

# Basic understanding of a company's financial statements

September 2020



# 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

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

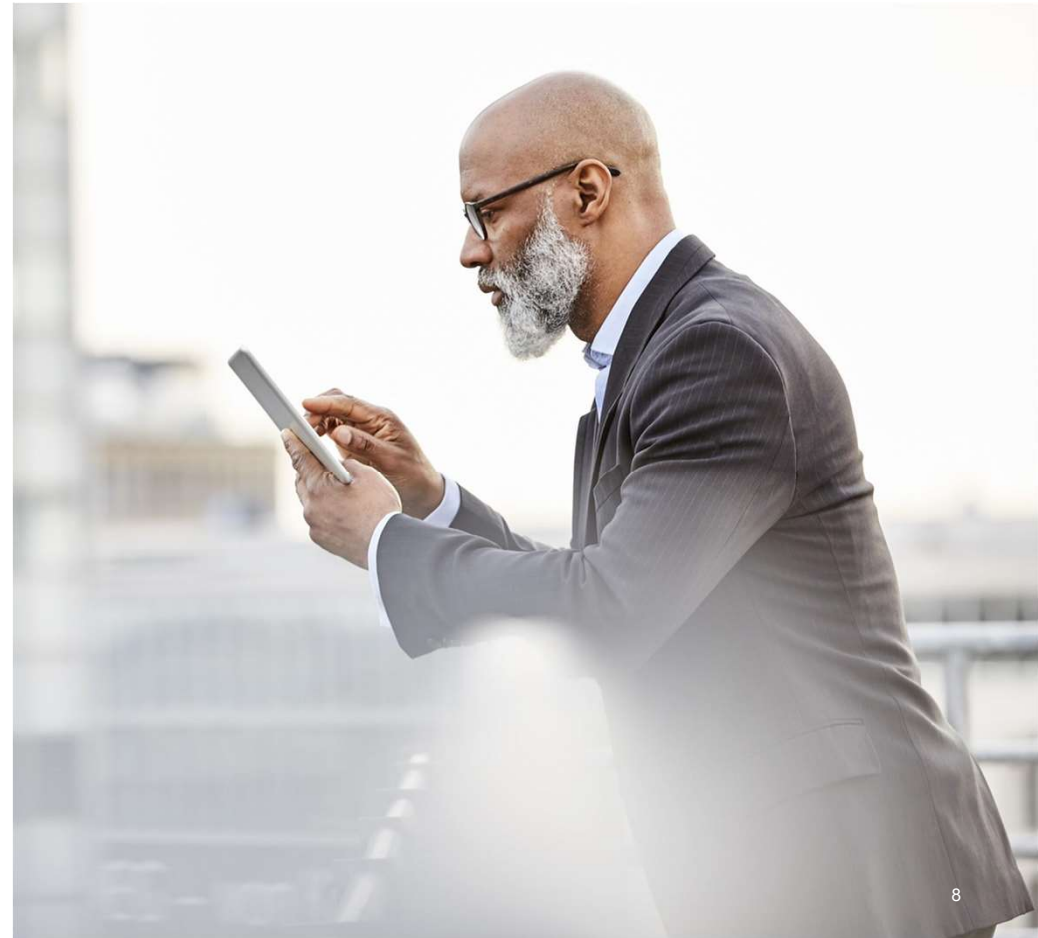
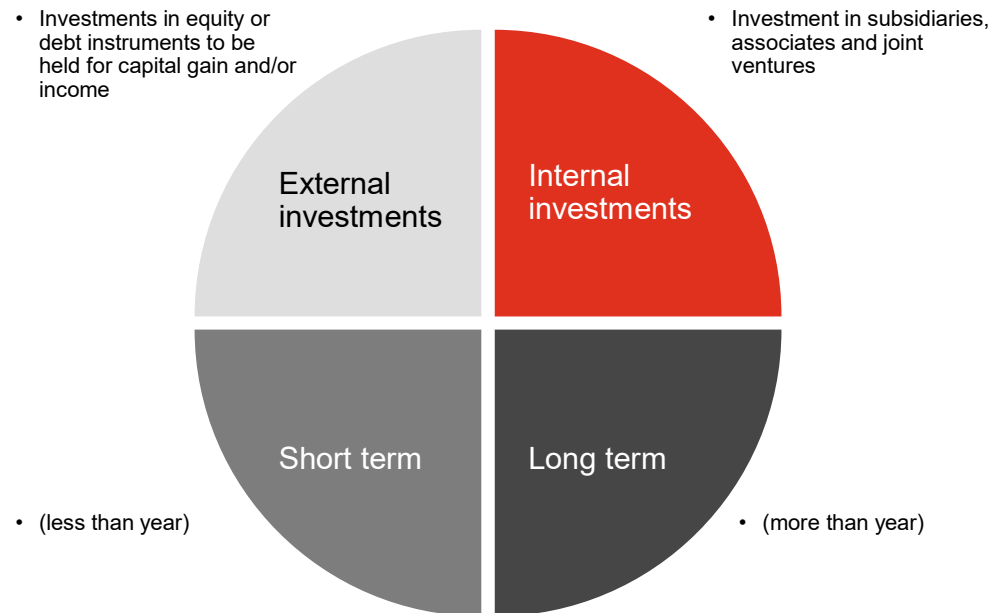
See accompanying notes.

# 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)

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Year ended 30 June 2019

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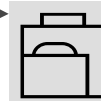
## Current



### Liabilities

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- Trade accounts payable

## Non-current



### Liabilities

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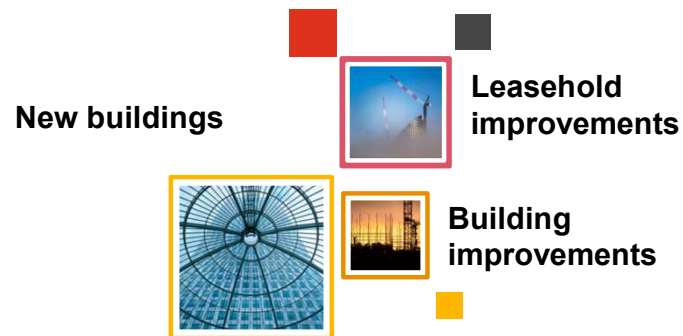
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# Other liabilities

## 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.



Source CFI



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

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

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## 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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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

Source CFI