Company - Investors and Customers: Investors are debtholders plus equityholders. Accounting is for the communication of information to investors - information about the underlying economics

0.1 Financial Reporting Process

Balance Sheet, Income Statement, and Financial Ratios

Balance Sheet = Stock "snapshot"

- Balance Sheet describes Financial Position
- $A = L + E$

Income Statement = Δstock or the Flow

- Financial performance over a period of time
- Operating Income = benefits & sacrafices due to operating
- Pre-Tax Income = benefits & sacrafices due to financing & investing
- NET INCOME = bottom line

Analytical Tools:

1. Journal Entries
2. T-Accounts
3. BSE Template

Left and Right:

- Lea - LEFT
  - Expenses
  - Assets
- lieR
  - liability
  - equity
  - income

Accounting Information = Underlying Economics + Accounting Rules & Principles + Manager Opportunism

$Usefulness = Relevance \cdot Reliability$

Assets

- economic resources
- owned or controleld by company
- probable future economic benefits
- result of past transactions or events

Liabilities

- claims to economic resources by creditors
- economic obligations paybable to outsiders
- probable future economic sacrafices of resources
- results of past transactions or events

Equity

- residual claim to economic resources
- paid what remains, so riskier than debt, but commands higher returns

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Ratios

$$GrossProfitMargin = \frac{GrossProfit}{Revenues}$$

Where gross profit = $Revenues - COGS$

$$OperatingProfitMargin = \frac{OperatingProfit}{Revenues}$$

Where operating profit = $Revenues - COGS - OperatingExpenses$

$$ProfitMargin = \frac{NetIncome}{Revenues}$$

Where net income = $Revenues - COGS - OperatingExpenses \pm OtherGains/Losses$

Efficiency Ratios

$$Asset\ Turnover = \frac{Revenues}{AvgTotalAssets}$$
$$AR\ Turnover = \frac{Revenues}{AvgAR}$$
$$AP\ Turnover = \frac{COGS}{Revenues}$$
$$Inv\ Turnover = \frac{COGS}{AvgInventory}$$

AND

$$DaysinAR = \frac{365}{ARTurnover}$$
$$DaysinAP = \frac{365}{APTurnover}$$
$$InvHoldingPeriod = \frac{365}{InvTurnover}$$

Liquidity Ratios

$$CurrentRatio = \frac{CurrentAssets}{CurrentLiabilities}$$
$$QuickRatio = \frac{CurrentAssets - Inventory}{CurrentLiabilities}$$

0.2 Earnings vs Cash Flow

Investors invest money in companies because they want a return on their invested capital.

Retained Earnings

$$EndingRE = BeginningRE + NetIncome - Dividends$$

ROIC:

$$ROIC = \frac{Return}{InvestedCapital}$$

Where IC = $OperatingAssets - OperatingLiabilities$
and IC = $\frac{beginningNOA+endingNOA}{2}$
NOPAT:

$$NOPAT = Operating_{rev} - NonTax_{OperatingExpenses} - Operating_{taxes}$$

$$ProfitMargin = \frac{NOPAT}{REVENUE}$$

$$ICTurnover = \frac{Revenue}{AvgInvestedCapital}$$

Hence

$$ROIC = ProfitMarge \cdot ICTurnover$$

FixedAssetTurnover

$$\frac{Revenue}{AvgTanginleFixedAssets}$$

0.3 Operating Activities

Balance Sheet, Income Statement, and Financial Ratios

0.4 Investing & Financing Activities

Balance Sheet, Income Statement, and Financial Ratios