

# Basic understanding of a company's financial statements

September 2020



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# What are financial statements?

# The financial statements

Financial statements are written records that illustrates the business activities and the financial performance of a company. In most cases they are audited to ensure accuracy for tax, financing, or investing purposes.

A methodically work through of the three financial statements in order to assess the Financial health of a company.



## Balance Sheet

- Statement of financial position

**Balance Sheet is a snapshot** at a point in time. On the top half you have the company's assets and on the bottom half its liabilities and Shareholders' Equity (or Net Worth). The assets and liabilities are typically listed in order of liquidity and separated between current and non-current.



## Income Statement

- Statement of operation/profit and loss

**The income statement** covers a period of time, such as a quarter or year. It illustrates the profitability of the company from an accounting (accrual and matching) perspective. It starts with the revenue line and after deducting expenses derives net income.






## Statement of Cash Flows

**The cash flow statement** look at the cash position of the company . It answers it answers the questions ; How much of the organisation's cash goes to its creditors and shareholders? Does it keep enough for its own investment and growth? has 3 components cash from operations, cash used in investing, and cash from financing. It "undoes" all of the accounting principles and shows the cash flows of the business.

# Balance sheet

# Balance sheet

The Balance sheet has 3 main categories:

	Assets
	Liabilities
	Equity

## Simplified Balance Sheet

### Assets

#### Current assets

Cash	20,000
Accounts receivable	3,000
Inventory	60,000
Prepaid expenses	11,000
<b>Total current assets</b>	<b>94,000</b>

#### Non current assets

Property plant & equipment	110,000
Intangible assets	10,000
<b>Total non current assets</b>	<b>120,000</b>
<b>Total assets</b>	<b>214,000</b>

### Liabilities

#### Current liabilities

Accounts payable	2,000
Accrued expenses	1,000
<b>Total current liabilities</b>	<b>3,000</b>
Non current liabilities	11,000
Bank loan	100,000

#### Shareholder equity

Common shares	89,000
Retained Earnings	11,000
<b>Total liabilities and shareholders equity</b>	<b>214,000</b>

## Current vs non-current

### Current



#### Assets

- Expected to be converted into cash in less than 1 year
- Accounts receivable, inventory



#### Liabilities

- Will be paid in less than 1 year
- Trade accounts payable

### Non-current



#### Assets

- Expected to be held greater than 1 year
- Property, plant, and equipment



#### Liabilities

- Repayment terms longer than 1 year
- Loan repayable over a 5 year

# Illustrative balance sheet (assets )

Consolidated Statement of Financial Position  
Year ended 30 June 2019

J\$'000	2018	2019
<b>Assets</b>		
<b>Current Assets</b>		
Inventories	2,199,273	3,225,686
Receivables and prepayments	2,302,693	2,585,519
Investment securities	269,530	130,385
Cash and short-term deposits	3,968,075	3,974,545
	<b>8,739,571</b>	<b>9,916,135</b>
<b>Non-Current Assets</b>		
Property, plant and equipment	6,775,727	6,724,278
Investment in associates	-	593,961
Loans receivable	-	165,545
Investment securities	215,760	379,060
	<b>6,991,487</b>	<b>7,862,844</b>
<b>Total Assets</b>	<b>15,731,058</b>	<b>17,778,979</b>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Trade and other payables	3,873,904	3,336,064
Short-term borrowings	376,686	485,724
Taxation payable	362,940	444,969
	<b>4,613,530</b>	<b>4,266,757</b>
<b>Non-Current Liabilities</b>		
Deferred tax liabilities	257,430	213,511
Borrowings	2,169,937	2,213,130
	<b>2,427,367</b>	<b>2,426,641</b>
<b>Total Liabilities</b>	<b>7,040,897</b>	<b>6,693,398</b>
<b>Equity</b>		
<b>Capital and reserves attributable to the company's equity holders</b>		
Share capital	1,192,647	1,192,647
Capital reserve	119,946	130,832
Translation reserve	30,086	29,048
Retained earnings	7,347,482	9,733,054
<b>Total Equity</b>	<b>8,690,161</b>	<b>11,085,581</b>
<b>Total Liabilities and Equity</b>	<b>15,731,058</b>	<b>17,778,979</b>

## Current



### Assets

- Expected to be converted into cash in less than 1 year
- Accounts receivable, inventory

## Non-current



### Assets

- Expected to be held greater than 1 year
- Property, plant, and equipment

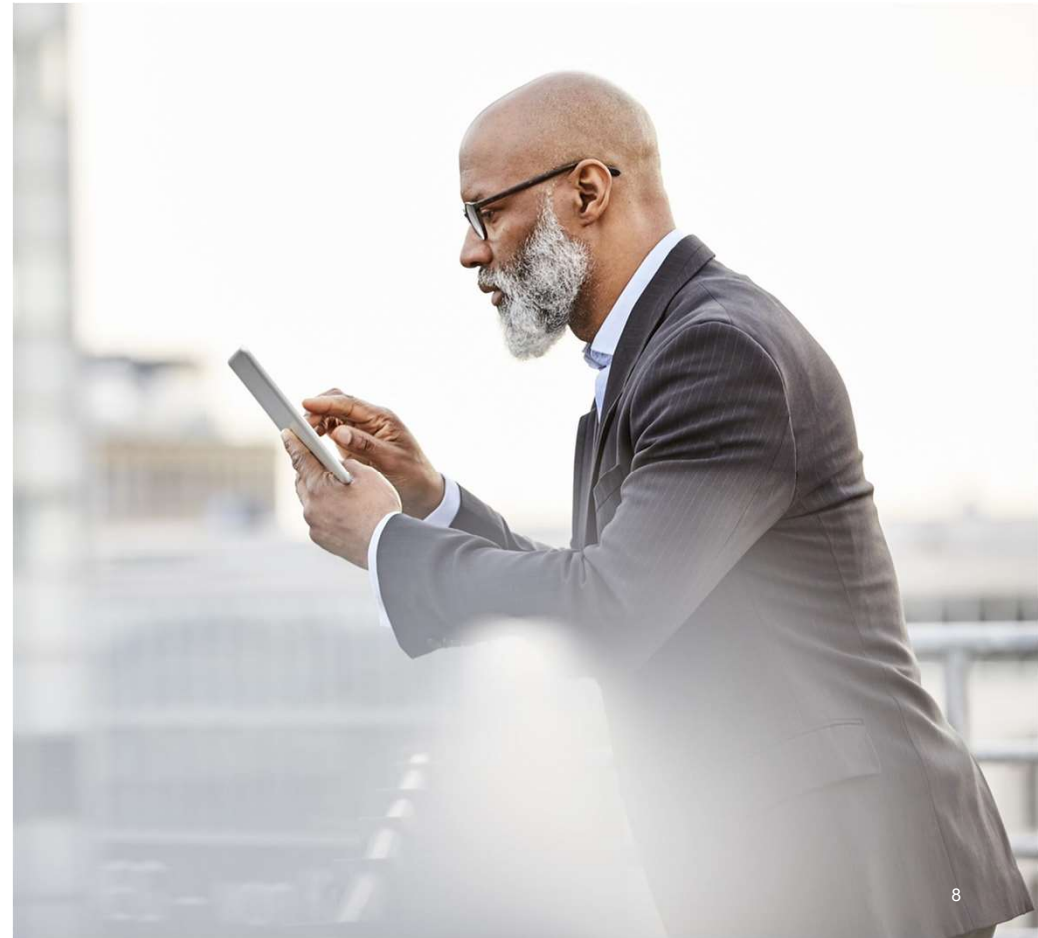
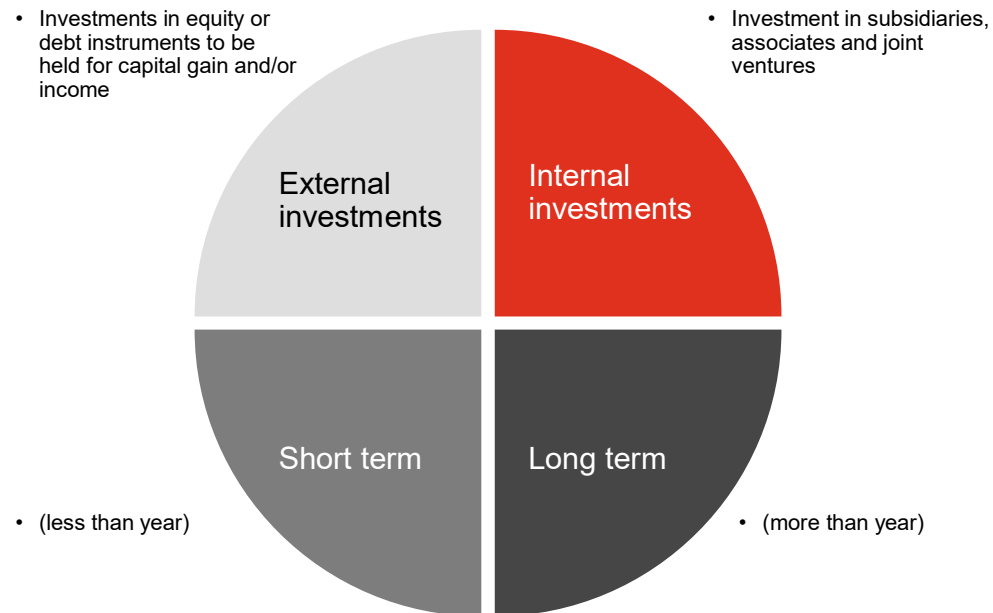
See accompanying notes.

# Cash and investments

A company will hold external investments for two reasons:

- Excess cash
- Accumulating cash to make a large purchase

A company can also make internal investments





# Other assets

## Goodwill

- Non-current asset
  - Company has intangible Value  
e.g. brand, customers, intellectual capital
- If a company is purchased for more than the fair value of net assets (assets less liabilities):

Purchase price	X
Fair value of net assets acquired	(X)
Goodwill	X

## Intangible Asset

Intangible assets are items of value that are used to **generate revenues and have no physical substance.**

Trademarks

Patents

Copyrights

## Unearned/Differed Revenue

Unearned revenue arises when a company sells something it has not yet delivered **e.g. licenses, subscriptions** 12 month subscription sold for \$1,200 in January:

Earned:	\$100	\$300	\$600	\$900	\$1,200
	Jan	Mar	Jun	Sep	Dec
Unearned	\$1,100	\$900	\$600	\$300	\$0

Source CFI

# Illustrative balance sheet (liabilities)

Consolidated Statement of Financial Position  
Year ended 30 June 2019

J\$'000	2018	2019
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<b>Current Assets</b>		
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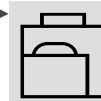
## Current



### Liabilities

- Will be paid in less than 1 year
- Trade accounts payable

## Non-current



### Liabilities

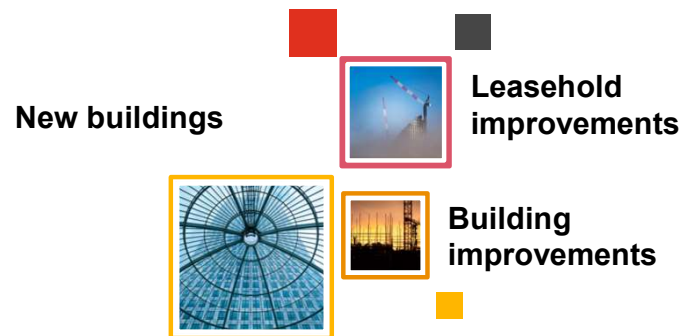
- Repayment terms longer than 1 year
- Loan repayable over a 5 year period

See accompanying notes.

# Other liabilities

## Commitments

Commitments are future obligations that a company agrees to.



## Contingencies

Contingencies are liabilities that may or may not happen, depending on circumstance.

**e.g. lawsuit**

The liability must be recorded if:

1. A **loss** will be suffered in the future
2. The loss **amount** can be reasonably estimated

If not, just disclose a note.

Contingent gains are never recorded in financial statements.



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# Illustrative balance sheet (statement of shareholder's equity)

## Consolidated Statement of Financial Position Year ended 30 June 2019

J\$'000	2018	2019
<b>Assets</b>		
<b>Current Assets</b>		
Inventories	2,199,273	3,225,686
Receivables and prepayments	2,302,693	2,585,519
Investment securities	269,530	130,385
Cash and short-term deposits	3,968,075	3,974,545
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<b>Non-Current Assets</b>		
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Investment in associates	-	593,961
Loans receivable	-	165,545
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<b>Equity</b>		
<b>Capital and reserves attributable to the company's equity holders</b>		
Share capital	1,192,647	1,192,647
Capital reserve	119,946	130,832
Translation reserve	30,086	29,048
Retained earnings	7,347,482	9,733,054
<b>Total Equity</b>	<b>8,690,161</b>	<b>11,085,581</b>
<b>Total Liabilities and Equity</b>	<b>15,731,058</b>	<b>17,778,979</b>

## Consolidated Statement of Changes in Equity Year ended 30 June 2019

	Attributable to Equity Holders of the Company					Non-Controlling Interest	Total Equity
	Number of shares '000	Share Capital \$'000	Capital Reserves \$'000	Retained Earnings \$'000	Translation Reserve \$'000	\$'000	\$'000
<b>Balance at 1 July 2017</b>	3,600,585	57,927	116,218	7,377,182	3,233	5,740	7,560,300
Net profit	-	-	-	2,292,961	-	(36)	2,292,925
Unrealised gain on investments	-	-	3,728	-	-	-	3,728
Exchange differences on translating foreign subsidiary	-	-	-	-	26,853	-	26,853
<b>Total comprehensive income</b>	-	-	<b>3,728</b>	<b>2,292,961</b>	<b>26,853</b>	<b>(36)</b>	<b>2,323,506</b>
Sale of ordinary shares (IPO)	149,415	1,134,720	-	-	-	-	1,134,720
<b>Transactions with owners -</b>							
Dividends paid	-	-	-	(1,304,933)	-	-	(1,304,933)
Transfer to owners consequent on reorganisation	-	-	-	(1,017,728)	-	(5,704)	(1,023,432)
<b>Balance at 30 June 2018</b>	<b>3,750,000</b>	<b>1,192,647</b>	<b>119,946</b>	<b>7,347,482</b>	<b>30,086</b>	-	<b>8,690,161</b>
Net profit	-	-	-	2,929,322	-	-	2,929,322
Unrealised gain on investments	-	-	10,886	-	-	-	10,886
Exchange differences on translating foreign subsidiary	-	-	-	-	(1,038)	-	(1,038)
<b>Total comprehensive income</b>	-	-	<b>10,886</b>	<b>2,929,322</b>	<b>(1,038)</b>	-	<b>2,939,170</b>
<b>Transactions with owners -</b>							
Dividends paid	-	-	-	(543,750)	-	-	(543,750)
	-	-	<b>10,886</b>	<b>2,385,572</b>	<b>(1,038)</b>	-	<b>2,395,420</b>
<b>Balance at 30 June 2019</b>	<b>3,750,000</b>	<b>1,192,647</b>	<b>130,832</b>	<b>9,733,054</b>	<b>29,048</b>	-	<b>11,085,581</b>

See accompanying notes.

# Common vs preferred shares

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Year ended 30 June 2019

J\$'000	2018	2019
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<b>Current Assets</b>		
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Receivables and prepayments	2,302,693	2,585,519
Investment securities	269,530	130,385
Cash and short-term deposits	3,968,075	3,974,545
	<b>8,739,571</b>	<b>9,916,135</b>
<b>Non-Current Assets</b>		
Property, plant and equipment	6,775,727	6,724,278
Investment in associates	-	593,961
Loans receivable	-	185,545
Investment securities	215,760	379,060
	<b>6,991,487</b>	<b>7,862,844</b>
<b>Total Assets</b>	<b>15,731,058</b>	<b>17,778,979</b>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Trade and other payables	3,873,904	3,336,064
Short-term borrowings	376,686	485,724
Taxation payable	362,940	444,969
	<b>4,613,530</b>	<b>4,266,757</b>
<b>Non-Current Liabilities</b>		
Deferred tax liabilities	257,430	213,511
Borrowings	2,169,937	2,213,130
	<b>2,427,367</b>	<b>2,426,641</b>
<b>Total Liabilities</b>	<b>7,040,897</b>	<b>6,693,398</b>
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<b>Total Liabilities and Equity</b>	<b>15,731,058</b>	<b>17,778,979</b>

See accompanying notes.

J\$'000	2018	2019
<b>Share Capital</b>		
<b>Authorised –</b>		
4,000,000,000 (2018 – 4,000,000,000) Ordinary stock units		
<b>Issued and fully paid –</b>		
3,750,000,000 (2018 – 3,750,000,000) Ordinary stock units at no par value		
	<b>1,192,647</b>	<b>1,192,647</b>

## Authorised shares

- The total number of shares a company can sell

## Outstanding (Issued) shares

- The total number of shares a company has sold/issued

## Common shares

- Allow for participation in the profits of the company
  - Comes in the form of a dividend
- Allow for voting rights in a company
  - One vote for every share held
- If dissolved, any residual amount after everyone else is paid would go to the common shareholders

## Preferred shares

- Offer investors a fixed dividend
  - It may not be paid annually
- Will accumulate/pay before common share dividends
- Most businesses don't issue because they are viewed as debt with a tax disadvantage
  - Dividends do not reduce taxable income

# Aspects of the equity

## Contributed Surplus



e.g. 180,000 shares 40¢/each 25¢/par

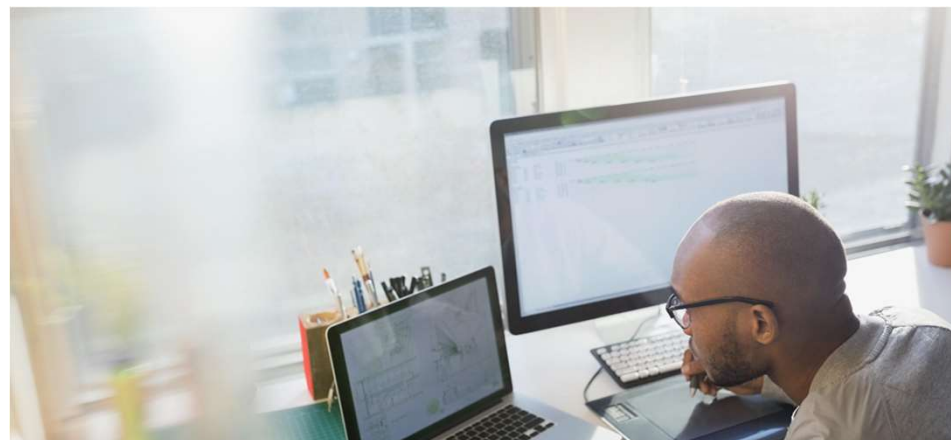
Paid-up share capital (180,000 x 25¢)	\$45,000
Contributed surplus (180,000 x 15¢)	\$27,000

## Other comprehensive income

### Other comprehensive income (OCI):

- certain company gains and losses that are not always recorded through the income statement

e.g. **unrealised gains** and losses on investments and hedging instruments



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# Understanding the income statement and cash flow



# Income statement



# Income Statement

The Income statement has 3 main sections:



**Revenues**



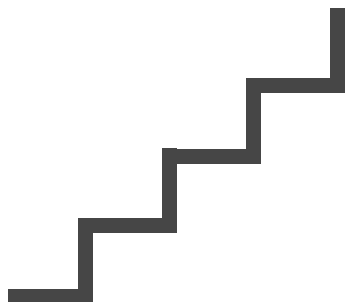
**Expenses**



**Profit or loss**



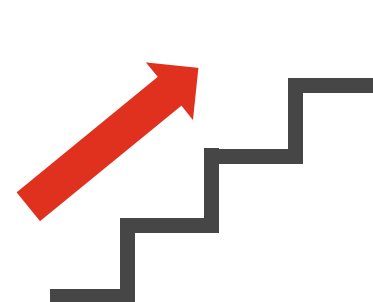
# Single step vs multi-step income statements



## Single Step

Example:	
Revenue (+)	
Gains (+)	
Total revenue	
Cost of Goods Sold (-)	
Selling, General & Administrative (-)	
Losses (-)	
Other Expenses	
Total expenses	
Income taxes (-)	
Net income	

VS



## Multiple Step

Example:	
Revenue (+)	
Cost of Goods Sold (-)	
Gross Profit	
Selling, General & Administrative (-)	
Operating income	
Gains (+)	
Losses (-)	
Other Expenses (-)	
Pre-tax income	
Income taxes (-)	
Net income	

# The Illustrative income statement

## Consolidated Statement of Comprehensive Income Year ended 30 June 2019

J\$'000	2018	2019
Revenue	24,544,049	28,412,414
Cost of sales	(15,421,144)	(17,878,208)
<b>Gross Profit</b>	<b>9,122,905</b>	<b>10,534,206</b>
Other operating income	92,157	288,656
Selling and distribution expenses	(5,412,601)	(6,124,947)
Administration expenses	(956,683)	(1,097,978)
<b>Operating Profit</b>	<b>2,845,778</b>	<b>3,599,937</b>
Finance income	130,837	119,218
Finance costs	(211,411)	(230,205)
Share of results of associates	-	7,792
<b>Profit before Taxation</b>	<b>2,765,204</b>	<b>3,496,742</b>
Taxation	(513,834)	(567,420)
<b>Profit for the year from continuing operations</b>	<b>2,251,370</b>	<b>2,929,322</b>
Profit from discontinued operations	41,555	-
<b>Net Profit</b>	<b>2,292,925</b>	<b>2,929,322</b>
<b>Other Comprehensive Income</b>		
Items that may be subsequently reclassified to profit or loss		
Exchange differences on translation of foreign subsidiary	26,853	(1,038)
Unrealised gains on investment securities	3,728	10,886
<b>Total Comprehensive Income</b>	<b>2,323,506</b>	<b>2,939,170</b>
<b>Net Profit attributable to:</b>		
Stockholders of Wisynco Group Limited	2,292,961	2,929,322
Non-controlling interest	(36)	-
	<b>2,292,925</b>	<b>2,929,322</b>
<b>Total Comprehensive Income attributable to:</b>		
Stockholders of Wisynco Group Limited	2,323,542	2,939,170
Non-controlling interest	(36)	-
	<b>2,323,506</b>	<b>2,939,170</b>
<b>Earnings Per Stock Unit from continuing and discontinued operations attributable to stockholders of the Group</b>		
From continuing operations	\$ 0.61	\$ 0.78
From discontinued operations	\$ 0.01	\$ -
	<b>\$ 0.62</b>	<b>\$ 0.78</b>



Operating Profit



OCI-other gains and losses



EPS –Investor Ratio



Net Operating Profit

# Cost of sales

## Cost of goods sold or Cost of sales:

- May be shown as summarised line item
- May be broken Down to its expense items



### Direct Materials

(e.g. materials used in manufacturing)



### Direct Labor

(e.g. professional services delivered)



### Direct overhead

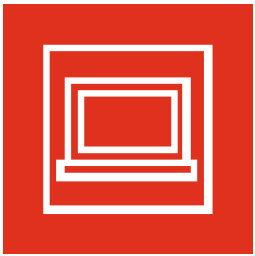
(to the production of the goods or services)



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# Selling, general and administrative expenses.

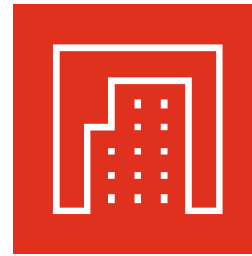
**Selling, general and administrative**, or SG&A contains a large number of expense items such as:



**Advertising and promotion** cost



**Legal, Insurance** and accounting expenses.



**Office supplies**



**Other related expenses.**

*Source CFI*

# Gains and losses

Gains and losses may appear separately or grouped after all operating items under “other income or expenses”. **They are related to activities that are incidental to operations such as:**



**Sale of Investments**

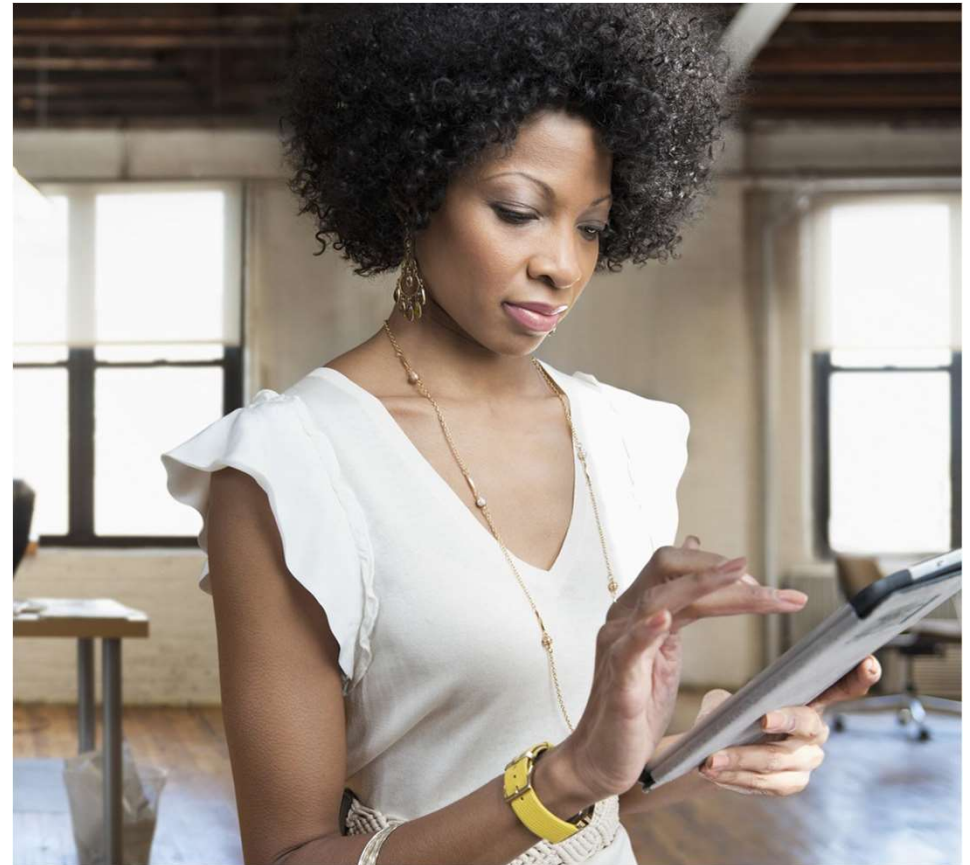


**Foreign exchange translations**



**Financial Instrument transactions**

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# Other aspects of the Income Statement

## Other comprehensive income

### Other comprehensive income (OCI):

- certain company gains and losses that are not always recorded through the income statement

e.g. **unrealised gains** and losses on investments and hedging instruments



Source CFI

# Cashflow statement



# The cash flow statement

**Statement of cash flows** demonstrates:

- Where cash is being generated
- Where cash is being used in the business



## Operating

### Day-to-day business operations;

Revenues and expenses that have been collected and paid during the year

Depreciation and amortisation are **not** included.



## Investing

**Non-current assets** that support the business:

- Property, plant and equipment
- Business acquisitions



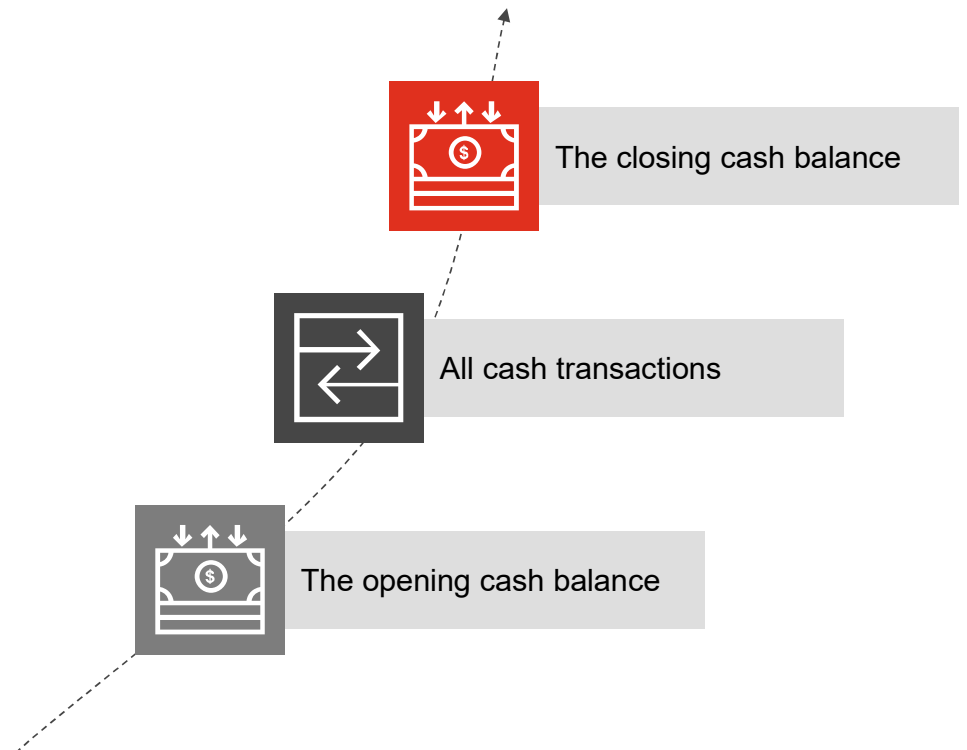
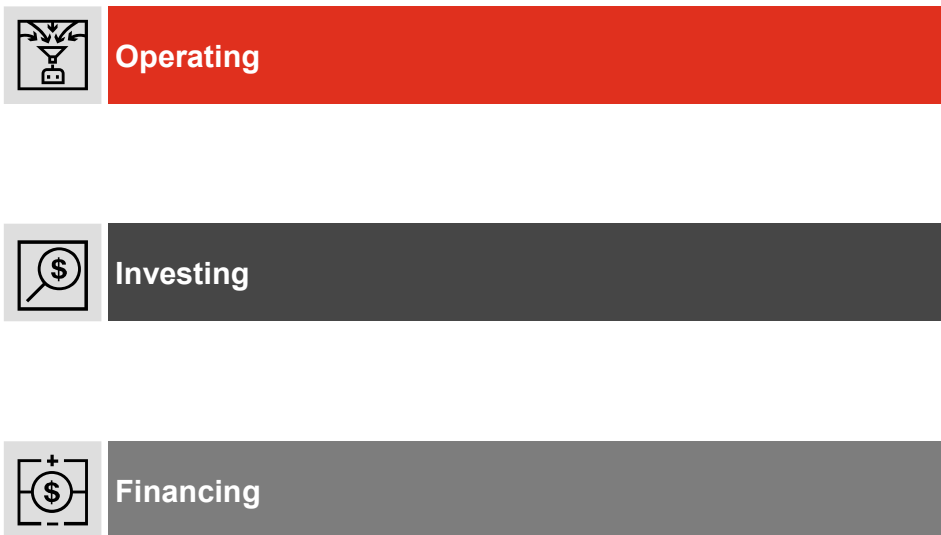
## Financing

Transactions regarding **shares** or **debt**.

Company raises funds by either **borrowing** or **issuing shares**.

# Statement of Cash Flows

The transactions are **sorted by activity type**:



# Direct method vs Indirect method

## Direct method

### Operating activities

Cash collected from customers  
Cash paid to suppliers  
Cash paid to employees

### Cash flow from operating activities

### Investing activities

Purchase of equipment  
Disposal of property

### Cash flow from investing activities

### Financing activities

Issuance of shares  
Repayment of debt

### Cash flow from financing activities

### Net movement in cash

=

## Indirect method

### Operating activities

Net income  
Add back depreciation and amortization  
Adjust change in working capital balances

### Cash flow from operating activities

### Investing activities

Purchase of equipment  
Disposal of property

### Cash flow from investing activities

### Financing activities

Issuance of shares  
Repayment of debt

### Cash flow from financing activities

### Net movement in cash

**Direct method** of cash flow starts with **cash transactions**.  
(Transactions are separated into **cash received** and **cash paid**.)

**Indirect method** of cash flow starts with **net income**.  
(Non-cash adjustments are then added.)

# Key elements in a cash flow statement

## Net cash provided by operating activities

Represents operating 'lifeblood' of business after paying necessary outgoings for financing and tax

## Changes in working capital

Shows whether business is absorbing funds for working capital or releasing them. Trend may indicate either financial stress or loose control over working capital

## PPE Investment

Companies must invest in PPE to maintain their productive capacity. A downward trend may indicate a declining company. Identify the necessary sustainable level of expenditure.

## Financing requirement/surplus

Shows whether internally generated funds are sufficient to cover investments made in fixed assets and businesses. Continuous deficits indicate that growth depends on regular injections of external finance.

# The Full Disclosure Principle

## Consolidated Statement of Financial Position Year ended 30 June 2019

J\$'000	2018	2019
<b>Assets</b>		
<b>Current Assets</b>		
Inventories	2,199,273	3,225,686
Receivables and prepayments	2,302,693	2,585,519
Investment securities	269,530	130,385
Cash and short-term deposits	3,968,075	3,974,545
	<b>8,739,571</b>	<b>9,916,135</b>
<b>Non-Current Assets</b>		
Property, plant and equipment	6,775,727	6,724,278
Investment in associates	-	593,961
Loans receivable	-	165,545
Investment securities	215,760	379,060
	<b>6,991,487</b>	<b>7,862,844</b>
<b>Total Assets</b>	<b>15,731,058</b>	<b>17,778,979</b>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Trade and other payables	3,873,904	3,336,064
Short-term borrowings	376,686	485,724
Taxation payable	362,940	444,969
	<b>4,613,530</b>	<b>4,266,757</b>
<b>Non-Current Liabilities</b>		
Deferred tax liabilities	257,430	213,511
Borrowings	2,169,937	2,213,130
	<b>2,427,367</b>	<b>2,426,641</b>
<b>Total Liabilities</b>	<b>7,040,897</b>	<b>6,693,398</b>
<b>Equity</b>		
<b>Capital and reserves attributable to the company's equity holders</b>		
Share capital	1,192,647	1,192,647
Capital reserve	119,946	130,832
Translation reserve	30,086	29,048
Retained earnings	7,347,482	9,733,054
	<b>8,690,161</b>	<b>11,085,581</b>
<b>Total Equity</b>	<b>8,690,161</b>	<b>11,085,581</b>
<b>Total Liabilities and Equity</b>	<b>15,731,058</b>	<b>17,778,979</b>

See accompanying notes.

For full disclosure:



Notes are provided to allow the reader of the financial statements to understand and make judgements of financial activities of the company.

# Three Key Financial Statements Notes

## Significant Accounting Policies



Company accounting standards



How inventory & investments are valued



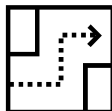
Financial instruments



Revenue is recognized



Property, plant & equipment is amortized



Any other policies

## Direct Information



A breakdown of the types of investments



Debt and financial instruments

### What is included in:

Inventory

Intangible assets

PP&E

Income taxes

## Indirect Information

### Indirect Information

Notes of indirect information:

- Help provide the entire financial picture of an organisation
- Not related to the numbers in the financial statements

Commitments

Contingencies

Stock based compensation plans

# Ratio Analysis

**The Ratio analysis** is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements such as the balance sheet and income statement. Ratio analysis is a cornerstone of fundamental equity analysis.



## Performance Ratio

- Net Profit margin,
- return on assets (ROA)
- return on equity (ROE)
- return on capital employed (ROCE),
- gross margin ratios
- Efficiency (



## Solvency Ratios

- Solvency Ratios
- **Current ratio = Current assets / Current liabilities**
- Leverage or Gearing
- Operating cash flow / Interest paid
- Operating cash **flow / Dividends paid**
- Operating cash flow / Operating profit



## Investor Ratios

- Dividend yield,
- P/E ratio,
- earnings per share (EPS),
- dividend payout ratio

# The benefits of an annual report

**The annual report contains** a significant amount of information:



## Financial

- Management discussion & analysis(MD&A)
- Financial statements
- Notes to financial statements



## Non-financial

- Messages from the Chair, CEO
- Corporate profile
- MD&A
- Risk and control processes and analysis





# Contents of an annual report

The annual report will always include:

**01.**

Letters to the  
shareholders

**02.**

Business description

**03.**

Management's  
Discussion and  
Analysis (MD&A)

**04.**

Reporting on internal  
controls

**05.**

Audit report

**06.**

Balance sheet,  
Income Statement  
and Statement of  
Cash Flows

**07.**

Notes to the financial  
statements

**08.**

Earnings per share

**09.**

Earnings per share  
Listing of directors of  
the company

# Management discussion and analysis

**MD&A** provides information regarding past performance and future strategic direction

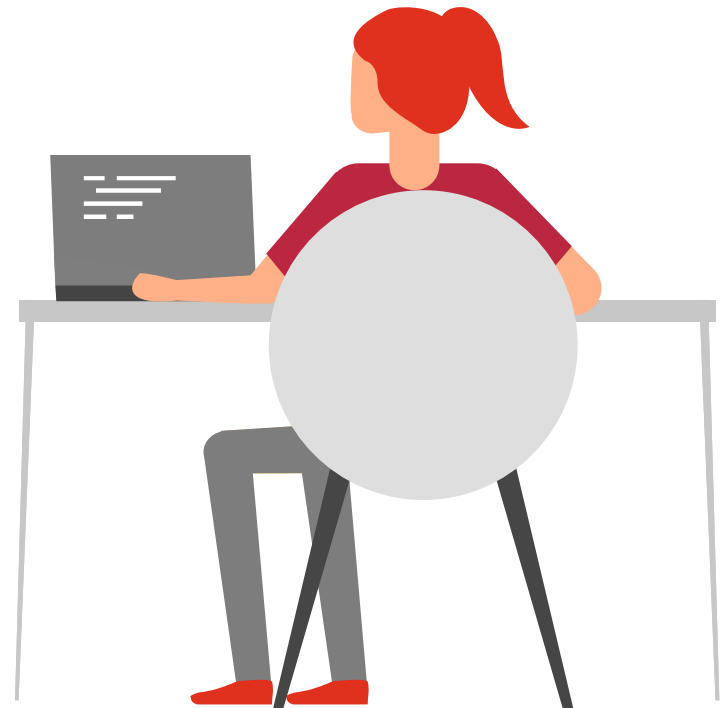
Acts as sort of variance analysis

Explains company performance

Lists future actions to be taken

Identifies the key risk facing the organization

*Source CFI*



# Thank you

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