

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
Total current assets	94,000
Non current assets	
Property plant & equipment	110,000
Intangible assets	10,000
Total non current assets	120,000
Total assets	214,000

Liabilities

Current liabilities	
Accounts payable	2,000
Accrued expenses	1,000
Total current liabilities	3,000
Non current liabilities	
Bank loan	100,000
Shareholder equity	
Common shares	89,000
Retained Earnings	11,000
Total liabilities and shareholders equity	214,000

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
Assets		
Current Assets		
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
	8,739,571	9,916,135
Non-Current Assets		
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
	6,991,487	7,862,844
Total Assets	15,731,058	17,778,979
Liabilities		
Current Liabilities		
Trade and other payables	3,873,904	3,336,064
Short-term borrowings	376,686	485,724
Taxation payable	362,940	444,969
	4,613,530	4,266,757
Non-Current Liabilities		
Deferred tax liabilities	257,430	213,511
Borrowings	2,169,937	2,213,130
	2,427,367	2,426,641
Total Liabilities	7,040,897	6,693,398
Equity		
Capital and reserves attributable to the company's equity holders		
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
	8,690,161	11,085,581
Total Equity	8,690,161	11,085,581
Total Liabilities and Equity	15,731,058	17,778,979

Current



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Assets

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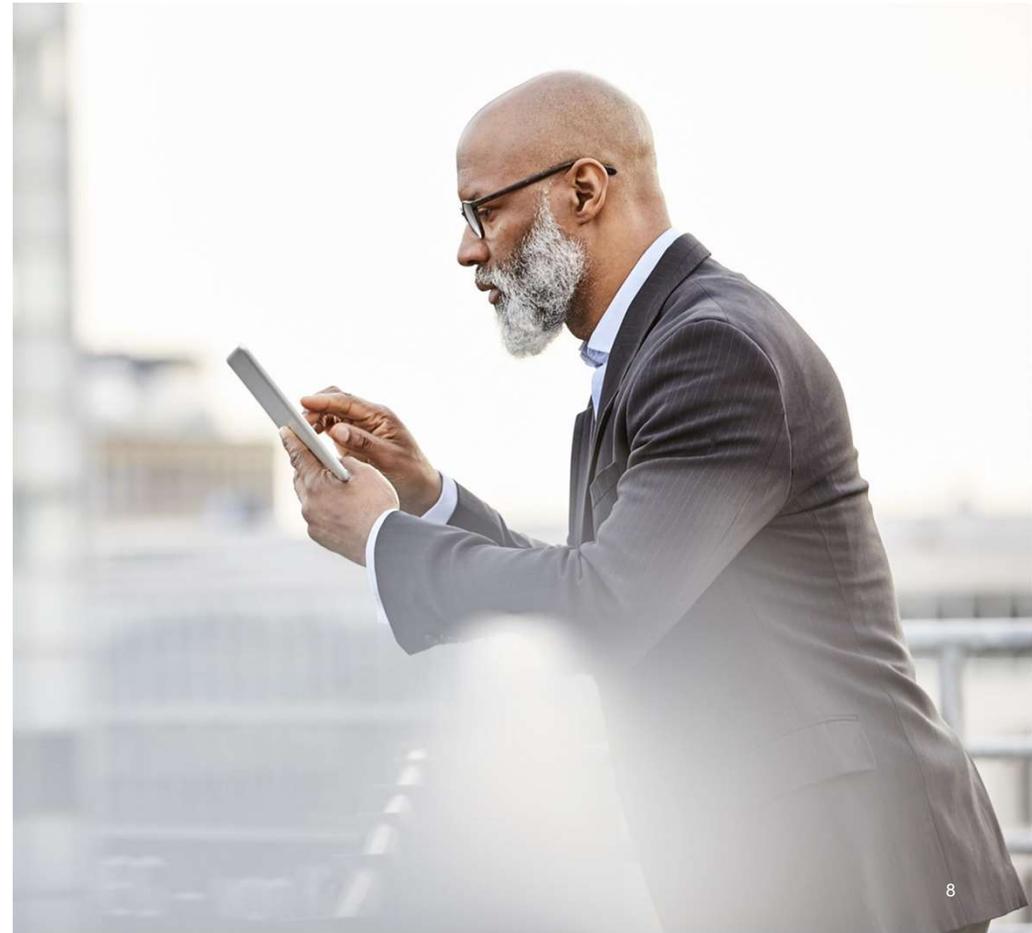
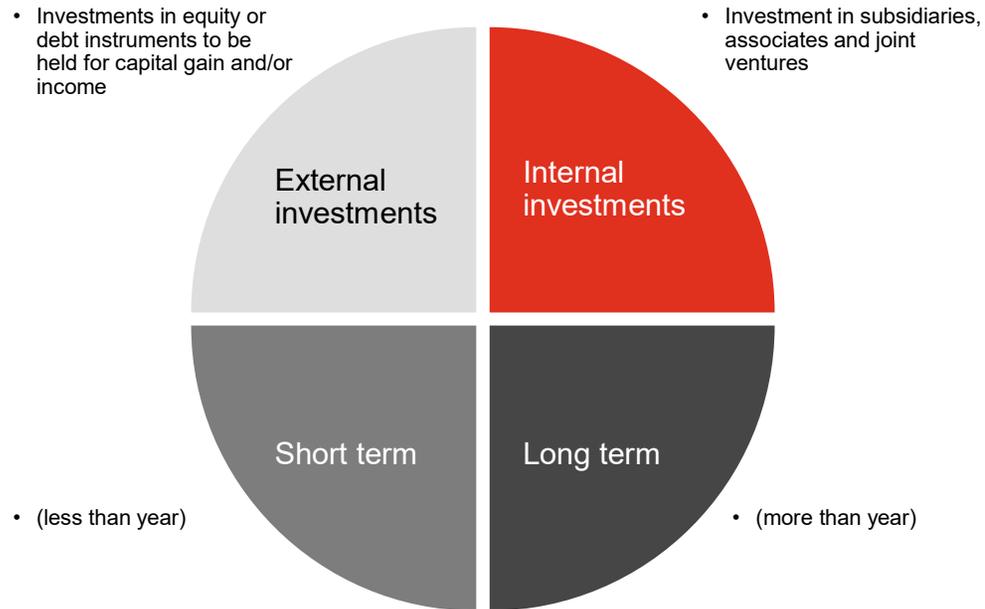
See accompanying notes.

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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Current



Liabilities

- Will be paid in less than 1 year
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Non-current



Liabilities

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- 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.



Source CFI

Illustrative balance sheet (statement of shareholder's equity)

Consolidated Statement of Financial Position Year ended 30 June 2019

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Total Liabilities and Equity	15,731,058	17,778,979

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
Balance at 1 July 2017	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
Total comprehensive income	-	-	3,728	2,292,961	26,853	(36)	2,323,506
Sale of ordinary shares (IPO)	149,415	1,134,720	-	-	-	-	1,134,720
Transactions with owners -							
Dividends paid	-	-	-	(1,304,933)	-	-	(1,304,933)
Transfer to owners consequent on reorganisation	-	-	-	(1,017,728)	-	(5,704)	(1,023,432)
Balance at 30 June 2018	3,750,000	1,192,647	119,946	7,347,482	30,086	-	8,690,161
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)
Total comprehensive income	-	-	10,886	2,929,322	(1,038)	-	2,939,170
Transactions with owners -							
Dividends paid	-	-	-	(543,750)	-	-	(543,750)
	-	-	10,886	2,385,572	(1,038)	-	2,395,420
Balance at 30 June 2019	3,750,000	1,192,647	130,832	9,733,054	29,048	-	11,085,581

See accompanying notes.

Common vs preferred shares

Consolidated Statement of Financial Position Year ended 30 June 2019

JS'000	2018	2019
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Total Liabilities and Equity	<u>15,731,058</u>	<u>17,778,979</u>

See accompanying notes.

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

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

Authorised shares

- The total number of shares a company can sell

Outstanding (Issued) shares

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

Aspects of the equity

Contributed Surplus



e.g. 180,000 shares 40¢/each 25¢/par

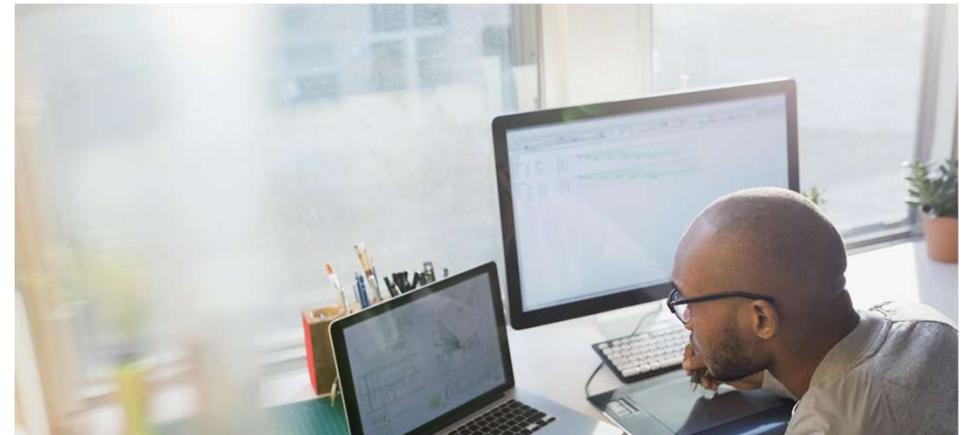
Paid-up share capital (180,000 x 25¢)	\$45,000
Contributed surplus (180,000 x 15¢)	\$27,000

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



Source CFI

Understanding the income statement and cash flow

Income statement

Income Statement

The Income statement has 3 main sections:



Revenues



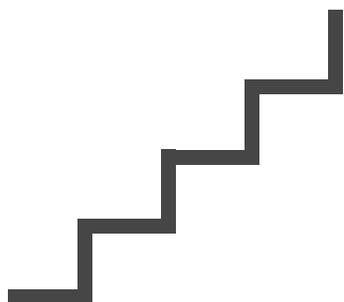
Expenses



Profit or loss



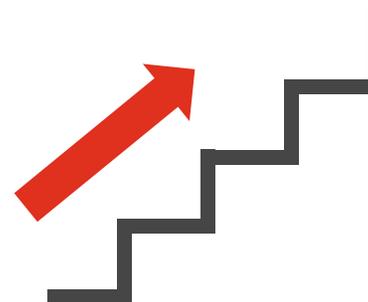
Single step vs multi-step income statements



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)
Gross Profit	9,122,905	10,534,206
Other operating income	92,157	288,656
Selling and distribution expenses	(5,412,601)	(6,124,947)
Administration expenses	(956,683)	(1,097,978)
Operating Profit	2,845,778	3,599,937
Finance income	130,837	119,218
Finance costs	(211,411)	(230,205)
Share of results of associates	-	7,792
Profit before Taxation	2,765,204	3,496,742
Taxation	(513,834)	(567,420)
Profit for the year from continuing operations	2,251,370	2,929,322
Profit from discontinued operations	41,555	-
Net Profit	2,292,925	2,929,322
Other Comprehensive Income		
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
Total Comprehensive Income	2,323,506	2,939,170
Net Profit attributable to:		
Stockholders of Wisynco Group Limited	2,292,961	2,929,322
Non-controlling interest	(36)	-
	2,292,925	2,929,322
Total Comprehensive Income attributable to:		
Stockholders of Wisynco Group Limited	2,323,542	2,939,170
Non-controlling interest	(36)	-
	2,323,506	2,939,170
Earnings Per Stock Unit from continuing and discontinued operations attributable to stockholders of the Group		
From continuing operations	\$ 0.61	\$ 0.78
From discontinued operations	\$ 0.01	\$ -
	\$ 0.62	\$ 0.78

 Net Operating Profit

 Operating Profit

 OCI-other gains and losses

 EPS –Investor Ratio

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)



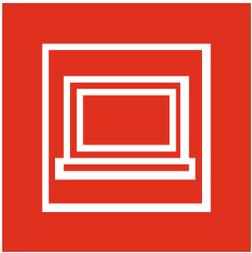
Direct overhead

(to the production of the goods or services)



Selling, general and administrative expenses.

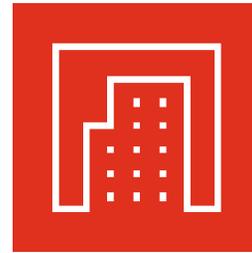
Selling, general and administrative, or SG&A contains a large number of expense items such as:



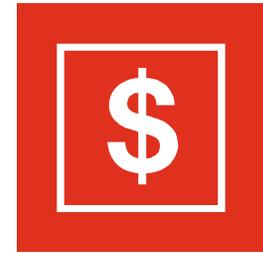
Advertising and promotion cost



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

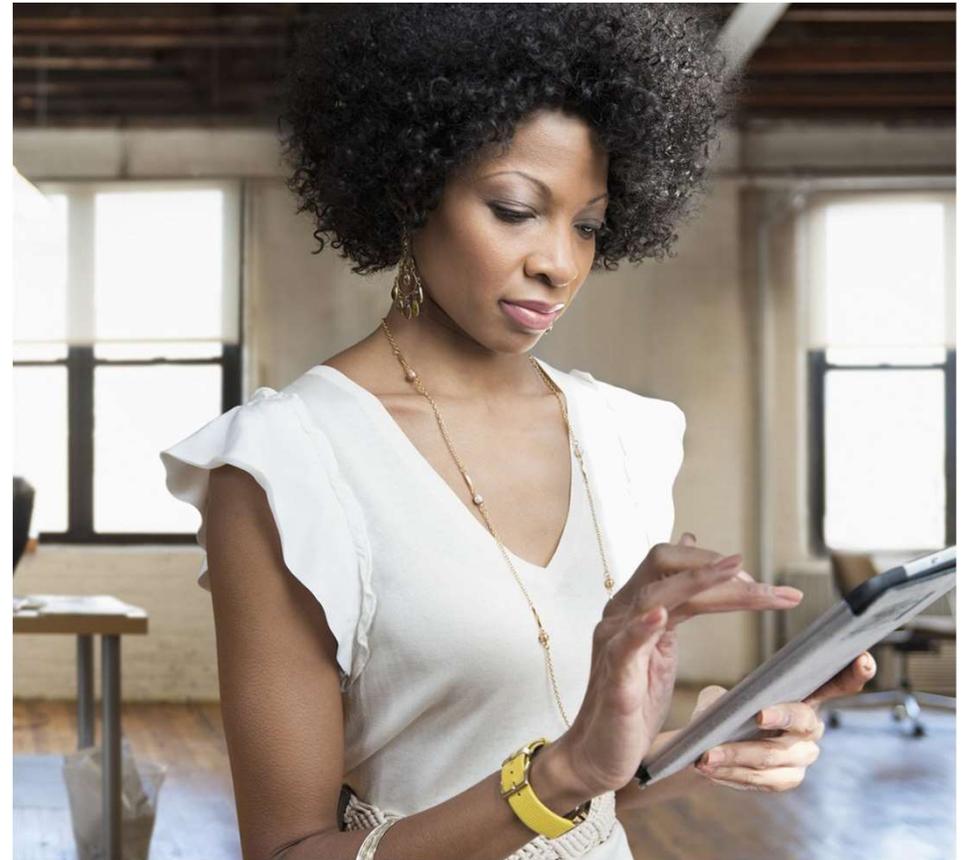


Foreign exchange translations



Financial Instrument transactions

Source CFI



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



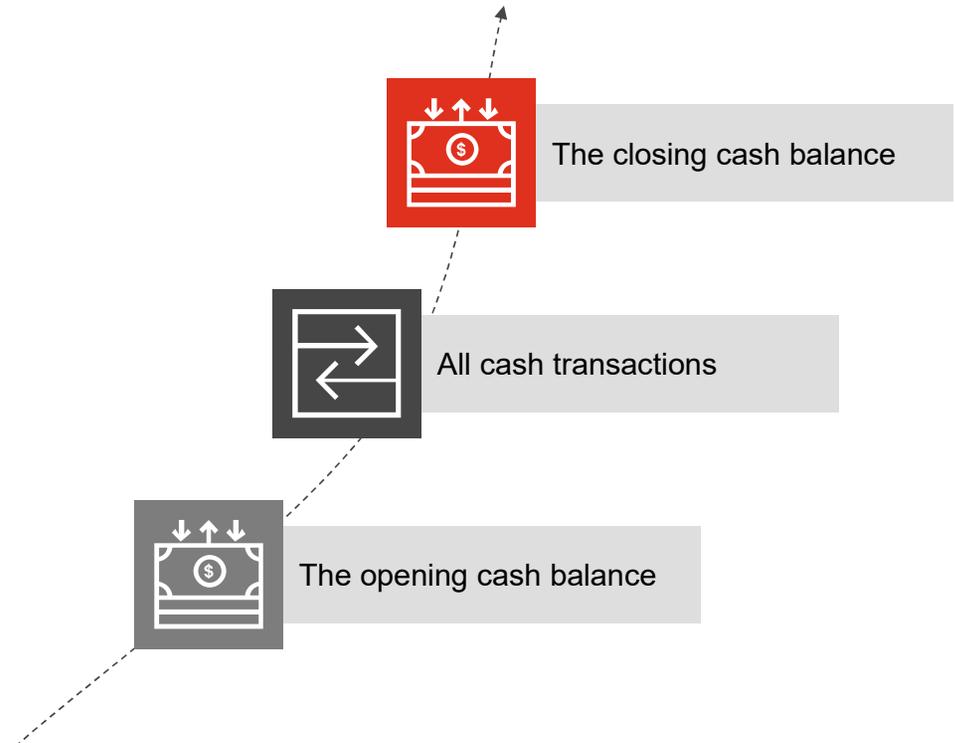
Financing

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

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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



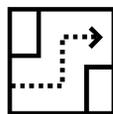
Financial instruments



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

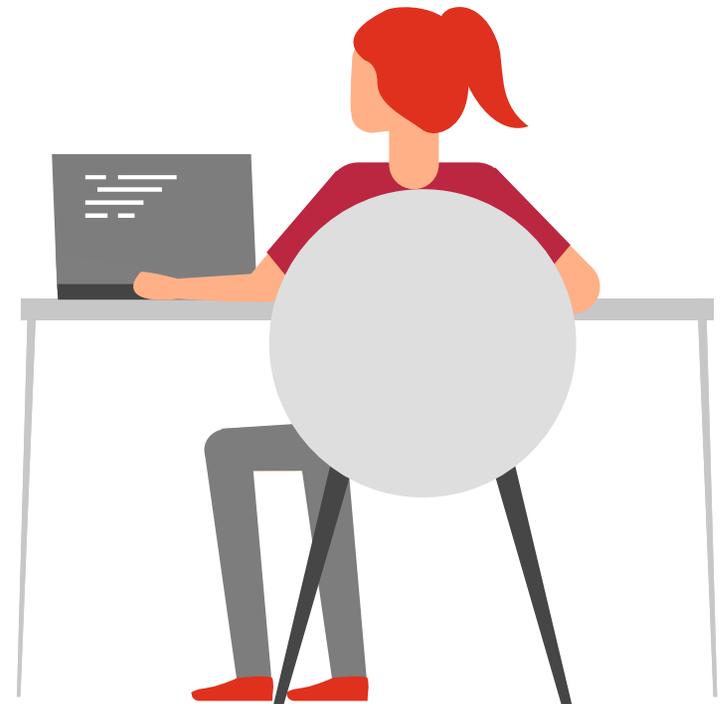
MD&A provides information regarding past performance and future strategic direction

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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