Financial Statement Review – Individual Project

I have posted the most recent and prior year financial statements foe the selected Company in the Course Project folder in Blackboard. You should use the details from the MOST RECENT financial statements in order to answer each of the questions below. If you use the incorrect financial statements, your project will not be graded.

Required: Review the 50 questions below and document your responses to the questions using this word document. You must use excel for the common size financial statement calculations in questions 17 and 30 and either embed your excel worksheet in the word document or attach a separate excel file. Your responses should show computations where applicable. You must submit your own original work for this project. *Please ensure your entire document (and excel file) is printer friendly, or it will not be graded.*

Due Date: You will upload the assignment through Blackboard Assignments by the due date posted in the Blackboard Assignment Folder.

Stockholders' letters and Other Materials

The Annual Report should contain a letter (or two) to the shareholders from one or two of the key officers of the Company and some additional financial information and highlights. (If you cannot find any letter, please research the annual report from another company and tailor the question below) Read them and answer the following questions:

1. Who wrote the letter? What is the name and title of the individual who signed the letter?
    - Larry J. Merlo, the President and Chief Executive Officer of CVS Health wrote this letter.
2. In 100 words or less what is the message in the letter or letters?
    - The acquisition of Aetna completed in November 2018 brings a bright future to the company. The company's business indicators in 2018 have developed steadily and created a series of highlights. New concept stores and pilot programs are actively progressing，bringing personalization to the next level. Meanwhile, the company made great efforts to meet their CSR commitments. Last, thanks for everyone.
3. What is the basic pattern for letters of this type?
    - The content usually includes the understanding of the general situation of the industry, the operating performance of the company in the previous year, the problems encountered in the operation and the development strategy of the company. Finally, CEO expresses the gratitude to the board of directors, shareholders and all colleagues for their support.

4. Provide a description in 150 words or less of this information and the message it communicates.
    - CVS has achieved good business performance in providing customers with more economical choices.
    - Merger projects can bring stronger market competitiveness to the company.
    - At the same time, due to the Aetna acquisition, the company will continue suspend any dividend increases as well as their share repurchase program in order to get their targeted leverage ratio.

A. Financial Highlights

5. What financial highlights does the Company highlight this year?
    - This year's financial highlights including: Revenues; Operating Income; Net income(loss); Diluted EPS from continuing operations; Free cash flow (in non-GAAP measure); Stock price at year-end and Market capitalization at year-end.

6. Explain how the Company portrays the highlighted items – (ie in a positive, mixed or negative way).
    - In this annual report, the company presented these financial data truthfully and compared them with 2017.
    - In addition, some bar charts were made for Revenues, Diluted EPS from continuing operations, and Annual cash dividends to compare the data trend in the past five years.
    - In the subsequent letter to shareholders, The CEO gave a very positive reading of all highlighted ted items.

7. What items are not included in the financial highlights that you believe should have been included?
    - Compared with other large enterprises, such as Coca-Cola, goodwill and intangible assets of CVS account for a large proportion in the total assets. Especially, the company took $6.1 billion of goodwill impairment charges related to their long-term care business, which I think should be included in the financial highlights.

(Hint: You might want to come back to this question after you have completed all of the questions below).

B. Fiscal Year

8. The fiscal year end in the Company extends from when to when? Where did you locate this information?
    - The consolidated financial statements for the year started on January 1,2018 and ended on December 31,2018.
    - I located this information both in the section of “Overview of Business” and the section of “Notes to Consolidated Financial Statements”.

9. Explain why the Company has chosen this particular time period for its fiscal year?
    - First reason is the acquisition of Aetna completed in November 2018. The chosen time period can give more comprehensive reflection of this acquisition.
    - Also, my guess is that the CVS is in an industry that has no obvious seasonal cycle, so they take the calendar year as their fiscal year.
    - Besides, FASB issued a series of “ASU 2016-” and the Company adopted those new accounting guidances and effective on January 1, 2018.

C. Balance Sheets (the amount of money is in millions in my following answers)

10. For which dates/years does the company report a balance sheet?
    - Consolidated Balance Sheets reported by December 31th, 2018.

11. Using totals for each category (total assets, liabilities and shareholders’ equity), what is the balance sheet equation for the most recent year.
    - Total Assets = Total liabilities + Total shareholders’ equity
    - $196,456 = $137,913 + $58,543

12. What are the three largest assets as reported on the most recent balance sheet?
    - The three largest assets are: Goodwill ($78,678); Intangible assets ($36,524) and Accounts receivable ($17,631).

13. Do the amounts reported as assets appear consistent as to what you might expect for the Company?
    - I knew Goodwill would be CVS's biggest asset, but I didn't expect it to be that big.
    - Also, I didn't expect the proportion of intangible assets to be so large.

14. What is the amount of accumulated depreciation for the current year? Where would you obtain this information?
    - The amount of accumulated depreciation for the current year is $15,520;

- Under the notes to consolidated financial statements, there are many detail information about the Property and Equipment.

15. What are the three largest liabilities as reported on the most recent balance sheet?
    - The three largest liabilities are Long-term debt, Pharmacy claims and discounts payable, and Accrued expenses.

16. Which is larger - the Company's retained earnings amount or capital stock/equity?
    - The company's retained earnings amount ($40,911) is larger than capital stock ($45,440-$28,228).

17. Prepare common size financial statements analysis (horizontal and vertical analysis) for the Company as we demonstrated in class using excel. (Ie You can download the comparative balance sheets to excel from the company website and compare the balance sheet items as a percentage of total assets for each year and the change in the items year over year as an amount and a percentage as we demonstrated in class).

Consolidated Balance Sheets								
In millions, except per share amounts **2018**							At December 31,	
		2018	Common		2017	Common	Change	Percentage
Assets:			Size			Size	Amount	Change
Cash and cash equivalents	$	4,059	2.07%	$	1,696	1.78%	$ 2,363	139%
Investments		2,522	1.28%		111	0.12%	$ 2,411	2172%
Accounts receivable, net		17,631	8.97%		13,181	13.86%	$ 4,450	34%
Inventories		16,450	8.37%		15,296	16.08%	$ 1,154	8%
Other current assets		4,581	2.33%		945	0.99%	$ 3,636	385%
Total current assets		45,243	23.03%		31,229	32.83%	$ 14,014	45%
Long-term investments		15,732	8.01%		112	0.12%	$ 15,620	13946%
Property and equipment, net		11,349	5.78%		10,292	10.82%	$ 1,057	10%
Goodwill		78,678	40.05%		38,451	40.42%	$ 40,227	105%
Intangible assets, net		36,524	18.59%		13,630	14.33%	$ 22,894	168%
Separate accounts assets		3,884	1.98%		-	-	$ 3,884	-
Other assets		5,046	2.57%		1,417	1.49%	$ 3,629	256%
Total assets	$	196,456	100.00%	$	95,131	100.00%	$ 101,325	107%
Liabilities:								
Accounts payable	$	8,925	4.54%	$	8,863	9%	$ 62	1%
Pharmacy claims and discounts payable		12,302	6.26%		10,355	11%	$ 1,947	19%
Health care costs payable		5,210	2.65%		5	0%	$ 5,205	104100%
Policyholders' funds		2,939	1.50%		-	-	$ 2,939	-
Accrued expenses		10,711	5.45%		6,581	7%	$ 4,130	63%
Other insurance liabilities		1,937	0.99%		23	0%	$ 1,914	8322%
Short-term debt		720	0.37%		1,276	1%	$ (556)	-44%

Current portion of long-term debt	1,265	0.64%	3,545	4%	$ (2,280)	-64%
Total current liabilities	44,009	22.40%	30,648	32%	$ 13,361	44%
Long-term debt	71,444	36.37%	22,181	23%	$ 49,263	222%
Deferred income taxes	7,677	3.91%	2,996	3%	$ 4,681	156%
Separate accounts liabilities	3,884	1.98%	-	-	$ 3,884	-
Other long-term insurance liabilities	8,119	4.13%	334	0%	$ 7,785	2331%
Other long-term liabilities	2,780	1.42%	1,277	1%	$ 1,503	118%
Total liabilities	137,913	70.20%	57,436	60%	$ 80,477	140%
Commitments and contingencies (Note 16)						
Shareholders' equity:						
CVS Health shareholders' equity:						
Preferred stock, par value $0.01: 0.1 shares authorized; none issued or outstanding	-	-	-	-	-	-
Common stock, par value $0.01: 3,200 shares authorized; 1,720 shares issued and 1,295 shares outstanding at December 31, 2018 and 1,712 shares issued and 1,014 shares outstanding at December 31, 2017 and capital surplus	45,440	23.13%	32,096	34%	13,344	42%
Treasury stock, at cost: 425 shares at December 31, 2018 and 698 shares at December 31, 2017	(28,228)	-14.37%	(37,796)	-40%	9,568	-25%
Retained earnings	40,911	20.82%	43,556	46%	-2,645	-6%
Accumulated other comprehensive income (loss)	102	0.05%	-165	0%	267	-162%
Total CVS Health shareholders' equity	58,225	29.64%	37,691	40%	20,534	54%
Noncontrolling interests	318	0.16%	4	0%	314	7850%
Total shareholders' equity	58,543	29.80%	37,695	40%	20,848	55%
Total liabilities and shareholders' equity	$ 196,456	100.00%	$ 95,131	100%	101,325	107%

18. What is the percentage of current assets to total assets for each year?
    - The percentage of current assets to total assets is 23.03% in 2018; and 32.83% in 2017.

19. What is the percentage of current liabilities to total assets for each year?
    - The percentage of current liabilities to total assets is 22.40% in 2018; and 32.22% in 2017.

20. What is the percentage of total debt to total assets for each year? (Note: This is the debt percentage)
    - The percentage of total debt to total assets is 70.20% in 2018; and 60.38% in 2017.

21. Did the debt percentage increase or decrease from year to year? What do you think this indicates about the Company?
    - The debt percentage increase from 2017 to 2018.
    - Although the company's total assets doubled and increased in 2018 compared with 2017, the company's borrowing scale was larger than the growth of assets. However, the company's liabilities are mainly long-term. The current liabilities tend to decline. I think the company's current liquidity and default risk is controllable.

22. What is the percentage of stockholders' equity to total assets for each year?
    - The percentage of stockholders' equity to total assets is 29.80% in 2018; 39.62% in 2017.

23. Explain if Company's ratio of stockholders' equity to total assets seem consistent with the business risk of the Company?
    - The company's equity-to-asset ratio decreased from 2017 to 2018, means the more leveraged the company is. In other words, the company owns a less than 1/3 of its assets outright. The rest of the equity of its assets is technically controlled by debtholders, which means the business risk of the company is increased.

24. Calculate the current ratio for each year. What does the ratio say about the Company?
    - The current ratio for 2018 is 1.03; and 1.02 in 2017.
    - The company's current ratio is greater than 1.0 implies positive working capital. In other words, the company can cover its short-term debts with cash provided by operations.

25. What is the percentage change in total assets from the prior year to the current year – increase or (decrease)?
    - The total assts increased 107% from the prior year to the current year.
    - ($196,456-$95,131)/$95,131=107%

26. Does the Company's common stock have a par value? If yes, what is the amount reported as par value per share?
    - The company's common stock have a par value, which is $0.01 per share.

27. How many shares of common stock were issued at the end of the fiscal year?
    - 1,720 shares issued and 1,295 shares outstanding at December 31,2018

D. Income Statements

28. For this Annual Report, for which dates does the Company report it income statements?
    - Consolidated Statements of income for the year reported by December 31th

29. What is the amount reported for net sales for each fiscal year?
    - The amount of net sales for 2018 is $194,579;
    - The amount of net sales for 2017 is $184,786;
    - And the amount of net sales for 2016 is $177,546.

30. Prepare common size financial statements analysis (horizontal and vertical analysis) for the Company as we demonstrated in class using excel. (Ie You can download the comparative income statements to excel from the company website and compare the income statement items as a percentage of net sales for each year and the change in the items year over year a $ amount and a percentage as we demonstrated in class)

Consolidated Statements of Comprehensive Income (Loss)					2018 vs. 2017				2017 vs. 2016	
In millions	2018	Common Size	2017	Common Size	Change Amount	Percentage	2016	Common Size	Change Amount	Percentage
Net income (loss)	$ (596)	100.00%	$ 6,623	100.00%	$ (7,219)	-109%	$ 5,319	100.00%	$ 1,304	25%
Other comprehensive income (loss), net of tax:										
Net unrealized investment gains	97	-16.28%	-	-	$ 97	-	-	-	-	-
Foreign currency translation adjustments	(29)	4.87%	(2)	-0.03%	$ (27)	1350%	38	0.71%	$ (40)	-105%
Net cash flow hedges	330	-55.37%	(10)	-0.15%	$ 340	-3400%	2	0.04%	$ (12)	-600%
Pension and other postretirement benefits	(124)	20.81%	152	2.30%	$ (276)	-182%	13	0.24%	$ 139	1069%
Other comprehensive income	274	-45.97%	140	2.11%	$ 134	96%	53	1.00%	$ 87	164%
Comprehensive income (loss)	(322)	54.03%	6,763	102.11%	$ (7,085)	-105%	5,372	101.00%	$ 1,391	26%
Comprehensive (income) loss attributable to noncontrolling interests	2	-0.34%	(1)	-0.02%	$ 3	-300%	(2)	-0.04%	$ 1	-50%
Comprehensive income (loss) attributable to CVS Health	$ (320)	53.69%	$ 6,762	102.10%	$ (7,082)	-105%	$ 5,370	100.96%	$ 1,392	26%

31. What is the percentage change in net sales for each year? Describe any trends that you believe to be developing.
    - 2018 vs. 2017 we had a net income of $9,793, with 5.3% increase in percentage;
      2017 vs. 2016 we had a net income of $7,240, with 4.1% increase in pencentage.
    - We can see the revenues showed a steady growth trend since 2014, for the year 2018 it increased by 5.3 percent to a record $194.6 billion. Therefore, I am optimistic about the company's long-term profitability in the future.

32. What are the categories of the income statement line items in order to calculate net income (ie revenue, expense etc).
    - Those categories are: Revenues, Operating Costs, Operating income, Interest expense, Loss on early extinguishment of debt, Other expense(income), Income tax provision, Loss from discontinued operations

33. What is the amount of net income reported for each fiscal year? Which is changing more rapidly – net sales or net income?
    - 2018 vs. 2017 we had a net loss of $7,219, with 109.00% decrease in percentage;
      2017 vs. 2016 we had a net income of $1,304, with 24.5% increase in pencentage.
    - Net income is changing more rapidly. This drop is dued to the acquisition of Aentna and the $6.1 billion of goodwill impairment charges.

34. What are the three largest expenses for each of the fiscal years presented?
    - The three largest expenses for each of the fiscal years are Cost of products sold, Operating expenses, and benefit costs

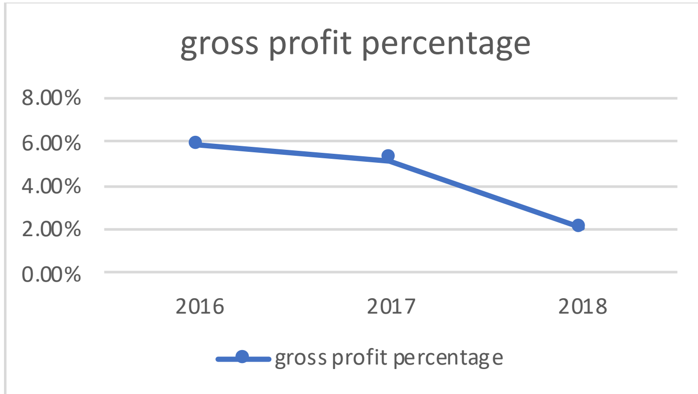
35. If the Company sells products, what is the gross margin and gross profit percentage for each fiscal year presented?
    - Gross profit margin= (Sales revenue – Cost of goods sold) / Sales revenue
    - Therefore for each fiscal year:

	2018	2017	2016
Total revenues	$ 194,579	$ 184,786	$ 177,546
Cost of products sold	$ 156,447	$ 153,448	$ 146,533
Gross margin	$ 38,132	$ 31,338	$ 31,013
gross profit percentage	19.60%	16.96%	17.47%

36. What is the amount of operating income for each fiscal year? What is the amount of operating income as a percentage of sales for each fiscal year? What is the trend?
    - As listed in the table:

	2018	2017	2016
Operating income	$ 4,021	$ 9,538	$ 10,386
Total revenues	$ 194,579	$ 184,786	$ 177,546
gross profit percentage	2.07%	5.16%	5.85%

    - The trend is decreasing:



E. Statements of Cash Flows

37. Does the Company use the Indirect or Direct Method to prepare their Statement of Cash Flows? How can you tell the difference?

- The company use both methods to prepare their Statement of Cash Flows.
- At first, In the Operating activities section, the statement presents the components of cash flow from operating activities as a list of gross cash receipts and gross cash payment, which is direct method.
- However, at the botten of this Statement of Cash Flow there is a "Reconciliation", which is under the indirect method, the cash flow from operations section begins with net income and applies a series of adjustments to net income to convert it to net cash flow from operating activities.

38. What is the amount of cash flows from operating activities, financing activities and investing activities for each fiscal year presented. What does this information tell us?

- The amount of cash flows for each fiscal year is presented in the following table:

Year	2016	2017	2018
Cash flow from operating activities	$ 10,141	$ 8,007	$ 8,865
Cash flow from investing activities	$ (2,470)	$ (2,877)	$ (43,285)
Cash flow from financing activities	$ (6,761)	$ (6,751)	$ 36,819

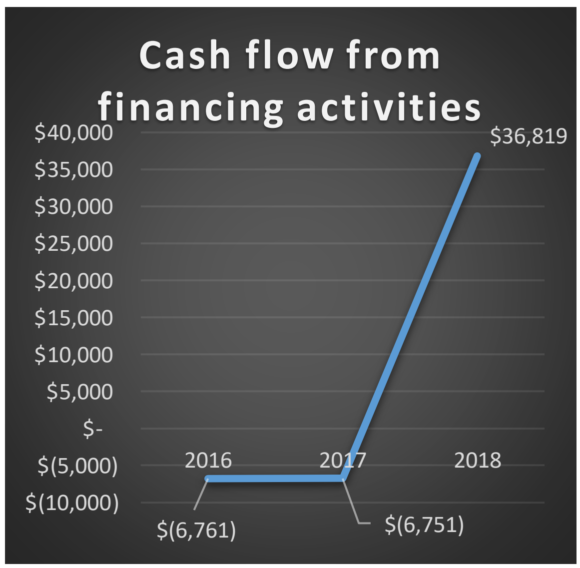
- In 2016 and 2017, the company can generate enough cash flow through their operating activities to cover the cash used in investing activities, purchased the common stock and paid dividends; however, in 2018 due to the Acquisitions, the company need to finance a lot of cash to meet the need of their investing activities.

39. On what statement(s) would you expect to find information regarding the declaration and payment of dividends? Did the Company pay dividends for any of the fiscal years presented?

- I found the information in the Consolidated Statement of Cash Flow. Also, from the "Notes to consolidated financial statements", there is many information about dividend payments in Note 8 "Borrowings and Credit Agreements" and Note 12 "Shareholders' Equity".
- In the latest three fiscal years, the numbers of " Dividends paid" are all negative, which means the company used the existing cash or raise additional money to pay the dividends.

40. Describe the trend in the cash flow from financing activities.

- The cash flow from financing activities had a dramatic increase associated with the Aetna Acquisition.



F. Statements of Stockholders' Equity

41. Using the amounts in the statement of changes in stockholders' equity, what is the amount to reconcile or roll-forward the beginning retained earnings to the ending retained earnings for the most recent year. (*Hint:* Use the statement of stockholders' equity).

- The beginning retained earnings ($43,556), subtract the Adoption of new accounting standards ($6) , subtract the Net loss ($594), then finally subtract the Dividends ($2,045), that's total -$2,645, to get the ending retained earnings for 2018 which is $40,911.

G. Notes to the Financial Statements

42. How many notes to the financial statements accompany these financial statements?
    - There are 18 notes to the financial statements.

43. The first or second footnote disclosure typically describes the significant accounting policies. Identify and briefly summarize 3 of these policies.

    - ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities.

      This ASU requires equity investments, except those under the equity method of accounting or those that result in the consolidation of an investee, to be measured at fair value with changes in fair value recognized in net income.

    - ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments.

      This ASU is intended to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows and to eliminate the diversity in practice related to such classifications.

    - ASU 2016-18, Statement of Cash Flows, which amends Accounting Standard Codification Topic 230.

      This ASU requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. The new guidance requires a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. Entities will also have to disclose the nature of their restricted cash and restricted cash equivalent balances.

H. Report of Independent Public Accountants

44. Although this is not an auditing class, what accounting firm audited the financial statements? (*Hint*: Were you able to find the "Report of Independent Registered Public Accounting Firm")
    - Ernst & Young LLP audited the financial statements.

45. What is the audit firm's responsibility for auditing financial statements?
    - The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

46. What type of audit opinion (audit report) did the audit firm issue on these financial statements for the periods presented? What does this mean?
    - According to audit opinion, CVS Health Corporation (the Company) maintained effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.
    - I think this opinion means that CVS Health Corporation has carried out effective risk management, and the company is now in good Health.

47. The auditors should investigate the internal controls of the Company. What is described in a letter about internal controls included with the financial statements?
    - A company's internal control over financial reporting includes those policies and procedures that

      (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

      (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

      (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

48. Is there a separate opinion included in the financial statements about the Company's internal control? If not, where do the auditors include their conclusion on the Company's Internal Control over Financial Reporting.
    - There is no separate opinion here.
    - As mentioned in the end of "Opinion on Internal Control over Financial Reporting", for all statements; the related notes and this report the auditors wrapped up with the saying "they expressed an unqualified opinion".

I. Management's Discussion and Analysis (MD&A)

49. Provide a description in approximately 250-300 words of what is included in the Company's MD&A section.

There is many information included in the company's management's discussion and analysis, which can be categorized into 9 parts:

- Overview of business
- Results of operations (overview of different operating segments)
- Liquidity and Capital Resources
  Including: cash flow, short-term/ long-term borrowing, derivative financial instruments, debt covenants, debt ratings, share repurchase programs, quarterly cash dividend, off-balance sheet arrangements, contractual obligations.
- Restrictions on Certain Payments
- Solvency Regulation
- Quantitative and Qualitative Disclosures About Market Risk
  Including: evaluations of the interest rate and credit quality risk, market valuation risks, foreign currency and commodity risk and operational risks.
- Critical Accounting Policies
- Holders of Common Stock
- Cautionary Statement Concerning Forward-Looking Statements

J. Conclusion

50. What is your feedback about this assignment for this class?

- This assignment really helps me to review the financial statements' system. All the concepts are linked together by this actual case.