Finance and Accounting

DISCLOSURE REQUIREMENTS

- An **annual report** is a document that public corporations must provide annually to shareholders that describes their operations and financial conditions
- Shareholders use it to evaluate the firm's financial performance and to make investment decisions.
- If the company is a public one, that is, if its shares are available for purchase by the public, through trading on a stock exchange, the stock exchange will impose additional **disclosure requirements**

Annual Report

- General corporate information
- Operating and financial highlights
- Narrative text, graphics, and photos
- Management's discussion and analysis (MD&A)
- Financial statements, including the balance sheet, income statement, and cash flow statement
- Auditor's report
- Summary of financial data
- Accounting policies

Balance Sheet

- The purpose of the balance sheet is to show what the company owns –its **assets – and what it owes, its liabilities. It is a snapshot of the state of** the company at a particular point in time, normally at the end of the last day of the company's financial year.

Balance Sheet

Jemima Puddleduck **Balance Sheet** **As at 31 October 2013**	**2013**	**2012**
ASSETS		
Cash in hand	25	40
Cash at bank	361	240
Pre-paid accommodation	300	180
Debts owed by friends	18	0
Computer	240	360
Guitar	160	180
Total assets	1,104	1,000
LIABILITIES		
Credit card bill	174	64
Student loans	4,800	1,900
Total liabilities	4,974	1,964
NET WORTH	(3,870)	(964)

Balance sheet

- Net worth: amount of cash which Jemima would have if all her assets were sold and all her debts paid off – in other words, how much, in financial terms, she is ‘worth’.

Balance sheet

Suppose Jemima owns a house worth $300,000, has $50,000 in cash and investments, and owns a car worth $20,000. These would be her **total assets**:

$$\text{Total Assets} = \$300,000(\text{house}) + \$50,000(\text{cash and investments}) + \$20,000(\text{car}) = \$370,000$$

Now, let's assume she has the following **liabilities**:

- Mortgage: $150,000
- Car loan: $10,000
- Credit card debt: $5,000

$$\text{Total Liabilities} = \$150,000(\text{mortgage}) + \$10,000(\text{car loan}) + \$5,000(\text{credit card debt}) = \$165,000$$

To calculate Jemima's **net worth**:

$$\text{Net Worth} = \$370,000(\text{total assets}) - \$165,000(\text{total liabilities}) = \$205,000$$

So, in financial terms, Jemima's net worth is **$205,000**. This means if Jemima were to sell all her assets and pay off her debts, she would have $205,000 left.

Balance sheet

- Standard accounting practice is to reduce the value of fixed assets each year to reflect the likely lifetime of each asset; the fall in the value of the asset from one year to the next is called the **depreciation**

Assets

Fixed Assets	Current Assets
Intangible/Tangible property and equipment that a business uses to produce income	That can be converted easily to cash In a short-term.
Cannot be convertible to cash immediately. Fixed assets are not expected to be sold in normal trading operations and their resale value is irrelevant; what is needed is a measure of their value to the company	Can be converted to cash immediately
Land, building, plant, computers, machinery, vehicles and furniture	Cash, inventory

Assets

Fixed Assets	Current Assets
Purchase price - depreciation or according to company's depreciation policy	Cost or market value whichever is low
contribute to the company's productive capacity and are held primarily for the purpose of creating wealth	current assets are items which are bought and sold in the course of its day to day trading activities

Example: Cost or market value whichever is low

- company has a stock of 1,000 Books
- Sells at Rs. 10 for each
- Cost Rs. 2 each to produce.
- On balance sheet current asset will appear as Rs. 2000(cost price) rather than (10,000)

XYZ Software Ltd
Balance Sheet
As at 31 October 1999

	1999	1998
FIXED ASSETS		
Intangible assets	475	–
Tangible assets	960	770
Investments	50	82
Total fixed assets	1,485	852
CURRENT ASSETS		
Work in progress	550	621
Debtors	3,400	2,580
Cash in hand and at bank	2,491	1,770
Total current assets	6,441	4,971
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	(3,210)	(2,601)
Net current assets	3,231	2,370
Total assets less current liabilities	4,716	3,222
CREDITORS: AMOUNTS FALLING DUE AFTER ONE YEAR		
Borrowings	(154)	(61)
Provisions for liabilities and charges	(7)	(16)
Net assets	4,555	3,145
CAPITAL AND RESERVES		
Called up share capital	318	308
Share premium reserve	350	145
Profit and loss account	3,887	2,692
Shareholders' funds-equity	4,555	3,145

Assets

- if a company buys a car to enable one of its sales staff to operate more effectively, this is a fixed asset but, if a car dealer buys a car in order to resell it as part of the business, this is a current asset.

Depreciation: Straight Line Method

- Decide how many years the asset will continue to be useful for
- divide its initial cost by that number to get the

annual depreciation

- Each year reduce by the amount of annual depreciation until the value of the asset reaches zero.

- Initial Cost of the Asset: $50,000
- Useful Life: 10 years
- Annual Depreciation = Initial Cost / Useful Life
- Annual Depreciation = $50,000 / 10 = $5,000 per year

Depreciation

- Suppose a company buys a large database server costing Rs.100,000 and expects to use it for five years. Then the annual depreciation will be Rs.20,000 (100,000/5) and the values shown in the balance sheet will be Rs.80,000 at the end of year 1, Rs.60,000 at the end of year 2, Rs.40,000

  at the end of year 3, Rs.20,000 at the end of year 4, and zero at the end of year 5.

DEPRECIATION

- Generally valued on the basis of historic cost
- If a fixed asset is sold for a sum higher than its depreciated value, the company must show the difference as income

Depreciation

Consider a payroll package. A company buys such a package because
It will help it to carry out part of its day-to-day operations more
efficiently.
The package will be bought with the intention of using it for some time, at least five years and probably 10 or 15. Logically, the
Package should be treated in the same way as a piece of machinery. It
should be treated as a fixed asset and the initial cost depreciated over
its useful lifetime. The rules of accounting allow this to be done.
But, because software is intangible, many companies treat the cost of
buying it as current expenditure

Working Capital

- The figure obtained by subtracting the current liabilities from the current assets, referred to as net current assets in the example, is also known as the **working capital. It represents the amount of money** invested in the day-to-day operations of the company

Creditors

- Creditors: amounts falling due after one year' refers to long term debts. These may be long term borrowings or they may be liabilities, that is sums that the company expects to have to pay at some time in the future

Called up share capital

- Amount raised from the par value of the shares that the company has issued
- Successful company decides to issue more shares, these are often sold at more than there par value. The extra is known as the share premium

Profit and Loss account

- how much money has been received and how much has been spent in a given period
- Also known as income statement/ income and expenditure account
- It does not include money borrowed or received from the sale of equity nor does it include expenditure on acquiring fixed assets

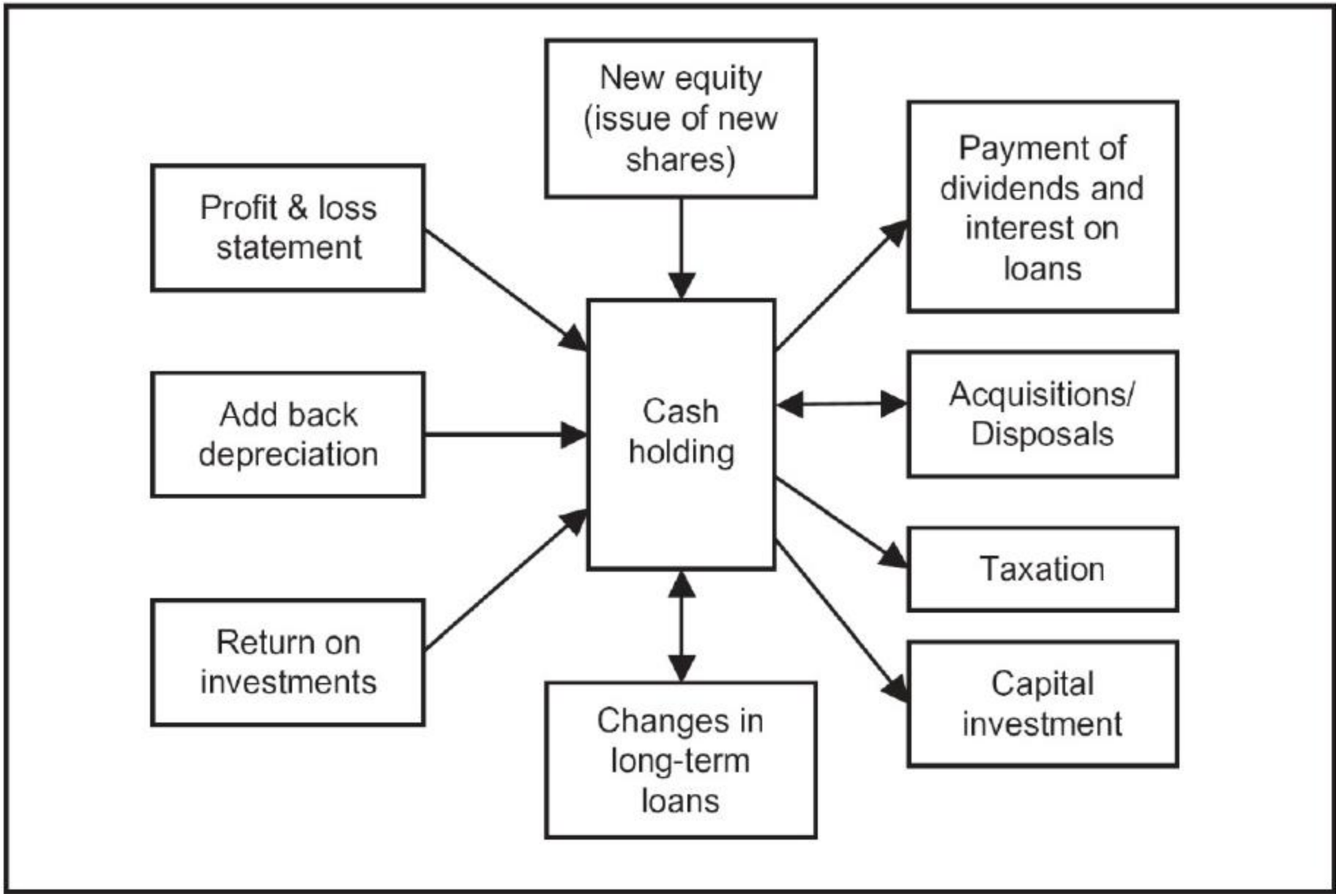
Profit and Loss Account

XYZ Software Ltd **Profit and Loss Account** **Year ending 31 October 2013**	**2013** **£'000**	**2012** **£'000**
TURNOVER		
Continuing operations	14,311	11,001
Acquisitions	407	
Total turnover	14,718	11,001
Cost of sales	(11,604)	(8,699)
Gross profit	3,114	2,302
Other operating expenses	(1,177)	(805)
OPERATING PROFIT	1,937	1,497
Interest payable	(23)	(27)
Profit on ordinary activities before taxation	1,914	1,470
Tax on profit on ordinary activities	719	480
Retained profit for the year	1,195	990

Cash Flow

- The link which ties the balance sheet and the profit and loss account to the capital expenditure is the cash flow statement
- Cash is defined as ‘cash at bank and in hand and cash equivalents less bank overdrafts and other borrowings repayable within one year of the accounting date’.

Year ending 31 October 1999	*1999*	*1998*
NET CASH INFLOW FROM OPERATING	2,105	1,620
ACTIVITIES		
Returns on investments and servicing of finance	(23)	(27)
Capital expenditure and financial investment	(320)	(265)
Taxation	(719)	(480)
Acquisitions and disposals	(380)	
Equity dividends paid		
Cash outflow before financing	(1,342)	(772)
NET CASH INFLOW BEFORE FINANCING	763	848
FINANCING		
Issue of share capital	215	100
Repayment of long term loan	(50)	
Net cash inflow from financing	165	100


New equity (issue of new shares)
Profit & loss statement
Payment of dividends and interest on loans
Add back depreciation
Cash holding
Acquisitions/ Disposals
Taxation
Return on investments
Capital investment
Changes in long-term loans