

1

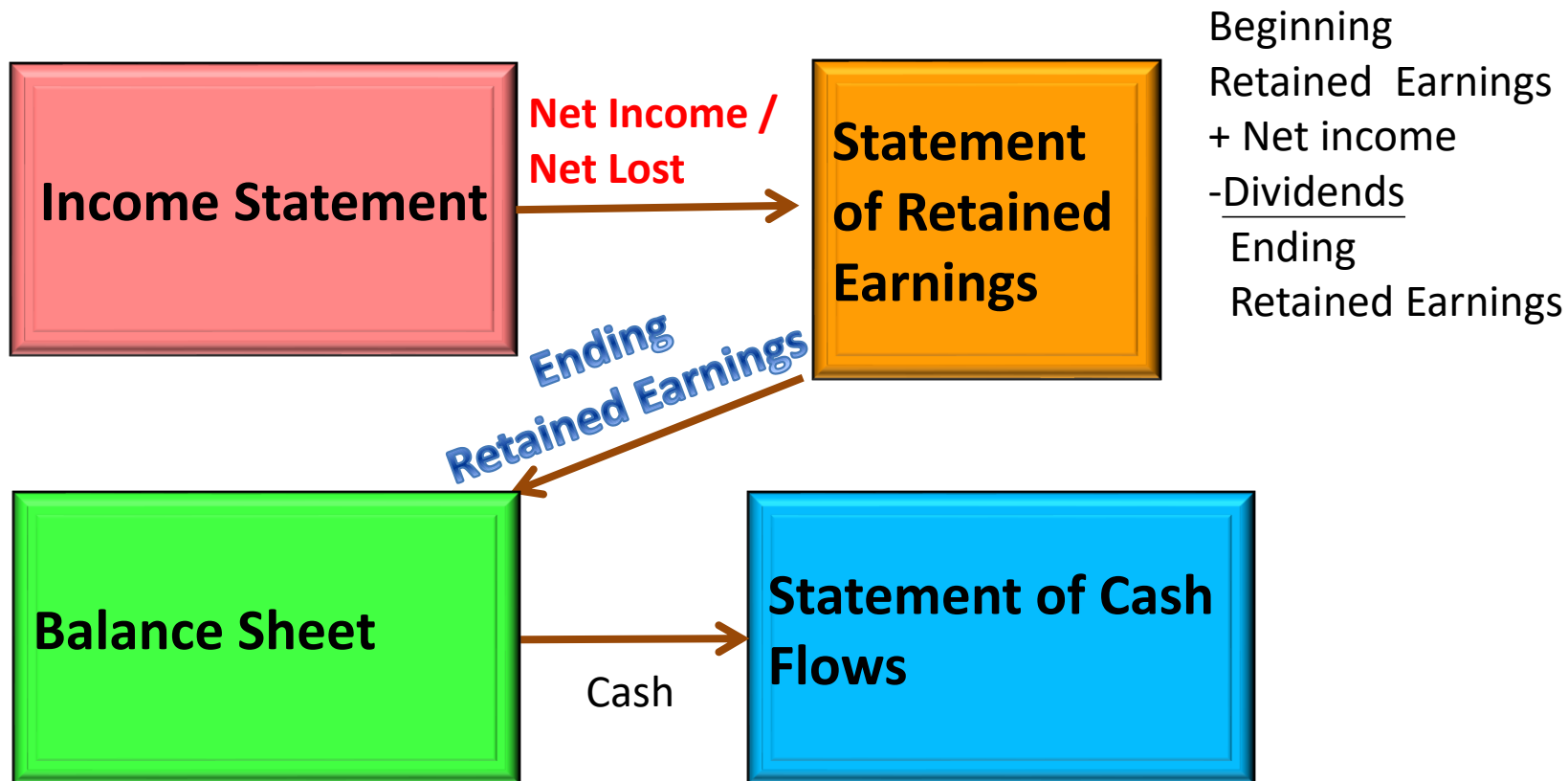
The Financial Statements

Learning Objective

4. **Evaluate** business operations through the financial statements

EVALUATE BUSINESS OPERATIONS THROUGH THE FINANCIAL STATEMENTS

Data flow from one financial statement to the next



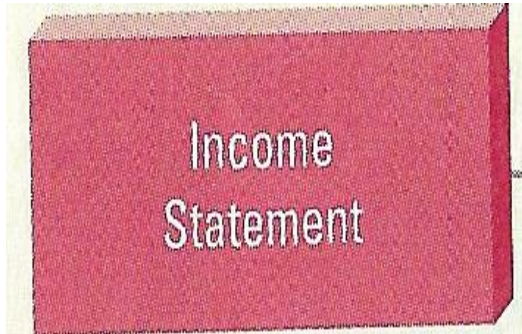
The Income Statement Measures Operating Performance

Income Statement

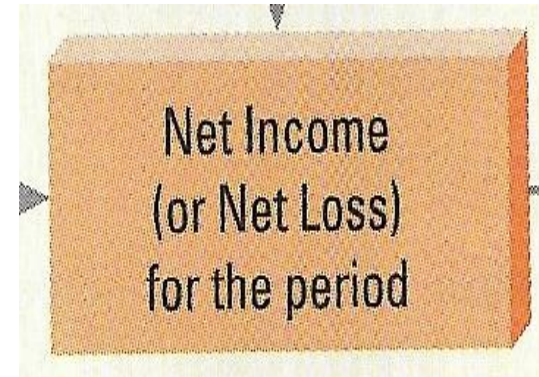
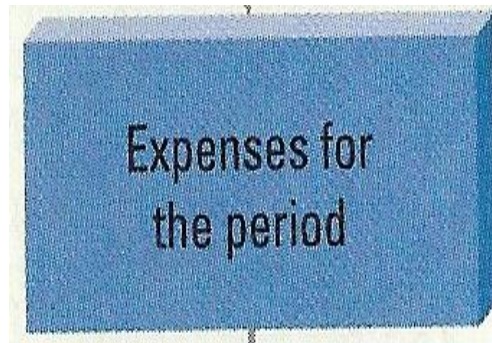
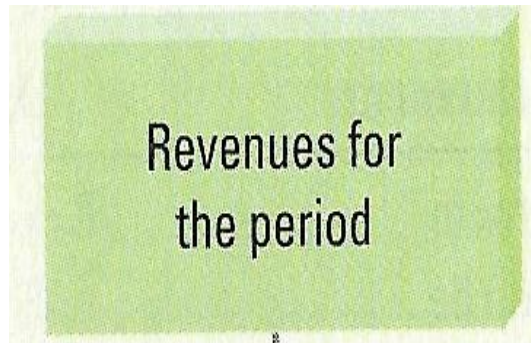
- ◆ Also called **statement of operations**
- ◆ Reports
 - ▶ Revenues and gains
 - ▶ Expenses and losses
 - ▶ Bottom line of net income or net loss *for the period*

Net Income = Total Revenues and Gains - Total Expenses and Losses

Income statement - Measures Operation Performance



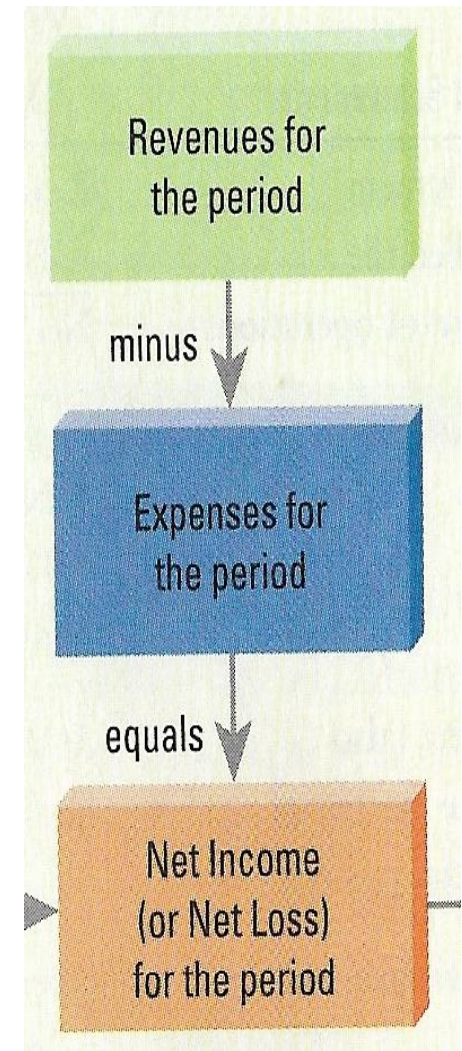
The income statement or statement of operations, reports revenues and expenses for the period



Example Corporation
Income Statement
For the year ended December 31, 2019

Sales (all on credit)	\$500,000
Cost of goods sold	380,000
Gross profit	<u>GP 120,000</u>
Operating expenses	
Selling expenses	35,000
Administrative expenses	45,000
Total operating expenses	<u>OE 80,000</u>
Operating income	<i>OI = GP - OE</i> 40,000
Interest expense	<i>interest of borrowing money from the bank</i> <u>12,000</u>
Income before taxes	28,000
Income tax expense	<u>5,000</u>
Net income after taxes	<u>\$ 23,000</u>

We measure net income as follows:



Example Corporation
Income Statement
For the year ended December 31, 2019

Sales (all on credit)	\$500,000
Cost of goods sold	380,000
Gross profit	<u>120,000</u>
Operating expenses	
Selling expenses	35,000
Administrative expenses	45,000
Total operating expenses	<u>80,000</u>
Operating income	40,000
Interest expense	<u>12,000</u>
Income before taxes	28,000
Income tax expense	<u>5,000</u>
Net income after taxes	<u><u>\$ 23,000</u></u>

Revenues:

1. Interest / interest expense
2. Other income

Expenses:

1. Cost of revenue / cost of goods sold
2. reserch Development
3. Selling General and administrative

The Statement of Retained Earnings Shows What a Company Did with Its Net Income

Retained Earnings

↑ by Net Income

↓ by Net Loss / Dividend Paid

- ◆ Portion of net income reinvested into the business
- ◆ Net income increases retained earnings
- ◆ Net losses and dividends decrease retained earnings
- ◆ Net income (net loss) flows from the income statement to the statement of retained earnings

The Financial Statement – The statement of Retained Earning



- shows what a company did with its net income
- which is that portion of net income the company has kept over a period of years.
- Net income increases retained earnings, and net losses and dividends decrease retained earning.

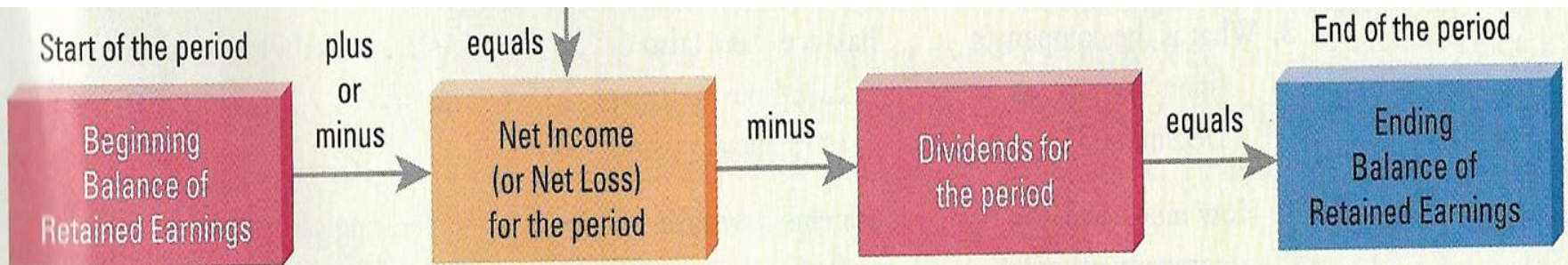


Illustration 2.3

During the year , Aynsley, Inc., has \$280,000 in revenues, \$145,000 in expenses, and \$6,000 in dividend declarations and payments.

**What is the net income of Aynsley, Inc., for the year is?
Stockholders' equity changed by ?**

Revenues - expenses = net income

net income - dividend = change in Stockholders' equity

$$\text{Net income} = \text{revenues} - \text{expenses} = \$280,000 - \$145,000 = \underline{\$135,000}$$

$$\text{changes in Stockholders' equity} = \text{Net income} - \text{dividend} = \$135,000 - \$6,000 = \underline{\$129,000}$$

The Balance Sheet Measures Financial Position

Balance Sheet

- ◆ Also called **statement of financial position**
- ◆ Reports three items: *a moment in time only*
 - ▶ Assets
 - ▶ Liabilities
 - ▶ Stockholders' equity
- ◆ Dated at the *moment in time* when the accounting period ends

Example Company
Balance Sheet
December 31, 2019

B/S

ASSETS

Current assets

Cash	存款	\$ 2,100
Petty cash	现金	100
Temporary investments		10,000
Accounts receivable - net	白条	40,500
Inventory		31,000
Supplies		3,800
Prepaid insurance		1,500
Total current assets		<u>89,000</u>

Investments

36,000

Property, plant & equipment	fixed assets PPE (Lands, Buildings, Equip)	
Land		5,500
Land improvements		6,500
Buildings		180,000
Equipment		201,000
Less: accum depreciation		(56,000)
Prop, plant & equip - net		<u>337,000</u>

Intangible assets

Goodwill	105,000
Trade names	200,000
Total intangible assets	<u>305,000</u>

Other assets

3,000

Total assets Σ \$ 770,000

LIABILITIES

Current liabilities

Notes payable	\$ 5,000
Accounts payable	35,900
Wages payable	8,500
Interest payable	2,900
Taxes payable	6,100
Warranty liability	1,100
Unearned revenues	1,500
Total current liabilities	<u>61,000</u>

Long-term liabilities

Notes payable	20,000
Bonds payable	400,000
Total long-term liabilities	<u>420,000</u>

Total liabilities 481,000

STOCKHOLDERS' EQUITY

Common stock	110,000
Retained earnings	229,000
Less: Treasury stock	(50,000)
Total stockholders' equity	<u>289,000</u>

Total liabilities & stockholders' equity \$ 770,000

Assets on the Balance Sheet

Current Assets

- ◆ Expected to be converted to cash, sold, or consumed during the next 12 months or within the business's operating cycle if longer than a year
- ◆ Includes
 - ▶ Cash and cash equivalents →
 - ▶ Short-term investments
 - ▶ Accounts and notes receivable
 - ▶ Inventory
 - ▶ Prepaid expenses

Cash is the liquid asset that's the medium of exchange

Cash equivalents include money-market accounts or other financial instruments that are easily convertible to cash

Assets on the Balance Sheet

Current Assets

- ◆ Expected to be converted to cash, sold, or consumed during the next 12 months or within the business's operating cycle if longer than a year

- ◆ Includes

- ▶ Cash and cash equivalents
- ▶ Short-term investments
- ▶ Accounts and notes receivable
- ▶ Inventory
- ▶ Prepaid expenses



Includes stocks and bonds of other companies that the company intends to sell within the next year

Assets on the Balance Sheet

Current Assets

- ◆ Expected to be converted to cash, sold, or consumed during the next 12 months or within the business's operating cycle if longer than a year
- ◆ Includes
 - ▶ Cash and cash equivalents
 - ▶ Short-term investments
 - ▶ Accounts receivable →

Amounts collectible from customers from the sale of goods and services
 - ▶ Inventory
 - ▶ Prepaid expenses

Assets on the Balance Sheet

Current Assets

- ◆ Expected to be converted to cash, sold, or consumed during the next 12 months or within the business's operating cycle if longer than a year
- ◆ Includes
 - ▶ Cash and cash equivalents
 - ▶ Short-term investments
 - ▶ Accounts receivable
 - ▶ Inventory → Merchandise that a company sells to customers
 - ▶ Prepaid expenses

Assets on the Balance Sheet

Current Assets

- ◆ Expected to be converted to cash, sold, or consumed during the next 12 months or within the business's operating cycle if longer than a year
- ◆ Includes
 - ▶ Cash and cash equivalents
 - ▶ Short-term investments
 - ▶ Accounts receivable
 - ▶ Inventory
 - ▶ Prepaid expenses



Amounts paid in advance for costs that include advertising, rent, insurance, and supplies

Assets on the Balance Sheet

Long-term Assets

◆ Expected to benefit the company for long periods of time

◆ Includes

- ▶ Property and equipment
- ▶ Accumulated depreciation
- ▶ Long-term investments
- ▶ Intangibles



Tangible assets that include land, buildings, computers, and equipment

Assets on the Balance Sheet

Long-term Assets

- ◆ Expected to benefit the company for long periods of time
- ◆ Includes
 - ▶ Property and equipment
 - ▶ Accumulated depreciation
 - ▶ Long-term investments
 - ▶ Intangibles



Amount of the historical cost of plant assets that has been allocated to expense in the income statement over time as the asset has been used in producing revenue

Assets on the Balance Sheet

Long-term Assets

- ◆ Expected to benefit the company for long periods of time
- ◆ Includes
 - ▶ Property and equipment
 - ▶ Accumulated depreciation
 - ▶ Long-term investments
 - ▶ Intangibles



Includes stocks and bonds of other companies that the company does not intend to sell within the next year

Assets on the Balance Sheet

Long-term Assets

- ◆ Expected to benefit the company for long periods of time
- ◆ Includes
 - ▶ Property and equipment
 - ▶ Accumulated depreciation
 - ▶ Long-term investments
 - ▶ Intangibles



Assets with no physical form, such as patents, trademarks, and goodwill

Liabilities on the Balance Sheet

Current Liabilities

- ◆ Debts payable in the next year or within the business's operating cycle if longer than a year
- ◆ Includes
 - ▶ Accounts payable
 - ▶ Income taxes payable
 - ▶ Accrued expenses
 - ▶ Current maturities of long-term debt



Amounts owed to vendors and suppliers for purchases of inventory

Liabilities on the Balance Sheet

Current Liabilities

- ◆ Debts payable in the next year or within the business's operating cycle if longer than a year
 - ◆ Includes
 - ▶ Accounts payable
 - ▶ Income taxes payable
 - ▶ Accrued expenses
 - ▶ Current maturities of long-term debt
- Tax debts owed to the government

Liabilities on the Balance Sheet

Current Liabilities

- ◆ Debts payable in the next year or within the business's operating cycle if longer than a year
- ◆ Includes
 - ▶ Accounts payable
 - ▶ Income taxes payable
 - ▶ Accrued expenses
 - ▶ Current maturities of long-term debt



Includes other liabilities such as interest payable on borrowed money, accrued liabilities for salaries, utilities, and other expenses that are owed but have not been paid

Liabilities on the Balance Sheet

Current Liabilities

- ◆ Debts payable in the next year or within the business's operating cycle if longer than a year
- ◆ Includes
 - ▶ Accounts payable
 - ▶ Income taxes payable
 - ▶ Accrued expenses
 - ▶ Current maturities of long-term debt



Portion of long-term liabilities that the company will have to pay off within the next year

Liabilities on the Balance Sheet

Long-term Liabilities

- ◆ Debts due beyond one year or the company's normal operating cycle if longer than a year
- ◆ Includes
 - ▶ Long-term notes payable
 - ▶ Bonds payable

Equity on the Balance Sheet

Stockholders' Equity

- ◆ Represents the stockholders' ownership of the business's assets
- ◆ Includes
 - ▶ Common stock
 - ▶ Additional paid-in capital
 - ▶ Retained earnings
 - ▶ Treasury stock
 - ▶ Accumulated other comprehensive income (loss)



Amount represents the par value of the shares issued to stockholders

Equity on the Balance Sheet

Stockholders' Equity

- ◆ Represents the stockholders' ownership of the business's assets
- ◆ Includes
 - ▶ Common stock
 - ▶ Additional paid-in capital → Amount of cash received on initial sale of the company's stock in excess of the par value
 - ▶ Retained earnings
 - ▶ Treasury stock
 - ▶ Accumulated other comprehensive income (loss)

Equity on the Balance Sheet

Stockholders' Equity

- ◆ Represents the stockholders' ownership of the business's assets
- ◆ Includes
 - ▶ Common stock
 - ▶ Additional paid-in capital
 - ▶ Retained earnings →

Portion of net income
reinvested into the business
 - ▶ Treasury stock
 - ▶ Accumulated other comprehensive income (loss)

Equity on the Balance Sheet

Stockholders' Equity

- ◆ Represents the stockholders' ownership of the business's assets
- ◆ Includes
 - ▶ Common stock
 - ▶ Additional paid-in capital
 - ▶ Retained earnings
 - ▶ Treasury stock
 - ▶ Accumulated other comprehensive income (loss)



Amounts paid by the company to repurchase its own stock

Equity on the Balance Sheet

Stockholders' Equity

- ◆ Represents the stockholders' ownership of the business's assets
- ◆ Includes
 - ▶ Common stock
 - ▶ Additional paid-in capital
 - ▶ Retained earnings
 - ▶ Treasury stock
 - ▶ Accumulated other comprehensive income (loss) →

Items of gain or loss that are allowed by the FASB to bypass the income statement and be recorded directly into stockholders' equity

STOCKHOLDERS' EQUITY

Common stock	110,000
Retained earnings	229,000
Less: Treasury stock	(50,000)
Total stockholders' equity	<u>289,000</u>

Stockholder's Equity

- The accounting equation states that :

Assets

=

Liabilities

+

Owner's
Equity

A corporation's owners' equity Stockholders' equity, and this title is descriptive. Remember that a corporation's owners' equity represents the stockholders' ownership of the business's assets. The Apple's Inc.'s stockholder' equity consists of the following:

1. Common stock, represented by shares issued to stockholders.
2. Retained earning as we discussed before **Retained Earnings** - the amount earned by income-producing activities and kept for use in the business.

Asset = Liabilities + Owners' Equity

Assets

**Total
Liabilities**

Owner's equity

The Statement of Cash Flows Measures Cash Receipts and Payments

The **Statement of Cash Flows** reports three types of activities

- ◆ **Operating:** Cash flows from selling goods and providing services to customers
- ◆ **Investing:** Cash flows from the purchase and sale of long-term assets
- ◆ **Financing:**
 - ▶ Borrowing and repayment of borrowed funds
 - ▶ Equity transactions, such as issuing stock, paying dividends, and repurchase of company stock

The statement of cash flows reports cash receipts and cash payment in each of the above Activities.

Example Corporation
Statement of Cash Flows
For the Year Ended December 31, 2019

Cash Flow from Operating Activities

Net income	\$23,000
Add: depreciation expense	4,000
Increase in accounts receivable	(6,000)
Decrease in inventory	9,000
Decrease in accounts payable	(5,000)
Cash provided (used) in operating activities	<u>25,000</u>

Cash Flow from Investing Activities

Capital expenditures	(28,000)
Proceeds from sale of property	7,000
Cash provided (used) by investing activities	<u>(21,000)</u>

Cash Flow from Financing Activities

Borrowings of long-term debt	10,000
Cash dividends	(5,000)
Purchase of treasury stock	(8,000)
Cash provided (used) by financing activities	<u>(3,000)</u>

Net increase in cash	1,000
Cash at the beginning of the year	1,200

Net Cash

Cash at the end of the year	<u><u>\$ 2,200</u></u>
-----------------------------	------------------------

Companies Operate by selling goods and services goods
 services to customers.

1. Operating activities result in net income or net loss, and they either increase or decrease cash, reports whether operations increased the company's cash balance.
2. Operating activities are most important, and they should be the company's main source of cash.
3. Continuing negative cash flow form operations can lead to bankruptcy.

Companies invest in long-term assets.

1. Both purchases and sales of long-term assets are investing cash flow.
2. Investing cash flows are the next most important after operations.

Companies need money for financing

1. Financing activities include issuing stock, paying dividends, borrowing, and repayments of borrowed funds.
2. The company may also pay loans, pay dividends, and repurchase its own stock. These payments are examples of financing cash flows.

Illustration 2.4

EVALUATE BUSINESS OPERATIONS THROUGH THE FINANCIAL STATEMENTS

Exhibit 1-6

Question	Financial Statement	Answer
How well did the company perform during the year?	Income statement	$\frac{\text{Revenues} - \text{Expenses}}{\text{Net Income / Net Loss}}$
Why did the company's retained earnings change during the year?	Statement of retained earnings	$\frac{\begin{array}{l} \text{Beginning retained earnings} \\ + \text{Net Income (-Net Loss)} \\ - \text{Dividends declared} \end{array}}{\text{Ending retained earnings}}$
What is the company's <u>financial position</u> at year-end? <i>financial resources</i>	Balance sheet	$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$
How much cash did the company generate and spend during the year?	Statement of Cash Flows	$\frac{\begin{array}{l} \text{operating cash flows} \\ +/- \text{ Investing cash flows} \\ +/- \text{ Financing cash flows} \end{array}}{\text{Increase (decrease) in cash}}$

Advance slide in presentation mode to reveal financial statement and answer.

LO 4

Illustration 2.5

Assume SB Technology, Inc., is expanding into Australia. Identify the financial statement where decision makers can find the following information about SB Technology, Inc. In some cases, more than one statement will report the needed data.

Financial Statement (s)

- | | |
|---|---------------------------------------|
| a. Revenue | Income Statement |
| b. Dividends | Cashflow Statement + Retained Earning |
| c. Current liabilities | Balance Sheet |
| d. Total assets | B/S |
| e. Selling, general, and administrative expense | Income Statement |

Illustration

Identify the financial statement where decision makers can find the following information about SB Technology, Inc.

Financial Statement (s)

f. Ending cash balance

Cashflow B/S

g. Cash spent to acquire a building

Cashflow

h. Ending balance of retained earnings

Retain Earnings B/S

i. Net income

Income Retain Earnings Cashflow

Quiz on:

<https://canvas.ipm.edu.mo/courses/4150/quizzes/4031>

Illustration

Identify the financial statement where decision makers can find the following information about SB Technology, Inc.

Financial Statement (s)

- j. Income tax expense
- k. Common stock
- l. Income tax payable
- m. Long-term debt
- n. Adjustments to reconcile
net income to net cash
provided by operations