

## 01. Financial Statements

**Consolidated Financial Statements** - Financial information about the group of companies including parent and subsidiaries  
How does a parent company control subsidiary?

- Own a controlling interest of subsidiary's share

- Remaining shares are **Non controlling interest** - Separated, under book value

**Associate Companies** - Interest in shares outside group that wields significant influence

- Includes one-line partial consolidation of associate company in book value

- Recorded using equity method

### Consolidated Balance Sheet

Purpose

- Report net worth of group at specific date

### Fundamental Accounting Equation

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

**Assets** Resource controlled by company (eg. cash, accounts receivable, inventory, land, equipment, buildings)

**Liabilities** Amount owed to others leading to outflow of resources (eg. accounts payable, expenses)

**Equity** Owner's claim on residual interest after deducting liabilities

### Problems

- Not market value
  - Does not tell what the equity is worth in market
  - Market value = market share price \* outstanding shares
- Mixed measurement model - Mathematically dubious calculation
  - Property measured using **cost less depreciation** - amount originally paid less depreciation, OR current market value

### Motivation

- Comparing
  - Compare companies using **Market-to-book ratio** -  $\frac{\text{Market value}}{\text{Total equity}}$
  - Why are they not the same?
    - Market takes into account future prospects not captured by book value
- Details
  - Provides useful information

### Statement of Changes in Equity

Lists impact of events on changes in equity

### Factors

- Contributions from shareholders
- Distributions to shareholders
- Business income/expenses
- Capital maintenance adjustments** - Remeasurement of asset/liability value

### Statement of Comprehensive Income

- Comprehensive Income** - Reflects changes of equity from non-owner sources and traditional income
- Show all operating and financial events that affect non-owners' interest in business
- Includes unrealised gains and losses

### Income Statement

Includes information about business income and expenses for the year

### Statement of Cash Flows

**Accrual Basis** - Record values when exchange of goods and services NOT cash flows

### Subsections

- Operating activities
- Investing activities
- Financing activities** - Borrowing or issuing shares (eg. repayments, share buybacks)

### Item Breakdown

**Current assets/liabilities** Likely to be converted to cash/settled within a year

**PPE** Property, plant and equipment used in business

**Right-of-use assets** Rented premises for business (Asset)

**Lease liabilities** Outstanding rental payments wrt ROU assets

**Trade Receivables** Outstanding dues from **credit** customers

**Cost of Goods Sold(COGS)** Amount paid to suppliers for goods sold to customers

**Gross Profit** = COGS - Sales

**Interest Income and expense** Profit from investing and financing activities

## 02. Ratios

- Comparing companies as investment opportunities
- Comparing previous years to measure progress
- Overcome difference in scale

### Profitability Ratios

- Measures performance of company over the year

**Profit Margin**  $\frac{\text{Net Profits}}{\text{Net sales (revenue)}}$

**Return on total assets**  $\frac{\text{Net Profit}}{\text{Average Total Assets}}$

**Return on ordinary shareholders' equity**  $\frac{\text{Net Profit}}{\text{Average total equity}}$

**Earnings per share**  $\frac{\text{Ordinary shareholders profits} - \text{Pref Dividends}}{\text{Weighted average number of shares during year}}$

### Equity Categories

- Share capital** - Amount collected when company originally issued shares
- Retained earnings** - Accumulated profits - Amount paid as dividends

### Liquidity and efficiency ratios

- Examine company capacity to meet short term debt obligation with current assets

**Current ratio**  $\frac{\text{Current assets}}{\text{Current liabilities}}$

**Acid Test ratio**  $\frac{\text{Cash} + \text{Short term fin assets} + \text{Current receivables}}{\text{Current liabilities}}$

**Accounts receivable turnover**  $\frac{\text{Net Sales}}{\text{Average accounts (Trade) receivables}}$

- Receivables is **net** - Adjustment made for customers who may default

**Inventory Turnover**  $\frac{\text{Cost of goods sold}}{\text{Average inventory}}$

**Accounts payable turnover**  $\frac{\text{Cost of goods sold}}{\text{Average accounts (trade) payable}}$

**Days' sales uncollected**  $\frac{\text{Accounts (Trade) receivables, net}}{\text{Net sales}} * 365$

**Days' sales in inventory**  $\frac{\text{Ending Inventory}}{\text{Cost of goods sold}} * 365$

**Days' purchases in accounts payable**  $\frac{\text{Account (trade) payable}}{\text{Cost of goods sold}} * 365$

**Total Asset Turnover**  $\frac{\text{Net sales}}{\text{Average total assets}}$

### Prepaid flows

- Prepaid Expense** - Payments made for services not yet received (Assets)
- Unearned Revenue** - Advanced payments received from customers (Liabilities)

### Solvency Ratios

- Identify the company's risk of going bankrupt
- Gauge company chances of staying afloat

**Debt Ratio**  $\frac{\text{Total liabilities}}{\text{Total assets}}$

**Equity Ratio**  $\frac{\text{Total equity}}{\text{Total assets}}$

**Times interest earned**  $\frac{\text{Profit before interest expense/tax}}{\text{Interest expense}}$

### Market prospects ratio

- Help compare share price to other investments

**Price-earnings ratio**  $\frac{\text{Market price per ordinary share}}{\text{Earnings per share}}$

**Divident yield**  $\frac{\text{Annual cash dividends per share}}{\text{Market price per share}}$