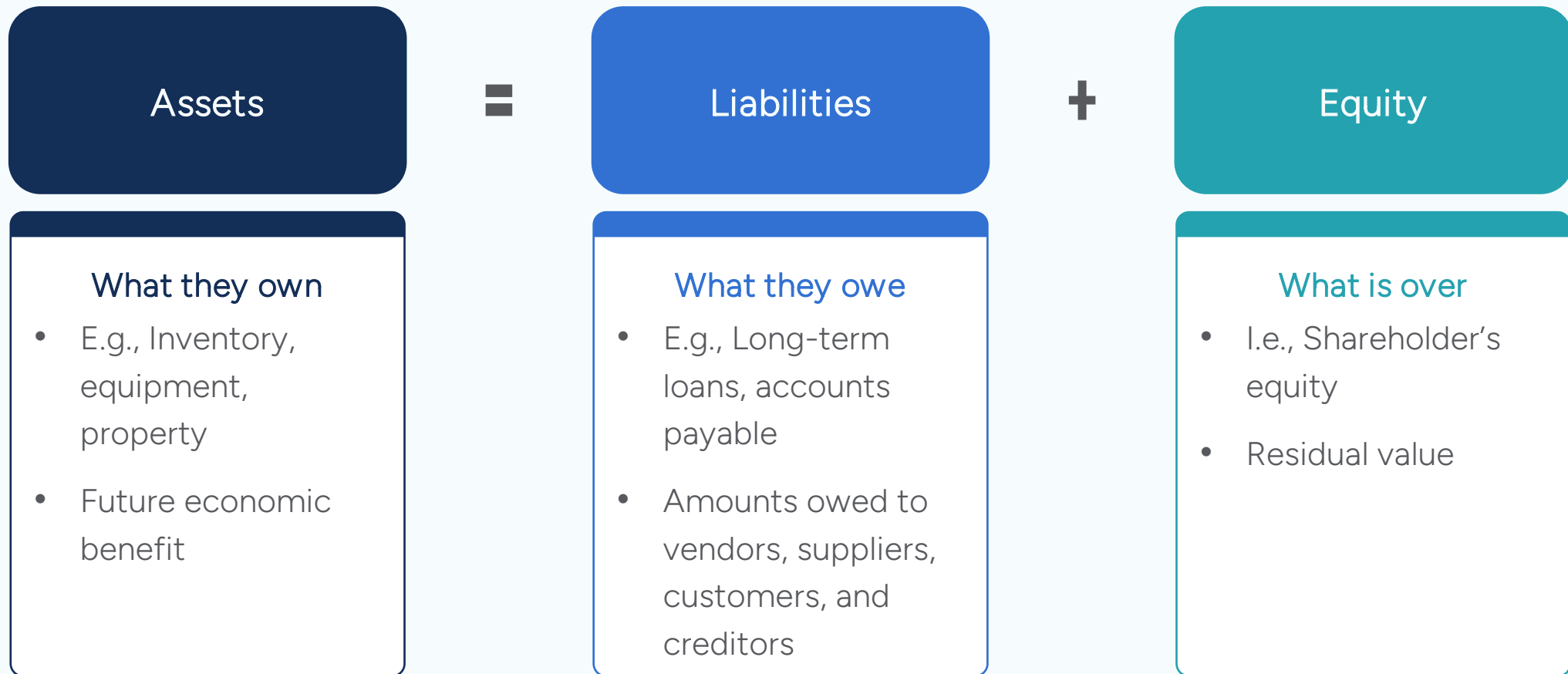
Financing

The Accounting Equation

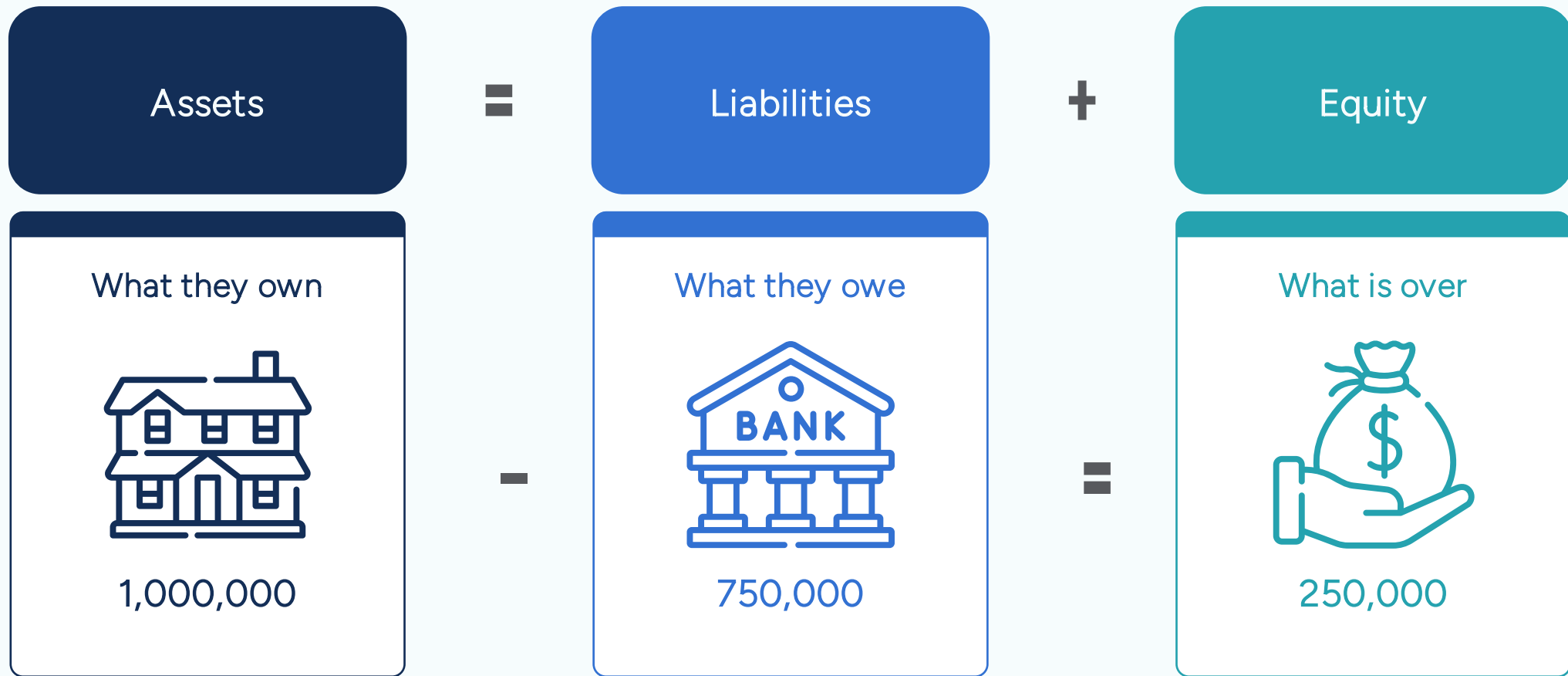
The accounting equation is the foundation of all accounting information.



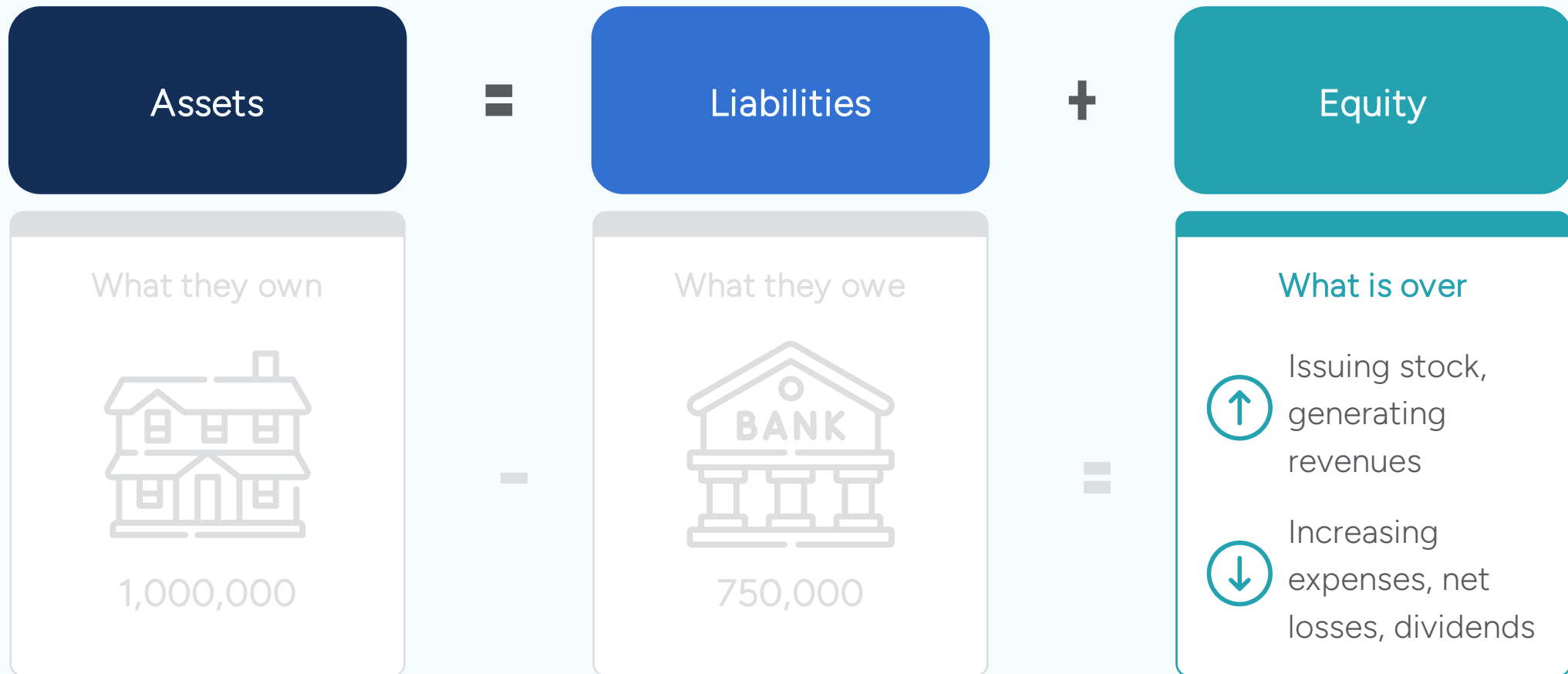
The Accounting Equation



The Accounting Equation



The Accounting Equation



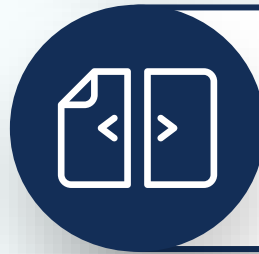
The Balance Sheet

Balancing the Balance Sheet

How do we make sure the balance sheet always balances?

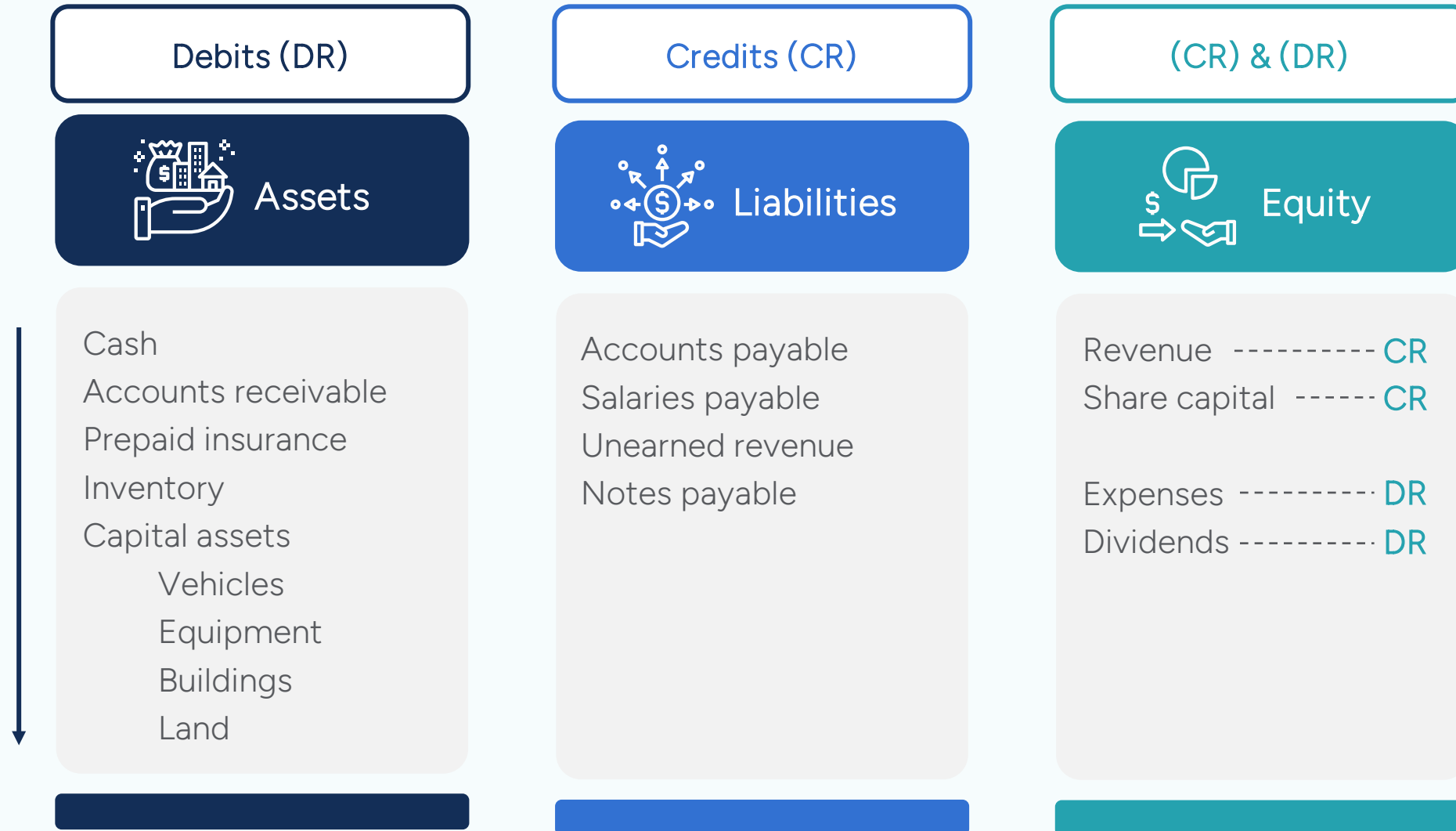


Every accounting transaction entered must always balance.



We use a system called **double-entry accounting** (i.e., double-entry bookkeeping).

Accounts



Recording Transactions

Let's imagine that a company engages in the following transactions:



Issued shares for 100,000 in cash



Sold all the inventory for 10,000



Took out a four-year bank loan of 50,000



Paid salaries of 1,000



Bought equipment and machinery for 80,000



Paid interest of 500



Bought inventory for 6,000



How would **each of these transactions be recorded** in the accounting records?

Issuing Shares

Let's start by looking at what happens when a company issues shares for 100,000 in cash.

Assets	
Current assets Cash	↑ 100,000
Non-current assets	
Total	↑ 100,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Shareholder's equity Common stock	↑ 100,000
Total	↑ 100,000

Issuing Shares

Let's start by looking at what happens when a company issues shares for 100,000 in cash.

Assets		Liabilities & Shareholder's Equity	
Current assets			
Cash			
Non-current as			
Total	↑ 100,000	Total	↑ 100,000

	Debit	Credit
Cash	100,000	
Shareholder's equity		100,000

Taking Out a 4-Year Bank Loan

Now let's see what happens when the company takes out a **four-year bank loan of 50,000**.

Assets	
Current assets Cash [100,000 + 50,000]	↑ 150,000
Non-current assets	
Total	↑ 150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities Loan payable	↑ 50,000
Shareholder's equity Common stock	100,000
Total	↑ 150,000

Taking Out a 4-Year Bank Loan

Assets		Liabilities & Shareholder's Equity	
Current assets			
Cash [100,000]			
	Debit	Credit	
Cash	50,000		↑ 50,000
Loan payable		50,000	100,000
Non-current as			
Total	↑ 150,000	Total	↑ 150,000

Taking Out a 4-Year Bank Loan

Now let's see what happens when the company takes out a **four-year bank loan of 50,000**.

Assets	
Current assets Cash [100,000 + 50,000]	↑ 150,000
Non-current assets	
Total	↑ 150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities Loan payable	↑ 50,000
Shareholder's equity Common stock	100,000
Total	↑ 150,000

Taking Out a 4-Year Bank Loan

Now let's see what happens when the company takes out a four-year bank loan of 50,000.

Assets	
Current assets	
Non-current assets	
Total	↑ 150,000

Liabilities	Equity
Current	
Non-current liabilities	
Loan	50,000
Shareholders' equity	
Common	100,000
Total	↑ 150,000




Assets are listed in **order of liquidity**.

Current assets can be liquidated quickly and are used in the short term.

Taking Out a 4-Year Bank Loan

Now let's see what happens when the company takes out a four-year bank loan of 50,000.

	
Current assets	
Cash [100,000 - 50,000]	50,000
Non-current assets	
Total	50,000

Liabilities are ordered by **due dates**.

Current liabilities are short-term obligations that a company must meet within the short term.

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Shareholder's equity	
Common stock	100,000
Total	↑ 150,000

Buying Machinery and Equipment

Let's see what happens when a company uses its own resources to buy 80,000 of equipment.

Assets	
Current assets Cash [150,000 - 80,000]	↓ 70,000
Non-current assets Equipment	↑ 80,000
Total	150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities Loan payable	50,000
Shareholder's equity Common stock	100,000
Total	150,000

Buying Machinery and Equipment

Let's see what happens when a company uses its own resources to buy 80,000 of equipment.

Assets		Liabilities & Shareholder's Equity	
Current assets			
Cash [150,000 - 80,000]			
Equipment	80,000		50,000
			100,000
Non-current assets			
Equipment			
Total	150,000	Total	150,000

Buying Inventory

The next thing this company needs to do is to **buy 6,000** of inventory to sell.

Assets	
Current assets	
Cash [70,000 - 6,000]	↓ 64,000
Inventory	↑ 6,000
Non-current assets	
Equipment	80,000
Total	150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Total	150,000

Buying Inventory

The next thing this company needs to do is to buy 6,000 of inventory to sell.

Assets		Liabilities & Shareholder's Equity	
Current assets			
Cash [70,000]			
Inventory			50,000
Non-current assets			
Equipment			100,000
Total	150,000	Total	150,000

	Debit	Credit
Inventory	6,000	
Cash		6,000

Buying Inventory

The next thing this company needs to do is to **buy 6,000** of inventory to sell.

Assets	
Current assets	
Cash [70,000 - 6,000]	↓ 64,000
Inventory	↑ 6,000
Non-current assets	
Equipment	80,000
Total	150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Total	150,000

Adjustments and Balances



Effect of making adjustments related directly to the main balance sheet.



The company adding equity and liabilities.



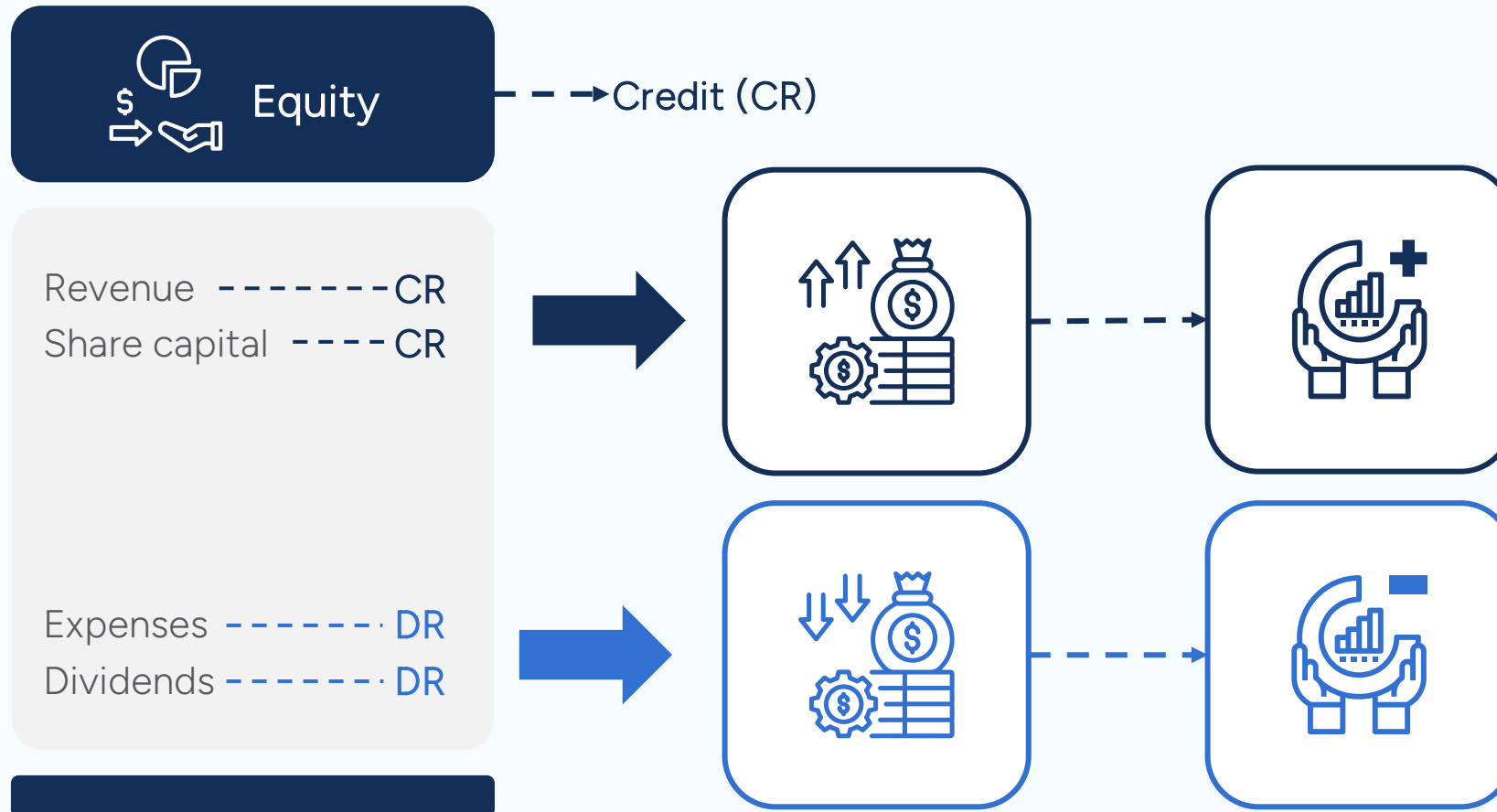
Several adjustments to our current and non-current assets.



We normally record transactions related to income and expenses on the income statement, but it is important to understand how they impact the balance sheet.

Adjustments and Balances

When we got to the equity section, you will remember we had a few different accounts that had different balances.



Selling All Inventory

Let's see what happens when the company **sells all the inventory for 10,000**.

Assets	
Current assets	
Cash [64,000 + 10,000]	↑ 74,000
Inventory [6,000 – 6,000]	↓ 0
Non-current assets	
Equipment	80,000
Total	↕ 154,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Retained earnings	↑ 4,000
Revenue	↑ 10,000
Cost of goods sold	↓ (6,000)
Total shareholder's equity	104,000
Total	↕ 154,000

Selling All Inventory

Let's see what happens when the company sells all the inventory for 10,000.

		Debit		Credit	
Current assets	Cash [64,000]	Cash	10,000		
	Inventory [6,000]				50,000
Non-current assets		Revenue		10,000	
		Cost of Goods Sold	6,000		100,000
					↑ 4,000
		Inventory		6,000	↑ 10,000
					↓ (6,000)
					104,000
Total			↓ 154,000	Total	↓ 154,000

Paying Salaries

Next, let's record the company's 1,000 in salaries.

Assets	
Current assets	
Cash [74,000 - 1,000]	↓ 73,000
Inventory	0
Non-current assets	
Equipment	80,000
Total	↓ 153,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Retained earnings	↓ 3,000
Revenue	10,000
Cost of goods sold	(6,000)
Salaries	↓ (1,000)
Total shareholder's equity	↓ 103,000
Total	↓ 153,000

Paying Salaries

Next, let's record the company's 1,000 in salaries.

Assets		Liabilities & Shareholder's Equity	
Current assets			
Cash [74,000]			
Inventory			50,000
Non-current assets			100,000
Equipment			↓ 3,000
			10,000
			(6,000)
		Salaries	↓ (1,000)
		Total shareholder's equity	↓ 103,000
Total	↓ 153,000	Total	↓ 153,000

	Debit	Credit
Salaries Expense	1,000	
Cash		1,000

Paying Interest

Finally, let's record the **500 of interest** the company accrues on the bank loan.

Assets	
Current assets	
Cash [73,000 – 500]	↓ 72,500
Inventory [0]	0
Non-current assets	
Equipment	80,000
Total	↓ 152,500

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Retained earnings	3,000
Revenue	10,000
Cost of goods sold	(6,000)
Salaries	(1,000)
Interest	↓ (500)
Total shareholder's equity	↓ 102,500
Total	↓ 152,500

Paying Interest

Finally, let's record the 500 of interest the company accrues on the bank loan.

Assets		Liabilities & Shareholder's Equity	
Current assets			
Cash [73,000]			
Inventory [0]			
Non-current as			
Equipment			
		Salaries	
		Interest	
		Total shareholder's equity	
Total		Total	

	Debit	Credit
Interest Expense	500	
Cash		500

		50,000
		100,000
		3,000
		10,000
		(6,000)
		(1,000)
		(500)
		102,500
		152,500

Paying Interest

Finally, let's record the **500 of interest** the company accrues on the bank loan.

Assets	
Current assets	
Cash [73,000 – 500]	72,500
Inventory [0]	0
Non-current assets	
Equipment	80,000
Total	152,500



Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Retained earnings	3,000
Revenue	10,000
Cost of goods sold	(6,000)
Salaries	(1,000)
Interest	(500)
Total shareholder's equity	102,500
Total	152,500

The Income Statement

The Income Statement



Financial statements are a
communication tool.



The income statement is
broken into **several**
sections.

The Income Statement

Revenue ← Also called Sales or Turnover

Direct operating costs

(e.g., cost of goods sold)

----- Gross profit

Indirect operating costs

(e.g., R&D, administration, selling,
distribution)

----- EBITDA

Earnings before interest, taxes,
depreciation, and amortization

(e.g., depreciation and amortization)

----- EBIT

Earnings before interest
and taxes

Cost of debt financing

(e.g., interest, bank charges)

----- EBT

Earnings before taxes

Tax

----- Net income

Time and the Income Statement

The income statement and balance sheet differ in how they relate to time.



Balance Sheet

Shows the financial position at **a point in time**.



Income Statement

Shows the results of operations over **a period of time**.



The period of time **depends on the reporting requirements** for each company.



A company's **location also impacts how many times they are required to report**.

Matching Principle

One of the key principles that guide the recording of accounting transactions is the **matching principle**.

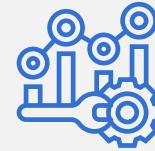
If expenses have been incurred to generate revenue, they need to be **recorded on the income statement in the same period**.



Regular Entries

Happens everyday

- Entries made:
 - As sales are made
 - Payments are received
 - Expenses incurred
 - Payments are made



Adjusting Entries

Happens at the end of the period

- Entries capture any revenues and expenses that may have been overstated or understated.
- Prepaids, unearned revenue, depreciation or amortization, and accruals of expenses and revenues.

Adjusting Entries – Prepayments

Insurance policies are generally **paid upfront for a year or more**. This is called a **prepayment**.



Policies expire over time.

They **cannot be recorded as an expense** at the time of purchase.



Record transaction as **prepaid insurance**.

It is an **asset** because there is a **future economic benefit**.

↓

	Debit	Credit
Prepaid insurance	✓	
Cash		✓



Adjusting Entries – Prepayments

To demonstrate this process, let's look at an annual insurance policy for 12,000.

Month 1...

... Month 12

1,000

1,000

1,000

1,000

1,000

1,000

1,000

1,000

1,000

1,000

1,000

1,000

Record a
reduction in
value of the
asset

Insurance
expense

Prepaid insurance

Debit

Credit

1,000

1,000




This **adjusting entry** has an impact on the **income statement** as well as the **balance sheet**.

Supplies Prepayment

Imagine that a company **purchased its office supplies in bulk** at certain times to ensure they always had enough to meet the needs of the office.

	Debit	Credit
Supplies	✓	
Cash/Accounts payable		✓



 It is **not practical to track** the use of office supplies.



	Debit	Credit
Supplies expense	✓	
Supplies		✓

Supplies Prepayment

Let's look at an example of what happens when **a company has supplies left** at the end of the year.



A company **buys 10,000 in supplies**, so they credit cash 10,000 and debit their supplies 10,000.



The inventory count at the end of the year indicates there are **2,000** left over.



We need to make an **adjustment to the supplies account** to reflect the **expenditure of 8,000 of supplies**.



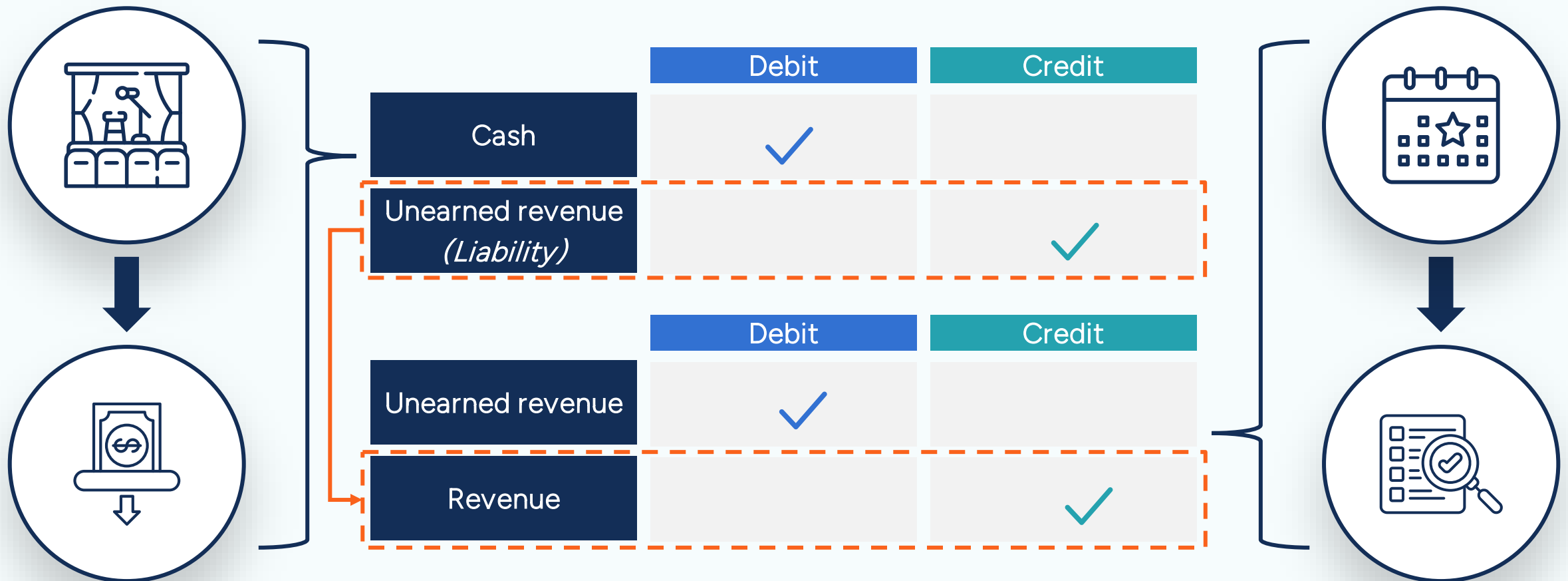
	Debit	Credit
Supplies expense	8,000	
Supplies		8,000



Adjusting Entries – Unearned Revenue

It is common for clients or customers to pay for goods or services to be delivered at a future date.

An example is putting money down as a deposit (i.e., houses, cars, event spaces, etc..)



Accruals

Sometimes, companies come to the end of a reporting period to realize that **some of their revenue and expenses have not been entered.**

Revenue

- i.e., unbilled and unfinished work
- The financial statements need to show **the revenues earned in that period** and the accounts receivable expected.

	Debit	Credit
Accounts receivable	✓	
Revenue		✓

Expenses

- i.e., telephone bills and utilities expense
- The financial statements need to show **the expenses incurred in that period** and the accounts payable expected.

	Debit	Credit
Expense account	✓	
Accounts payable		✓

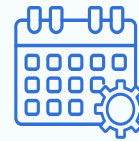
Adjusting Entries – Depreciation

The final **adjusting entries concept** to understand is **depreciation**.

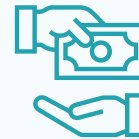
Assets	
Current assets Cash [150,000 - 80,000]	↓ 70,000
Non-current assets Equipment	↑ 80,000
Total	150,000



Equipment was **purchased** for 80,000.



Equipment has a **useful life** of 4 years.

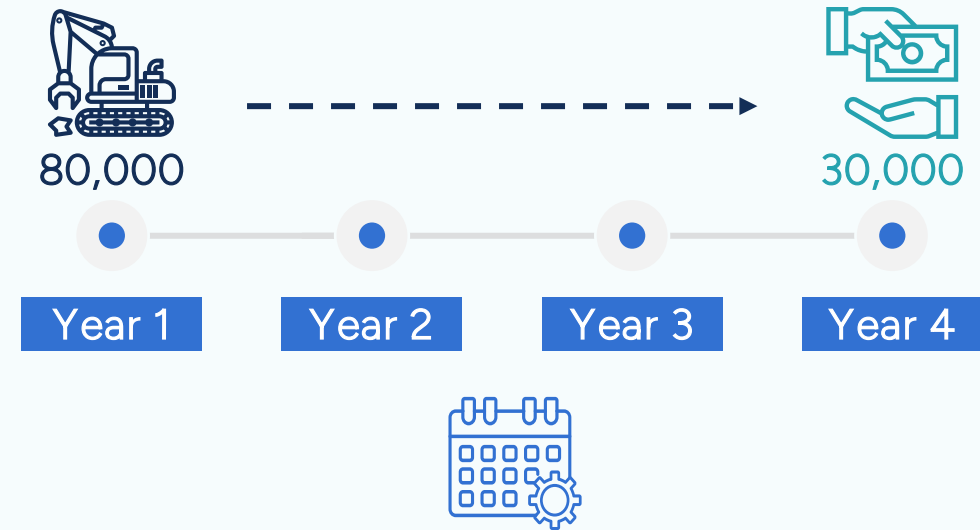


Equipment has a **scrap value** of 30,000.

Adjusting Entries – Depreciation

The final **adjusting entries concept** to understand is **depreciation**.

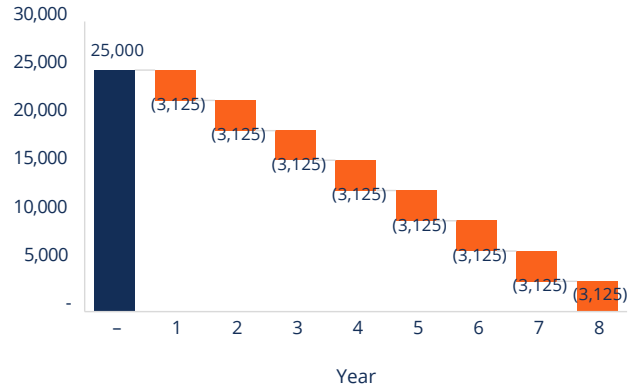
Assets	
Current assets Cash [150,000 - 80,000]	↓ 70,000
Non-current assets Equipment	↑ 80,000
Total	150,000



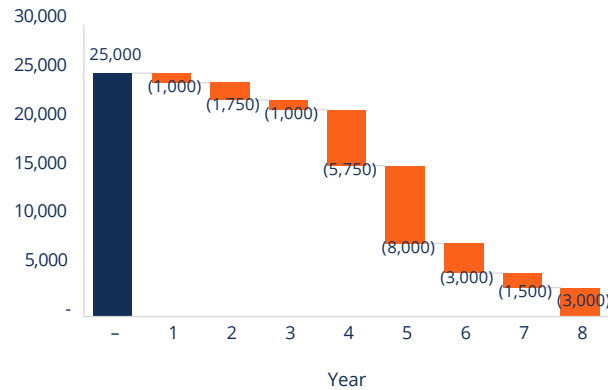
Depreciation Approaches

Depreciation is an expense and is used to reflect the decline in value of the asset over its useful life.

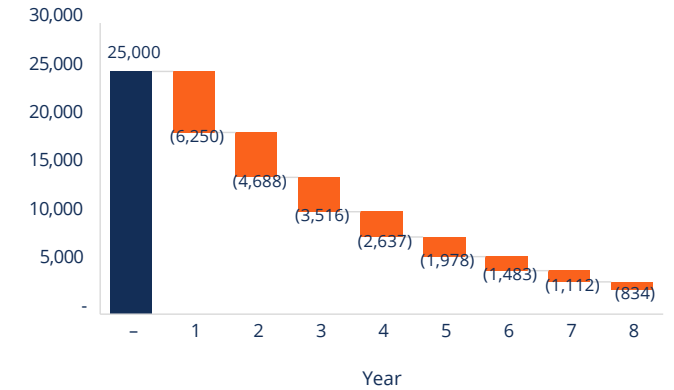
Straight Line Approach



Units of Production Approach



Double Declining Balance Approach



All methods depend on several factors, including **the cost of the asset**, **useful life**, **how the asset is used**, and **salvage value**.



The business needs to **select the depreciation approach that best matches how the asset will be used** in the business.

Straight Line Approach

Straight line depreciation assumes that an **asset** will decline at a consistent rate over its lifetime.

Straight Line Depreciation Approach

Examples

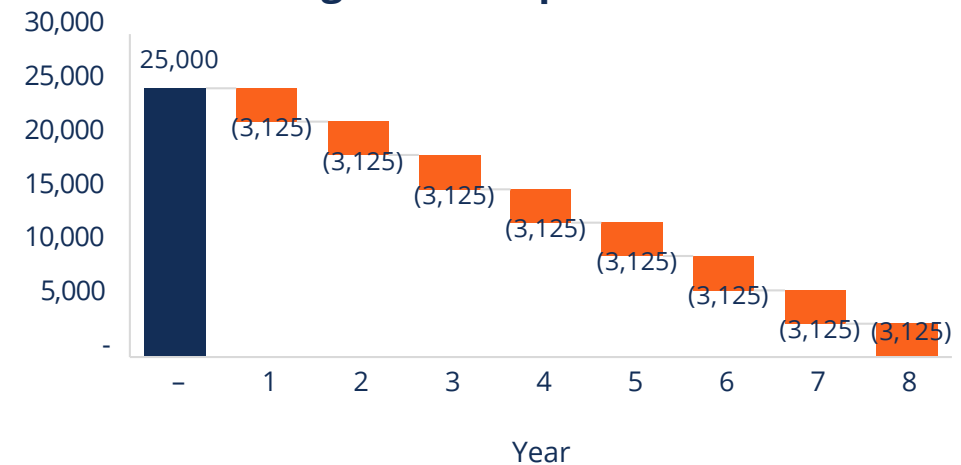


Assets that provide the **same level of service or production** over time.

Equation

$$= \frac{\text{Cost} - \text{Salvage value}}{\text{Useful life of asset}}$$

Straight Line Depreciation



$$= \frac{25,000}{8} = 3,125$$

The Impact of Depreciation

Let's go back to our example of purchasing 80,000 in equipment and calculate the depreciation expense using the straight line approach.



Equipment was purchased for 80,000.



Equipment has a useful life of 4 years.



Equipment has a scrap value of 30,000.



Straight Line Approach

$$= \frac{\text{Cost} - \text{Salvage value}}{\text{Useful life of asset}}$$

$$= \frac{50,000}{4}$$
$$= 12,500$$

The Impact of Depreciation

Let's go back to our example of purchasing 80,000 in equipment and calculate the depreciation expense using the straight line approach.



Equipment



Equipment



Equipment

	Debit	Credit
Depreciation	12,500	
Accumulated depreciation		12,500

Contra account or contra-asset account
(contra means against)

Accumulated Depreciation

Accumulated depreciation is an example of a **contra-asset account**.

Assets	
Current assets	
Cash	70,000
Non-current assets	
Equipment	80,000
Accumulated depreciation	(12,500)

Year 1

80,000

(12,500)

67,500

Net Book Value

←

Accumulated Depreciation

Accumulated depreciation is an example of a **contra-asset account**.

Assets	
Current assets	
Cash	70,000
Non-current assets	
Equipment	80,000
Accumulated depreciation	(12,500)

Assets	
Current assets	
Cash	70,000
Non-current assets	
Equipment	80,000
Accumulated depreciation	(25,000)

Year 1
80,000
(12,500)
67,500

Year 3
80,000
(37,500)
42,500

Year 2
80,000
(25,000)
55,000

Year 4
80,000
(50,000)
30,000

Double Declining Balance Approach

This method recognizes that the business gets more value from an asset at the beginning of its useful life.

Double Declining Balance Approach

Examples

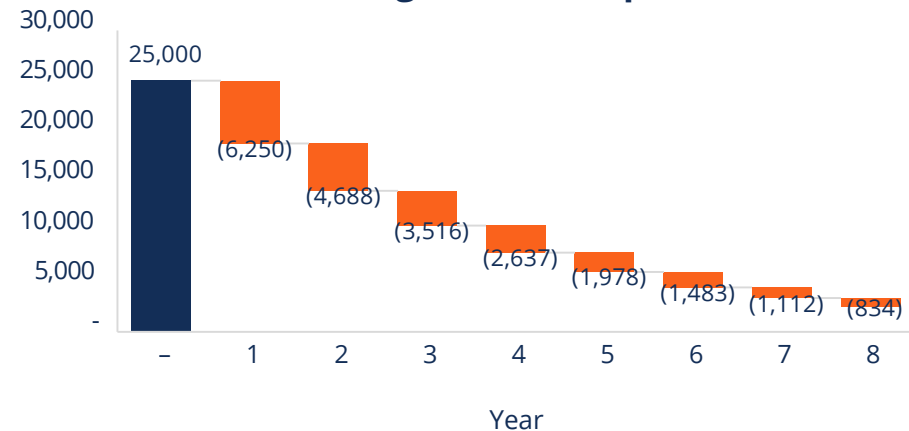


The asset has a higher level of depreciation at the beginning of its life.

Equation

$$= \frac{100\%}{\text{Useful life of asset}} \times 2 \times \text{Net book value}$$

Double Declining Balance Depreciation



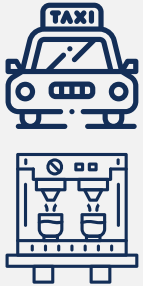
$$= \frac{100\%}{8} \times 2 \times 25,000 = 6,250$$

Units of Production Approach

This method recognizes that the asset's expense **directly relates to its productive capacity.**

Units of Production Approach

Examples



The more the asset is used,
the higher the cost of
depreciation.

Equation

$$= \frac{\text{\# of units produced}}{\text{Lifetime \# of units}} \times (\text{Cost} - \text{Salvage value})$$

Units of Production Depreciation



Lifetime units: 50,000

First year units: 2,000

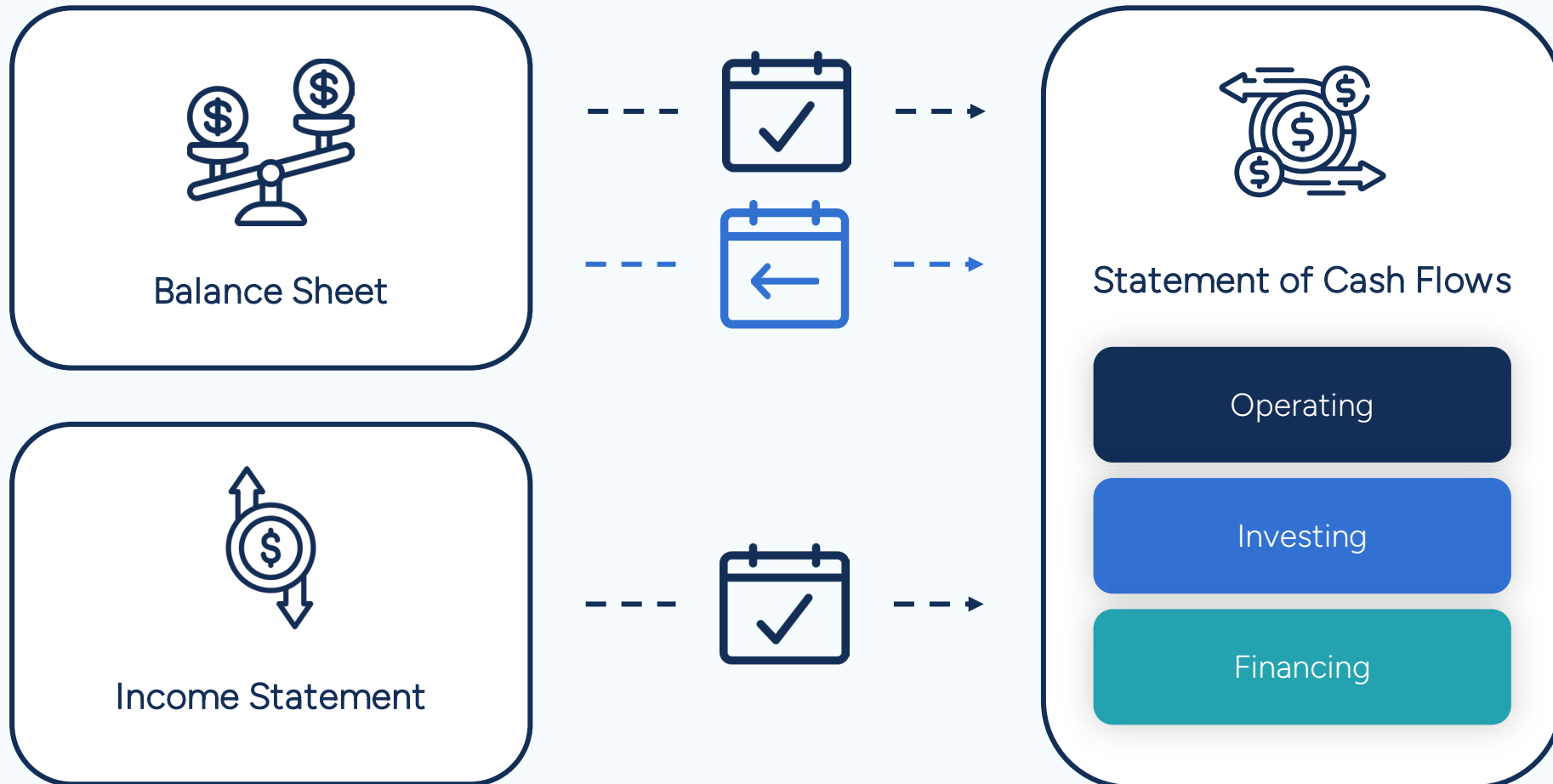


$$= \frac{2,000}{50,000} \times (25,000 - 0) = 4\% \times (25,000)$$
$$= 1,000$$

Constructing a Cash Flow Statement

The Three Key Financial Statements

Cash is an important asset. Much of a company's success depends on its ability to efficiently manage the cash flows.



The Role of the Cash Flow Statement



Although preparing a cash flow statement is not a requirement, it **provides some very valuable information.**



The balance sheet **does not provide any insight** into how efficiently and effectively cash is being generated and used.



Understanding **where cash comes from and how it has been utilized** is very useful for both management and potential investors.



There are many **transactions that have an impact on cash:**
Issuing shares, borrowing debt, revenue generation, purchases, debt payments, repurchase of outstanding shares.

Profit Versus Cash

The accrual concept recognizes **revenues and costs as a business earns or incurs them**, not as it receives or pays money.

It includes them in the **relevant period's income statement**, and as far as possible, matches them with each other.



Income Statement

01. Earned

01. Incurred




Statement of Cash Flows

01. Received

01. Paid


Matching over Time

A five-day transit pass costs 40 and is paid in cash on Monday.



How much is the daily cost of travel on Thursday?

- On a cash flow basis?
- On a matching/accrual basis?



Which basis better reflects the cost?

- Of cash inflow and outflow?
- Of an individual journey?

Cash flow basis

0, because the cash expense happened on Monday

Matching/Accrual Basis

$40/5 \text{ days} = 8 \text{ expense per day}$

Cash flow basis

Better for planning cash inflows and outflows

Matching/Accrual Basis

Better for planning the daily cost



Both approaches provide valuable information

Methods for Creating a Cash Flow Statement

There are **two methods** that can be used to create a cash flow statement, **direct method**, and **indirect method**.



Direct Method

The direct method **can be tricky and requires much more detail** which can make it more time-consuming.

VS



Indirect Method

The indirect method talks about the **impact on cash of management's decisions around operating, investing, and financing.**

Indirect Method

There are three main sections on the cash flow statement.



Operating Cash Flow

Operating transactions that relate directly to the **generation of revenue** for the company.



Investing Cash Flow

Investing transactions include decisions around the **purchase of assets** that support the operations.



Financing Cash Flow

Financing transactions are based on management's decisions to **fund business activities** (e.g., raising equity or raising debt financing).

Working Capital

One of the trickiest parts of the cash flow statement is understanding how **changes in working capital** impact cash flow.

Working Capital

All figures in USD thousands unless stated

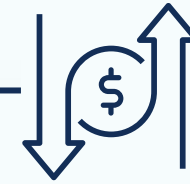
	Year 1	Year 2
Accounts Receivable	7,550	35,000
Inventory	6,100	74,000
Accounts Payable	16,250	35,000
Unearned Revenue	10,520	5,600
Net Change in Working Capital	13,120	(81,520)



Cash Flow Statement

All figures in USD thousands unless stated

	Year 1	Year 2
Operating Cash Flow		
Net Earnings	47,240	27,151
Plus: Depreciation and Amortization	4,550	9,550
Adjust for Changes in Working Capital	13,120	(81,520)
Cash from Operations	64,910	(44,819)



We need to look at **what has changed** and determine if that indicates an **increase or decrease** in cash flow.

Changes in Working Capital

Accounts Receivable

Year 1: 46,000

Year 2: 51,000

Net cash decrease: 5,000

Accounts Receivable

Increases



Decreases



Balance Sheet

All figures in USD thousands unless stated

Assets

Current Assets

	Year 1	Year 2
Cash	37,715	37,186
Accounts Receivable	46,000	51,000
Inventory	82,250	78,050
Total Current Assets	165,965	166,236

Non-Current Assets

Property Plant and Equipment (PPE)	155,000	155,000
Accumulated Depreciation-PPE	(39,150)	(54,650)
Net Carrying Value	115,850	100,350

Total Assets

281,815 266,586

Liabilities

Current Liabilities

Accounts Payable	64,580	65,536
Unearned Revenue	5,214	2,314
Total Current Liabilities	69,794	67,850

Long Term Debt

50,000 -

Total Liabilities

119,794 67,850

Shareholder's Equity

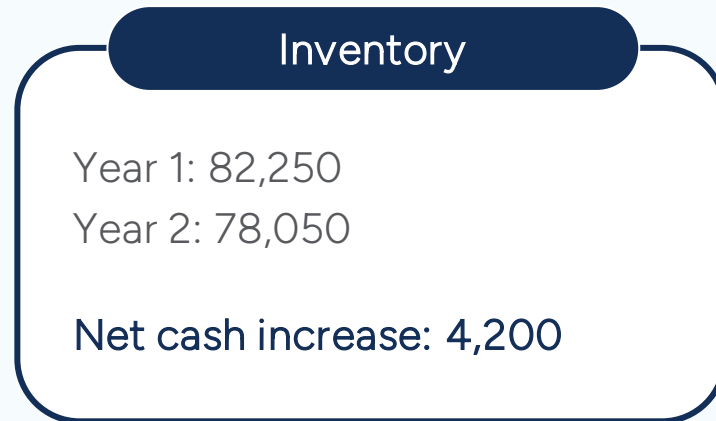
Equity Capital	70,000	70,000
Retained Earnings	92,021	128,736
Total Shareholder's Equity	162,021	198,736

Total Liabilities and Shareholder's Equity

281,815 266,586

- -

Changes in Working Capital



Balance Sheet

All figures in USD thousands unless stated

	Year 1	Year 2
Assets		
Current Assets		
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Inventory	82,250	78,050
Total Current Assets	165,965	166,236
Non-Current Assets		
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Net Carrying Value	115,850	100,350
Total Assets	281,815	266,586
Liabilities		
Current Liabilities		
Accounts Payable	64,580	65,536
Unearned Revenue	5,214	2,314
Total Current Liabilities	69,794	67,850
Long Term Debt	50,000	-
Total Liabilities	119,794	67,850
Shareholder's Equity		
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Retained Earnings	92,021	128,736
Total Shareholder's Equity	162,021	198,736
Total Liabilities and Shareholder's Equity	281,815	266,586

Changes in Working Capital

Balance Sheet

All figures in USD thousands unless stated

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Total Liabilities and Shareholder's Equity	281,815	266,586
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Accounts Payable

Increases

Decreases



Accounts Payable

Year 1: 64,580

Year 2: 65,536

Net cash increase: 956

Changes in Working Capital

Balance Sheet

All figures in USD thousands unless stated

Assets

Current Assets

	Year 1	Year 2
Cash	37,715	37,186
Accounts Receivable	46,000	51,000
Inventory	82,250	78,050
Total Current Assets	165,965	166,236

Non-Current Assets

Property Plant and Equipment (PPE)	155,000	155,000
Accumulated Depreciation-PPE	(39,150)	(54,650)
Net Carrying Value	115,850	100,350

Total Assets

281,815	266,586
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Liabilities

Current Liabilities

Accounts Payable	64,580	65,536
Unearned Revenue	5,214	2,314
Total Current Liabilities	69,794	67,850

Long Term Debt	50,000	-
Total Liabilities	119,794	67,850

Shareholder's Equity

Equity Capital	70,000	70,000
Retained Earnings	92,021	128,736
Total Shareholder's Equity	162,021	198,736

Total Liabilities and Shareholder's Equity	281,815	266,586
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Unearned Revenue

Increases



Decreases



Unearned Revenue

Year 1: 5,214

Year 2: 2,314

Net cash decrease: 2,900

Cash From Investing

The second section of the cash flow statement is **cash from investing**.

Cash Flow Statement

All figures in USD thousands unless stated

Investing Cash Flow

Investments in Property and Equipment

Cash from Investing

Year 1	Year 2	Year 3	Year 4	Year 5
(45,500)	(50,000)	–	(59,500)	–
(45,500)	(50,000)	–	(59,500)	–

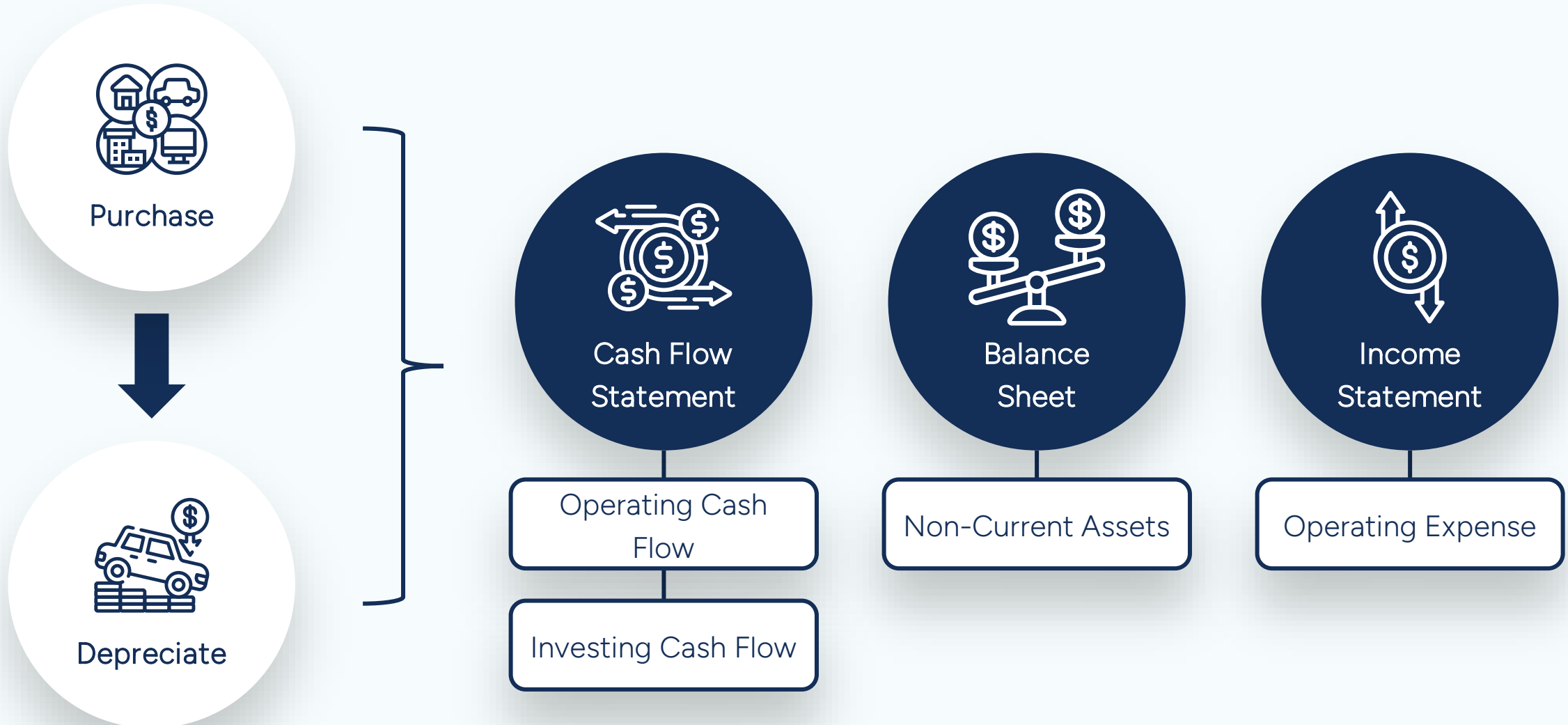


In each of these cases, this investment is considered a **cash outflow**.



These investments are often **referred to as CAPEX**, which is short form for capital expenditures.

How Investing Activities Hit the Three Financial Statements



How Investing Activities Hit the Three Financial Statements

Let's imagine that a company has an **equipment purchase** in Year 1 for a company car.



Equipment was **purchased** for 45,500



Equipment has a **useful life** of 10 years



Equipment has a **no salvage value**

Straight-Line Depreciation Approach

Equation

$$= \frac{\text{Cost} - \text{Salvage value}}{\text{Useful life of asset}}$$

Depreciation

$$= \frac{45,500 - 0}{10}$$

$$= 4,550 \text{ a year}$$

How Investing Activities Hit the Three Financial Statements

Let's imagine that a company has an equipment purchase in Year 1 for a company car.



Income
Statement

Depreciation Expense: (4,550)

Income Statement

All figures in USD thousands unless stated

Year 1

Revenue From Operations

Sales Revenue 763,127

Cost of Goods Sold (343,407)

Gross Profit 419,720

Operating Expenses

Selling Costs (23,850)

Administrative Costs (4,550)

Salary Costs (325,000)

Total Operating Expenses (353,400)

Earnings Before Interest and Tax (EBIT) 66,320

Financing Costs and Tax (19,080)

Net Income/(Loss) 47,240

How Investing Activities Hit the Three Financial Statements

Let's imagine that a company has an equipment purchase in Year 1 for a company car.



Income
Statement

Depreciation Expense: (4,550)



Balance
Sheet

Historical Cost: 45,500

Depreciation Expense: (4,550)

Balance Sheet

All figures in USD thousands unless stated

Assets

Current Assets

Cash	139,410
Accounts Receivable	7,550
Inventory	6,100
Total Current Assets	153,060

Non-Current Assets

Property Plant and Equipment (PPE)	45,500
Accumulated Depreciation-PPE	(4,550)
Net Carrying Value	40,950

Total Assets

194,010

Liabilities

Current Liabilities

Accounts Payable	16,250
Unearned Revenue	10,520
Total Current Liabilities	26,770

Long Term Debt

50,000

Total Liabilities

76,770

Shareholder's Equity

Equity Capital	70,000
Retained Earnings	47,240
Total Shareholder's Equity	117,240

Total Liabilities and Shareholder's Equity

194,010

-

How Investing Activities Hit the Three Financial Statements

Let's imagine that a company has an **equipment purchase** in Year 1 for a company car.



Income
Statement

Depreciation Expense: (4,550)



Balance
Sheet

Depreciation Expense: (4,550)

Historical Cost: 45,500



Cash Flow
Statement

Add Back Depreciation Expense: 4,550

CAPEX Cash Outflow: (45,500)

Cash Flow Statement

All figures in USD thousands unless stated

	Year 1
Operating Cash Flow	
Net Earnings	47,240
Plus: Depreciation and Amortization	4,550
Adjust for Changes in Working Capital	13,120
Cash from Operations	64,910
Investing Cash Flow	
Investments in Property and Equipment	(45,500)
Cash from Investing	(45,500)
Financing Cash Flow	
Issuance (repayment) of debt	50,000
Issuance (repurchase) of equity	70,000
Payment of dividends	-
Cash from Financing	120,000
Net Increase (decrease) in Cash	139,410
Opening Cash Balance	-
Closing Cash Balance	139,410

Cash From Financing

The cash from financing section has two main areas: **debt finance** and **equity finance**.

Cash Flow Statement

All figures in USD thousands unless stated

Financing Cash Flow

Issuance (repayment) of debt

Issuance (repurchase) of equity

Payment of dividends

Cash from Financing

	Year 1	Year 2
Issuance (repayment) of debt	50,000	(50,000)
Issuance (repurchase) of equity	–	–
Payment of dividends	(5,000)	(5,000)
Cash from Financing	45,000	(55,000)

Cash From Financing

The cash from financing section has two main areas: **debt finance** and **equity finance**.

Cash Flow Statement

All figures in USD thousands unless stated

Financing Cash Flow

	Year 1	Year 2
Issuance (repayment) of debt	50,000	(50,000)
Issuance (repurchase) of equity	–	–
Payment of dividends	(5,000)	(5,000)
Cash from Financing	45,000	(55,000)

Debt

Borrow



Repayment



Payments can be either **principal payments**, **interest payments**, or a combination of both.

Cash From Financing

The cash from financing section has two main areas: **debt finance** and **equity finance**.

Cash Flow Statement

All figures in USD thousands unless stated

Financing Cash Flow

Issuance (repayment) of debt

Issuance (repurchase) of equity

Payment of dividends

Cash from Financing

Year 1	Year 2
50,000	(50,000)
–	–
(5,000)	(5,000)
45,000	(55,000)



Debt

Borrow



Repayment



 
50,000 (50,000)



Payments can be either **principal payments**, **interest payments**, or a combination of both.

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Cash Flow Statement

All figures in USD thousands unless stated

Financing Cash Flow

	Year 1	Year 2
Issuance (repayment) of debt	50,000	(50,000)
Issuance (repurchase) of equity	–	–
Payment of dividends	(5,000)	(5,000)
Cash from Financing	45,000	(55,000)

Equity

Issue Shares



Repurchase



Pay Dividends



Cash From Financing

The cash from financing section has two main areas: **debt finance** and **equity finance**.

Cash Flow Statement		
<i>All figures in USD thousands unless stated</i>		
Financing Cash Flow		
Issuance (repayment) of debt	50,000	(50,000)
Issuance (repurchase) of equity	-	-
Payment of dividends	(5,000)	(5,000)
Cash from Financing	45,000	(55,000)

