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## FINANCIAL ACCOUNTING

### ► BALANCE SHEET

↳ A financial statement that shows

↳ what the company OWNS - its ASSETS

↳ what it OWES - its LIABILITIES

↳ Also known as Statement Of Financial Positions

↳ How much is INVESTED by owners - EQUITY

↳ It follows the fundamental accounting eqn.

$$\text{ASSETS} = \text{LIABILITIES} + \text{Owner's EQUITY}$$

↳ Both sides always balance

→ Assets : what business own / controls that has future economic benefit

Eg: Cash, Equipment, Inventory, Land, Accounts

Receivable (an invoice yet to be paid by a customer)

→ Liabilities : What the business owes to others

Eg: Loans, Acc Payable (company owes money to a supplier), Tax Payable

Owner's Equity (Capital) : The owner's claim after liabilities are minor from assets

Eg: Owner's Capital, Retained Earnings, Share Capital

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So if,

Asset increases, either Liability or Equity must increase

## ▷ Components of Balance Sheet

### A. Assets

↳ Current Assets — Expected to be converted to cash within 1 year

Eg: Cash, Acc Recv, Inventory, Prepaid Expenses creditors

↳ payments made in adv for goods/service that a company will recvr or use in future

↳ Non-Current (Fixed) Assets — Long term assets used for business operations

Eg: Land, Buildings, Equipment, Vehicle, Intangible Assets (e.g. Software, patents)

Total Assets = Current Assets + Non-Current Assets

### Types of Asset

#### Classification

Convertibility

Current Asset

Non-Current Asset

Physical Existence

Tangible Asset

Intangible Asset

Usage

Operating Asset

Non-Operating Asset



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- Depreciation — Reduction in value of fixed assets over time
- Liquidity — How easily an asset can be converted into cash.

■ BALANCE SHEET - TechNor Pvt Ltd

31<sup>st</sup> - December - 2025

Assets	
Current Assets	
- Cash	\$90,000
- Inventory	\$60,000
- Acc Receivable	\$40,000
Non- Current Assets	
- Equipment	\$150,000
Total Assets	\$340,000
Liabilities	
- Notes Payable	\$50,000
- Bonds Payable	\$100,000
Total Liabilities	\$150,000

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

$$\text{Equity} = \text{Assets} - \text{Liabilities} = \$340,000 - \$150,000 \\ \Rightarrow \$190,000$$

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## ► INCOME STATEMENT

↳ It summarizes:

↳ Revenue (income earned)

↳ Expenses (cost incurred)

↳ Profit & Loss

$$\boxed{\text{Net Profit (or Loss)} = \text{Total Revenue} - \text{Total Exp}}$$

1. Revenue

2. Cost of Goods Sold (COGS)

→ Gross Profit

Revenue - COGS

3. Operating Expense (OPEX)

→ Operating Profit

Gross Profit - OPEX

4. Other Income / Expense

5. Interest Expense

6. Taxes

→ Net Profit (or Loss)

Profit after all expenses &  
taxes

↳ COGS — The direct cost of producing or purchasing the goods sold during the period

$$\boxed{\text{COGS} = \text{Opening Inventory} + \text{Purchase} + \text{Closing Inv}}$$

Eg: Raw material, direct labour, & manufacturing costs

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- ↳ Operating Expense — Expense related to daily operations
  - ↳ Admin Expense
  - ↳ Selling & Distribution Expense
  - ↳ Depreciation
  - ↳ Other Operating Costs
- ↳ To measure cost of running the business

### ↳ Operating Profit (EBIT)

- ↳ Earnings Before Interest & Taxes
- ↳ It shows the profit from core business activity before financing & taxation

### ↳ Other Income / Non-Operating Income

- ↳ Interest earned on earnings
- ↳ Rent from subletting office space
- ↳ Profit on sale of equipment
- ↳ Capture additional gains that don't come from company's main business activity

### ↳ Interest Expense

- ↳ The cost incurred for borrowing money (loans, bonds etc)

### ↳ Taxes

- ↳ Income tax payable to the govt. based on profit

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$$\text{Tax Expense} = \text{Tax Rate} \times \text{Profit Before Tax}$$

$$\hookrightarrow \text{Net Profit} = \text{Total Revenue} - \text{All Exp (COGS + OPEX + Interest + Taxes)}$$

#### ► CASHFLOW STATEMENT

↪ It shows where cash came from & where it went over a specific period

↪ It records cash inflows & outflows from:

- ① Operating Activities (day-to-day business)
- ② Investing Activities (buying/selling long-term assets)
- ③ Financing Activities (loans, owner's inv., dividends)

↪ It helps to answer

↪ Is the business generating enough cash to pay its bills?

↪ How much cash is being borrowed or invested

↪ Is the company dependent on external financing

↪ Structure of Cashflow

#### (A) Cash Flow from Operating Activities (CFO)

↪ Cashflows from the company's core operations i.e activities that generate revenue & incur exp.

↪ Examples of Cash Inflows

→ Cash recd from customers

→ Receipts from sales of goods or services

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→ Interest Income

↳ Example of Cash Outflows

→ Payments to supplier for goods / services

→ Wages & salaries

→ Rent, utilities, Oper. Exp

→ Taxes paid

- Calculations (Indirect Method)

↳ Starts from Net Profit (from Income Stat.) & adjust for

↳ Non-cash items (like depreciation)

↳ Changes in working capital (like receivables, payable, inventory)

↳ Formula:

$$\text{Net Cash from Operations} = \text{Net Profit} + \text{Non-Cash Exp.} \pm \text{Changes in Working Capital}$$

↳ Ex Adjustments

Adjustment

① Depreciation → Non-cash expense, added back

② Incr. in Acc Rec → More credit sales, less cash

③ Decr. in Inventory → Sold Inv., more cash

④ Incr. in Acc. Payable → Delayed supplier payments, more cash

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(B)

Cashflow from Investing Activities (CFI)

↳ Cashflows from buying or selling long term assets & investments

↳ Examples of Cash Inflows

→ Sale of Land, Buildings or Equipment

→ Sale of Investments

→ Cash received from interest / dividends (if considered investment income)

↳ Examples of Cash Outflows

→ Purchase of equipment, land or machinery

→ Investment in securities or other firms

(C)

Cashflow from Financial Activities (CFF)

↳ Cashflows related to funding the business —

borrowing, repaying debt, issuing shares or distributing dividends

↳ Examples of Cash Inflows

→ Issuing new shares

→ Taking out loans or bonds

→ Capital contributed by owners

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↳ Example Cash Outflow

- Repayments of loans or interest
- Paying dividends
- Buying back company shares

Net Change in Cash:

$$\text{Net increase (or decrease)} = \text{CFO} + \text{CFI} + \text{CFF}$$

in Cash

This is added to the Opening Cash Balance (from last period) to find the Closing Cash Balance

$$\text{Closing Cash} = \text{Opening Cash} + \text{Net change}$$

in Cash

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AL-JAZEERA Ltd

Cashflow Statement for the Year Ended 31<sup>st</sup> Dec 2025

Cashflow from Operating Activities (CFO)

Net Profit	\$ 70,000
+ Depreciation (non-cash)	\$ 10,000
- Increase in Acc. Receivable	\$ (5,000)
+ Increase in Acc Payable	\$ 3000
<u>Net Cash from Operating Activities</u>	<u>\$ 78,000</u>

Cashflows from Investing Activities (CFI)

- Purchase of Equipment	\$ (40,000)
+ Sale of Old Computer	\$ 5,000
<u>Net Cash used in Investing Activities</u>	<u>\$ (35,000)</u>

Cashflow from Financing Activities (CFF)

+ Loan from Bank	\$ 20,000
- Dividends Paid	\$ (10,000)
<u>Net Cash from Financing Activities</u>	<u>\$ 10,000</u>

<u>Net Increase in Cash</u>	<u>\$ 53,000</u>
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<u>Opening Cash</u>	<u>\$ 10,000</u>
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<u>Closing Cash Balance</u>	<u>\$ 63,000</u>
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" MANAGEMENT ACCOUNTING "Financial Accounting

- ① Reports overall company financial positions
- ② Audience are investors, regulators & partners
- ③ It gives historical (past performance)
- ④ Err Pnl, Balance Sheet,

Management Accounting

- ④ Supports internal management decisions
- ② Managers, internal teams
- ③ Forward-looking (future planning)
  - ① Budgets, Forecasts, Cost analysis

- Annual Salary: 30,000
- Insurance = 2,500
- Pension = 1,500
- Total Annual Cost =  $30,000 + 2,500 + 1,500 = 34,000$
- Rev earning hr = 1500 hr/yr
- Hourly cost =  $34,000 / 15000 = 22.67 \text{ p\$}$



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Units Produced	Product A	Product B
Direct Labor /unit	100 units	50 units
Direct cost /unit	2 hrs	6 hrs
	\$100	\$100

∴ Total Overhead  $\rightarrow \$12,000$

### ① Fixed Overhead /Unit

$$\text{Overhead Cost} = \frac{\$12,000}{\$150}$$
$$= 80\$ \text{ /unit}$$

$$\text{Product A} \rightarrow 80\$ + \$100 = 180\$$$

$$\text{Product B} \rightarrow 80\$ + \$100 = \$180$$

### ② Overhead Proportional to Labor Hrs.

$$\text{Overhead rate /hr} = \frac{12000}{(100 \times 2) + (50 \times 6)} = \$24/\text{hr}$$

$$\text{Product A} \rightarrow 2 \times \$24 = \$48 \text{ overhead /unit}$$

$$\text{Product B} \rightarrow 6 \times \$24 = \$144$$

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• DATA:

↳ No. of employees = 3  
↳ Annual cost / employee = ~~\$700~~ \$19/hr

↳ Total productive hrs / employee per yr = 17,00

↳ Target sales = 600 bats

↳ Annual Fixed overhead = \$96,000

	Basic	Advantage	Pro Series
Material Cost	\$48	\$92	\$175
Production time	5 hrs	9 hrs	15 hrs
Expected Sales	260 units	200 units	170 units

(1) Fixed Cost Per Unit:

$$= \$96,000 / 600 = \$160 \text{ /unit overhead}$$

$$\text{Basic} \rightarrow \$160 + \$48 + 5 \text{ hrs} \times \$19 = 303$$

$$\text{Adv} \rightarrow \$160 + \$92 + 9 \text{ hrs} \times \$19 = 423$$

$$\text{Pro} \rightarrow \$160 + \$175 + 15 \text{ hrs} \times \$19 = 620$$

(2) Overhead Proportional to Labor Hr

$$= \$96,000 / 3 \times 17,00 = 18.82 \text{ overhead}$$

$$= 18.82 + \$19 = 37.82 \text{ on labor}$$

$$\text{Basic} \rightarrow \$48 + 5 \text{ hrs} \times 37.82 = 237$$

$$\text{Adv} \rightarrow \$92 + 9 \text{ hrs} \times 37.82 = 432$$

$$\text{Pro} \rightarrow \$175 + 15 \text{ hrs} \times 37.82 = 742$$

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### (3) Overhead Proportional To Direct Cost.

Total Direct Cost of Each Product

$$\text{Basic} \rightarrow \$48 + 5 \text{ hrs} \times 19 = 143$$

$$\text{Adv} \rightarrow \$92 + 9 \text{ hrs} \times 19 = 263$$

$$\text{Pro} \rightarrow \$175 + 15 \text{ hrs} \times 19 = 460$$

Total Direct Costs:

$$260 \times 143 + 200 \times 263 + 140 \times 460 \\ = \$154180$$

Total Overhead Cost + 1

~~or~~ Total Direct Cost /

$$= 96,000 / 154180 + 1$$

$$= 0.62 + 1 = 1.62$$

$$\text{Basic} \rightarrow 143 \times 1.62 = 231$$

$$\text{Adv} \rightarrow 263 \times 1.62 = 426$$

$$\text{Pro} \rightarrow 460 \times 1.62 = 745$$

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## "INVESTMENT APPRAISAL"

- Projected Cashflows
  - Year 1 : \$100,000
  - Year 2 : \$110,000
  - Year 3 : \$120,000
  - Year 4 : \$130,000
  - Year 5 : \$140,000

- Inflation Rate → 3%
- Discount Rate (Interest Rate) → 8%

Real

→ First we will calculate ~~Present~~ Value of each cash flow for each year with inflation

Year	Nominal CP	Real CP (3% inflation)
1	\$100,000	$\$100,000 / (1+0.03)^1$ = \$97,087
2	\$110,000	$\$110,000 / (1+0.03)^2$ = \$103,683
3	\$120,000	$\$120,000 / (1+0.03)^3$ = \$109,800
4	\$130,000	$\$130,000 / (1+0.03)^4$ = \$105,485
5	\$140,000	$\$140,000 / (1+0.03)^5 = \$120,726$

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Calculate Present Value (P.V. disc rate)

$$PV = \text{Real Cash Flow} \div (1 + \text{dis rate})^n$$

Year	Real CP	Present Value
1	\$97,087	\$97,087 / (1.08) = \$89,895
2	\$103,683	\$103,683 / (1.08)^2 = \$88,924
3	\$109,800	\$109,800 / (1.08)^3 = \$87,142
4	\$115,485	\$115,485 / (1.08)^4 = \$84,920
5	\$120,726	\$120,726 / (1.08)^5 = \$82,166

$$\begin{aligned} \text{Total PV} &= \$89,895 + \$88,924 + \$87,142 + \\ &\quad \$84,920 + \$82,166 \\ &= \$433,047 \end{aligned}$$

$$NPV = \text{Total PV} - \text{Initial Investment}$$

↳ if  $NPV > 0 \rightarrow$  should proceed with investment

$NPV < 0 \rightarrow$  should reject

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### → Discounted Cash Flow (DCF) :

↳ Method to evaluate the investment projects by discounting future cash flows to their present value

$$PV = \frac{\text{Future Value of Money}}{(1 + \text{interest rate})^{\text{year}}}$$

$$\text{Discount Factor} = \frac{1}{(1 + \text{Interest rate})^{\text{years}}}$$

→ a multiplier used to convert future cashflows into present values adjusting for time value of money

### → Payback Period

↳ Financial metric used to evaluate how long it takes for the cashflows generated by an investment to cover its initial cost.

Year	Inflow	Cumulative
0	-400,000	-40,000
1	+10,000	-30,000
2	+15,000	-15,000
3	+20,000	-5,000

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- We simply add the inflows year by year until the investment is fully recovered.
- We start adding inflow from Year #01 becz ~~Year 00 + Year 01~~ on year 0 we invested not earned.

$$\text{Year 1} + \text{Year 2} = 25,000$$

At end of year 2, 15,000 still remains

$$\begin{aligned}\text{Payback Period} &= \frac{\text{Years Before Recovery}}{\text{Cash inflow during recovery year}} \\ &= \frac{2 + \frac{15,000}{20,00}}{20,00} \\ &= 2.75 \text{ yrs}\end{aligned}$$

2<sup>nd</sup> year

Amount still recovered at start of recovery year

cash inflow during recovery year

20,000

→ Internal Rate of Return

↳ The value of discount (interest rate) at which the NPV of all cashflows from a project equals zero  
↳ Interest rate that balances the cash inflows & outflows

$$\delta_{\text{month}} = (1 + \text{interest rate})^{\frac{1}{12}} - 1$$

$$\delta_{\text{week}} = (1 + \text{interest rate})^{\frac{1}{52}} - 1$$

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### → Real Rate

↳ It represents the true incs. in purchasing power you gain from an investment after accounting for inflation

$$\text{Real Rate} = \frac{1 + \text{Nominal (Interest) Rate} - 1}{1 + \text{Inflation Rate}}$$

$$\text{Nominal interest rate} = 10\% (0.10)$$

$$\text{Inflation rate} = 5\% (0.05)$$

$$\text{Real rate} = \frac{1.10 - 1}{1.05} = 4.76\%$$

So, even though your investment "grows" by 10%. real purchasing power, you have gained only 4.76%.

### → Pitfalls of DCF

- ① Over-reliance on accuracy
- ② Cashflow predictions are uncertain
- ③ Sensitivity to key assumptions
- ④ Assume accurate timings of cashflow