Change Zone
Inspiring the Attitude of Change

Financial Intelligence In Practice ®

CEO In Practice®

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Agenda

- Basic terminology
- Cost Types
- Chart of Accounts
- Financial Statements
- Income Statement
- Balance Sheet
- Cash flow Statement
- Linkage among Financial Statements
- Managing Account Receivables

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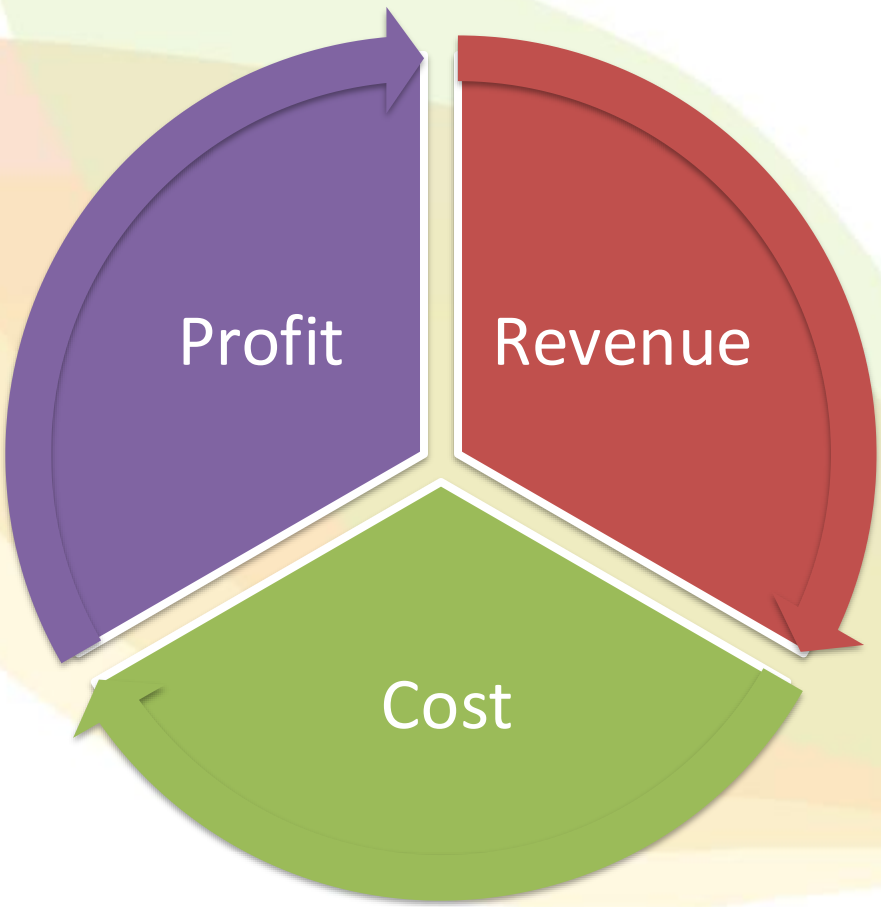
Basic Terminology

Basic Terminology



Revenue


SALE OF PRODUCT Y
SALE OF PRODUCT X
REVENUE
OTHER EARNINGS FROM PRIMARY OPERATIONS

- Revenue is the total earnings generated by a business through its primary operations

- Revenue is the money generated by the business through its primary operations which usually include sales but isn’t limited just to sales.

- Sales are a subset of revenue and can be defined as the economic price paid by the customers for a product or service offered by the business.

- While sales are a source of revenue, a company may include other revenue sources like interest on loans, rent on the property, etc. as well.

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Cost

	Direct Cost of Sales /Goods Sold	Indirect (Operating Expenses)
Variable :generated only with sales	Material On-demand labor Corrective maintenance	Sales Commission Marketing Displays
Fixed: incurred anyway	Full Time Labor Machine deprecation	Rent Insurance Sales Marketing

Application:

- List All of Your Business Cost

- Categorize as:
  - Direct, Indirect,
  - Variable, Fixed

Direct Cost

Direct Cost

- The cost that can be directly attributable to/identified with/ associated with the specific **cost center** or **cost object** like:
  - Product
  - Function
  - Activity
  - Project.

- **Direct Material**: The cost of material that can be allocable to production. **Example**: Raw material consumed during production of the unit.

- **Direct Labor**: Wages to the laborers that can be identified with a cost object. **Example**: The wages.

- **Direct Expenses**: It includes all the other expenses that are directly linked to the production of a product. **Example**: Job processing charges, hire charges for tools and equipment, subcontracting expenses.

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Indirect Cost

Indirect cost

- Indirect cost is those costs that **cannot be directly assigned** to/related to/identified with a particular cost center or cost object, but they **benefit multiple cost objects**. It is not possible to calculate them for a single cost object. However, it needs to be apportioned over various products as well as among the different departments of the organization.

- It includes production, office & administration, selling & distribution costs.

- **Indirect Material**: Material Cost which cannot be identified with a particular product or project.
  Example: Printing Consumables

- **Indirect Labor**: Salary to the employees that cannot be allocable to a particular cost object.
  Example: Salary to the management team and employees of the HR department.

- **Indirect Expenses**: All the expenses other than indirect material and labor are included in this category.
  Example: Rent, Marketing, etc.

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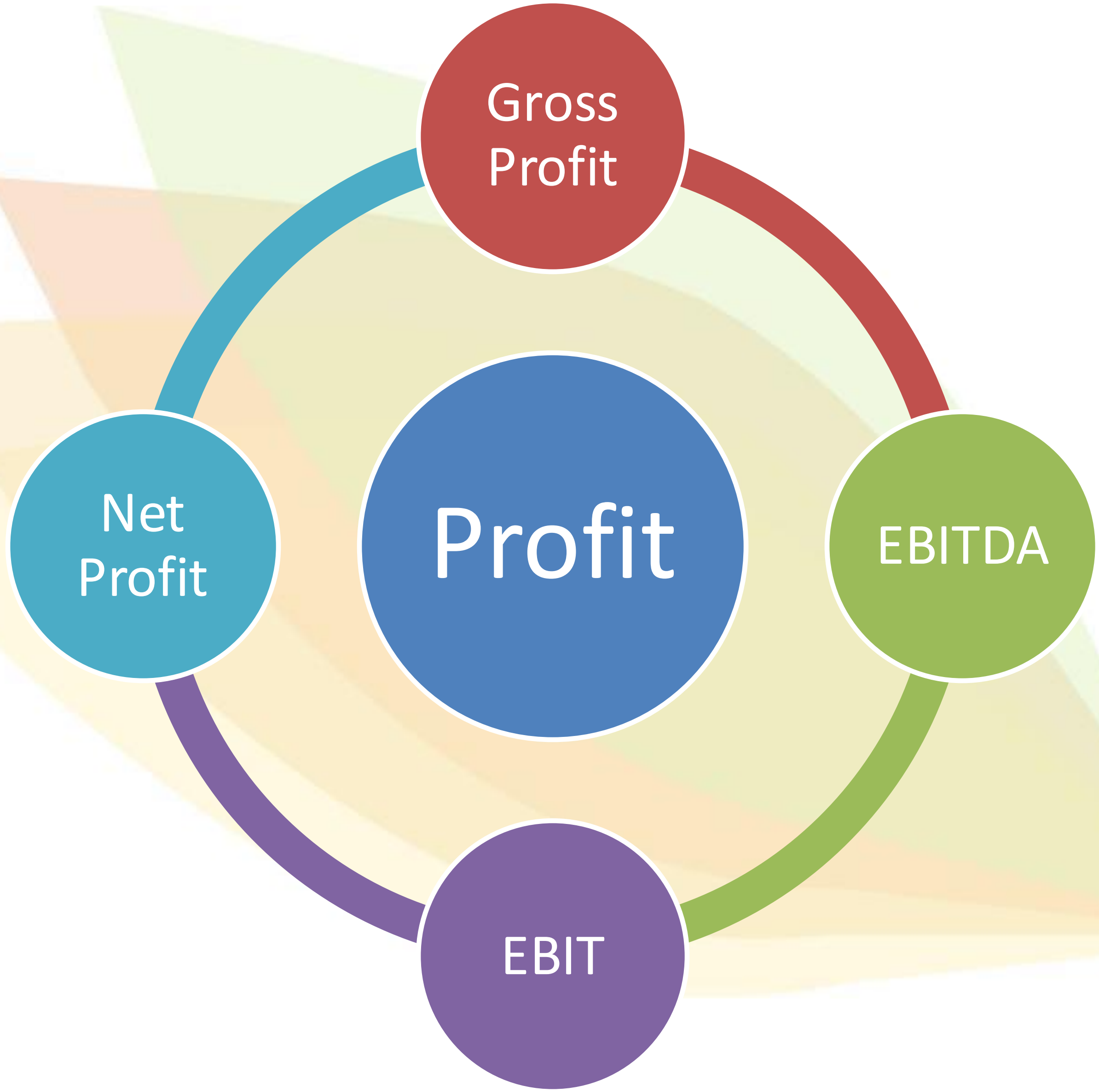
Key Differences

- The cost which is easily apportioned to a particular cost object is known as Direct Cost. Indirect Cost is the cost that can't be charged to a particular cost object.
- Direct Cost benefits the single product or project. Conversely, Indirect Cost benefits multiple product or projects.
- The total of all the direct cost results in prime cost whereas the result of all the indirect cost is known as overheads.
- Direct Cost is traceable while Indirect Cost is not.

Profit

- Profit = Revenue – Total Cost


Gross Profit
EBITDA
Profit
Net Profit
EBIT

Types of Profit

- Gross Profit = Sales - Direct Cost (COGS)
- EBITDA = GP - Operating Expenses Before Depreciation, Amortization, Interests and Taxes
- Operating Profit (EBIT) = GP – Operating Expenses -
- Net Profit = GP - (Operating Expenses + D&A + I +T)

Revenue	$100
Cost of Goods Sold	$ 50
Gross Profit	$ 50
Operating Expenses	$ 30
Operating Profit, EBIT	$ 20
Interest	$ 3
Taxes	$ 5
Net Profit	$ 12

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Assets & Liabilities


Assets put money in your pocket
Liabilities take money out of your pocket

- A successful company has more assets than liabilities, meaning it has the resources to fulfill its obligations. On the other hand, a company whose liabilities exceed its assets is probably in trouble.

Assets

- Asset as something your company owns that can provide future economic benefits. Cash, inventory, accounts receivable, land, buildings, equipment -- these are all assets.

Liabilities

- Liabilities are your company's obligations -- either money that must be paid or services that must be performed.

Chart of Accounts

Align COA with the Focused Business Model

COA Aligned with Strategy

- Support the strategic focus
- Insights for growth and cost optimization
- Creative data analysis

DETAILED COA AS PER THE FINANCIAL ANALYSIS

COST CENTER

REPORTING TAGS

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- A **chart of accounts** is a listing of the names of the **accounts** that a company has identified and made available for recording transactions in its general ledger.

- A company has the flexibility to tailor its **chart of accounts** to best suit its needs, including adding **accounts** as needed.

- A **chart of accounts** (COA) is a financial organizational tool that provides a complete listing of every account in an **accounting** system. An account is a unique record for each type of asset, liability, equity, revenue and expense.

Balance sheet accounts	• Assets • Liabilities • Owner's (Stockholders') Equity
Income statement accounts	• Operating Revenues • Operating Expenses • Non-operating Revenues and Gains • Non-operating Expenses and Losses

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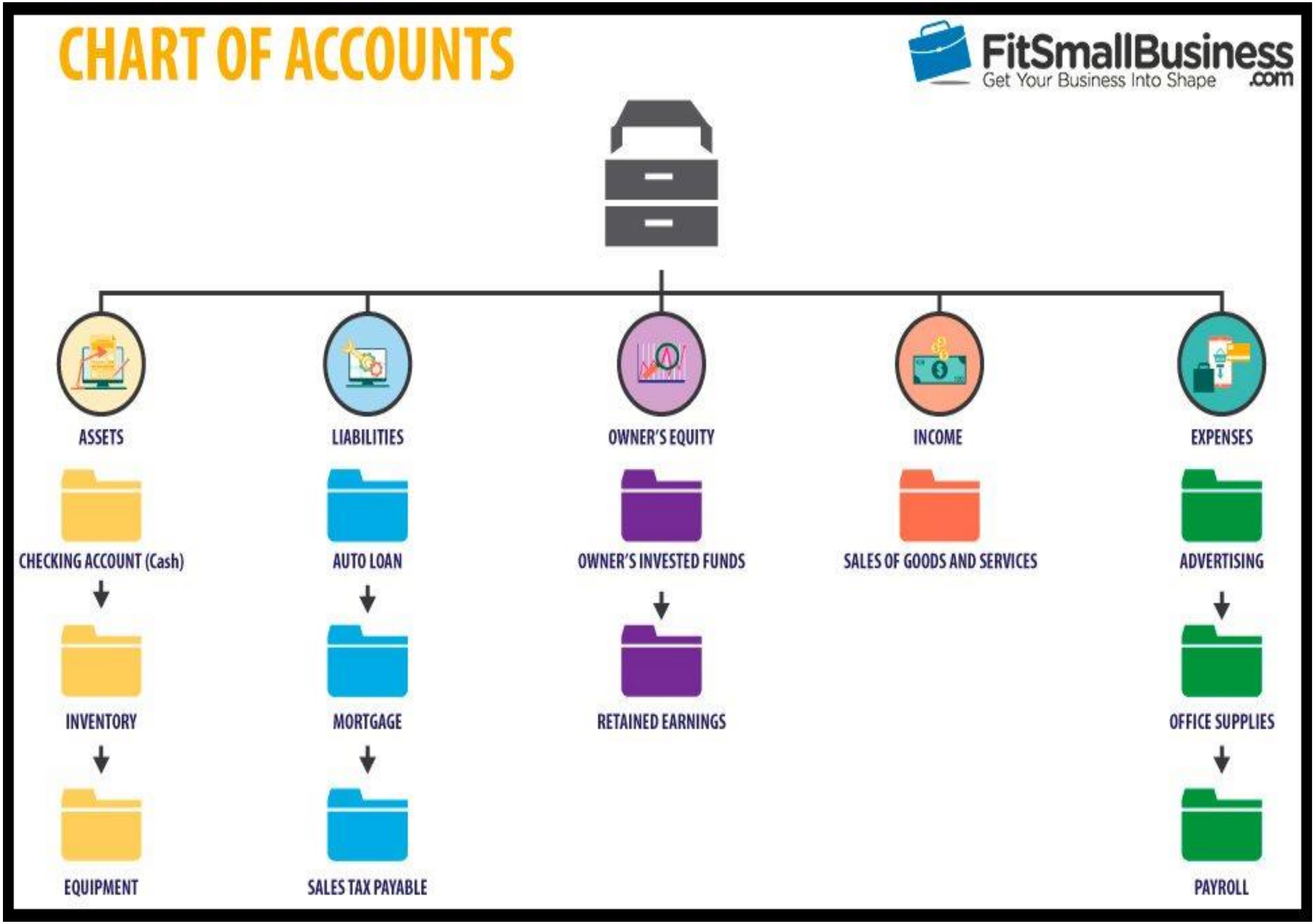

Chart of Accounts

Assets (100 to 199)	
Cash	110
Checking Account	120
Accounts Receivable	130
Inventory	140
Equipment	160
Vehicles	170
Liabilities (200 to 299)	
Sales Tax Collected	210
Accounts Payable	220
Wages Payable	240
Interest Payable	250
Equity (300 to 399)	
Revenue (400 to 499)	
Sales	410
Expenses (500 to 599)	
Mortgage Payment	520
Supplies	550
Salaries	570

640	Human Resources Expenses	
	641	Dues and Subscriptions
	642	Employee Housing
	643	Employee Relations
	644	Medical Expenses
	645	Recruitment
	646	Relocation
	647	Training
	648	Transportation

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660	Marketing Expenses	
	661	Commissions
	662	Direct Mail Expenses
	663	In-house Graphics
	664	Outdoor Advertising
	665	Point-of-Sale Material
	666	Print Materials
	667	Radio and Television Expenses
	668	Selling Aids
	669	Franchise Fees

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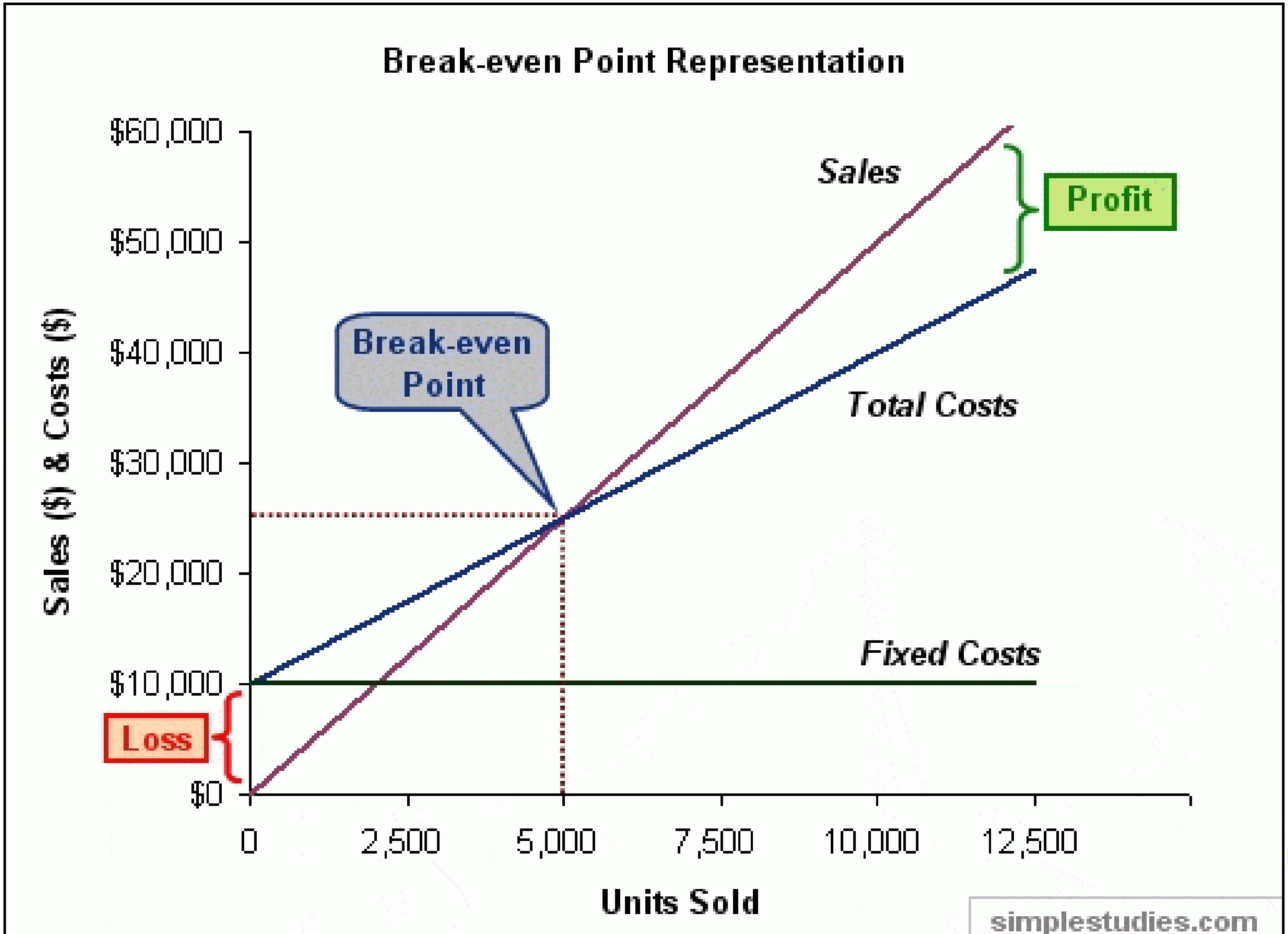
Cost Types

	Direct Cost of Sales /Goods Sold	Indirect (Operating Expenses)
Variable :generated only with sales	Material On-demand labor Corrective maintenance	Sales Commission
Fixed: incurred anyway	Technical Manager Full Time Labor Factory/ WH Rent Machine deprecation	Admin Rent General Manager Insurance Marketing Expenses Sales Expenses


Break-even Point Representation
Sales
Profit
Break-even Point
Total Costs
Fixed Costs
Loss
Sales ($) & Costs ($)
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0
0
2,500
5,000
7,500
10,000
12,500
Units Sold
simplestudies.com

Application:

- List All of Your Business Cost

- Categorize as:
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Financial Statements

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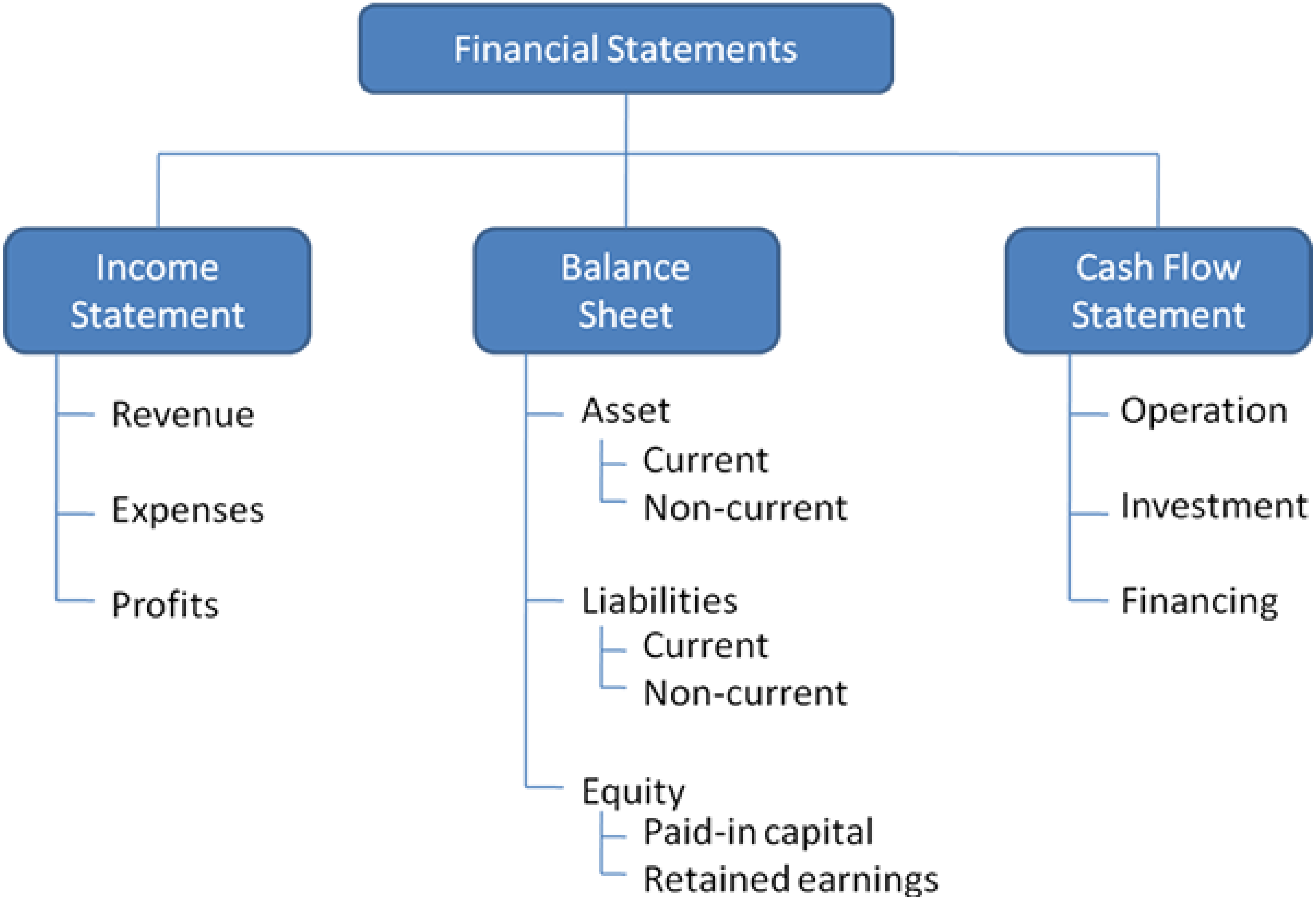

- The income statement, balance sheet and cash flow statement are all interrelated.

- The income statement describes how the assets and liabilities were used in the stated accounting period.

- The cash flow statement explains cash inflows and outflows, and it will ultimately reveal the amount of cash the company has on hand, which is also reported in the balance sheet.

- The balance sheet tells the financial position of the company until this point of time, and will show the result of numbers shown in the income statement and cash flow statement

- By themselves, each financial statement only provides a portion of the story of a company's financial condition; together, they provide a more complete picture.

Cash Basis	Accrual Basis
Revenues are recognized when cash is received and expenses are recorded when cash is paid.	Revenues are recognized when earned and expenses are recognized when incurred.

Overview:
The Profit & Loss Statement

Basic Terminology

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The Profit and Loss Statement (P&L):

Income Statement

P & L (Income statement)

- The **income statement shows cumulative business** results within a defined time frame, such as a quarter or a year.

- It tells you whether the company is making a profit or a loss—that is, whether it has positive or negative net income (net earnings)—and how much.

- This is why the income statement is often referred to as the **profit-and-loss statement, or P&L.**

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Component of P & L

- Sales – Revenue
- Cost of Sales (COS-COGS): direct cost (material, labor, machines)
  - <u>Gross Profit (GP) = Sales – COS</u>
  - <u>Gross Margin = GP/Sales</u>
- Overhead (Operating Expenses, Sales, General, & Admin): indirect cost
  - EBIT (Earnings Before Interests and Tax) = GP – Overhead
  - Operating Margin: OP/Sales
- Net Profit = EBIT – I & T
  - Net Profit Margin: Sales/Net Profit

- **Revenue Mix:**
  - Service A
  - Product B

- **COGS**:
  - Direct Material
  - Direct Labor
  - Direct Machines
  - Direct Overhead

- Operating Expenses (Overhead)
  - Sales and Marketing expenses
  - Admin Salaries
  - R & D
  - Deprecation

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Example

My company Income Statement For the month of August 2008

Income		
	Sales revenue	$2,000
Expenses		
	rent	$ 850
	utilities	75
	payroll	400
	insurance	25
	marketing	250
Total expenses	1,600	
Profit/Loss		$400

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Amalgamated Hat Rack Income Statement

	For the period ending December 31, 2010
Retail Sales	$ 2,200,000
Corporate Sales	1,000,000
Total Sales Revenue	3,200,000
Less: Cost of Goods Sold	1,600,000
Gross Profit	1,600,000
Less: Operating Expenses	800,000
Less: Depreciation Expenses	42,500
Earnings Before Interest and Taxes	757,500
Less: Interest Expense	110,000
Earnings Before Income Taxes	647,500
Less: Income Taxes	300,000
Net Income	$ 347,500

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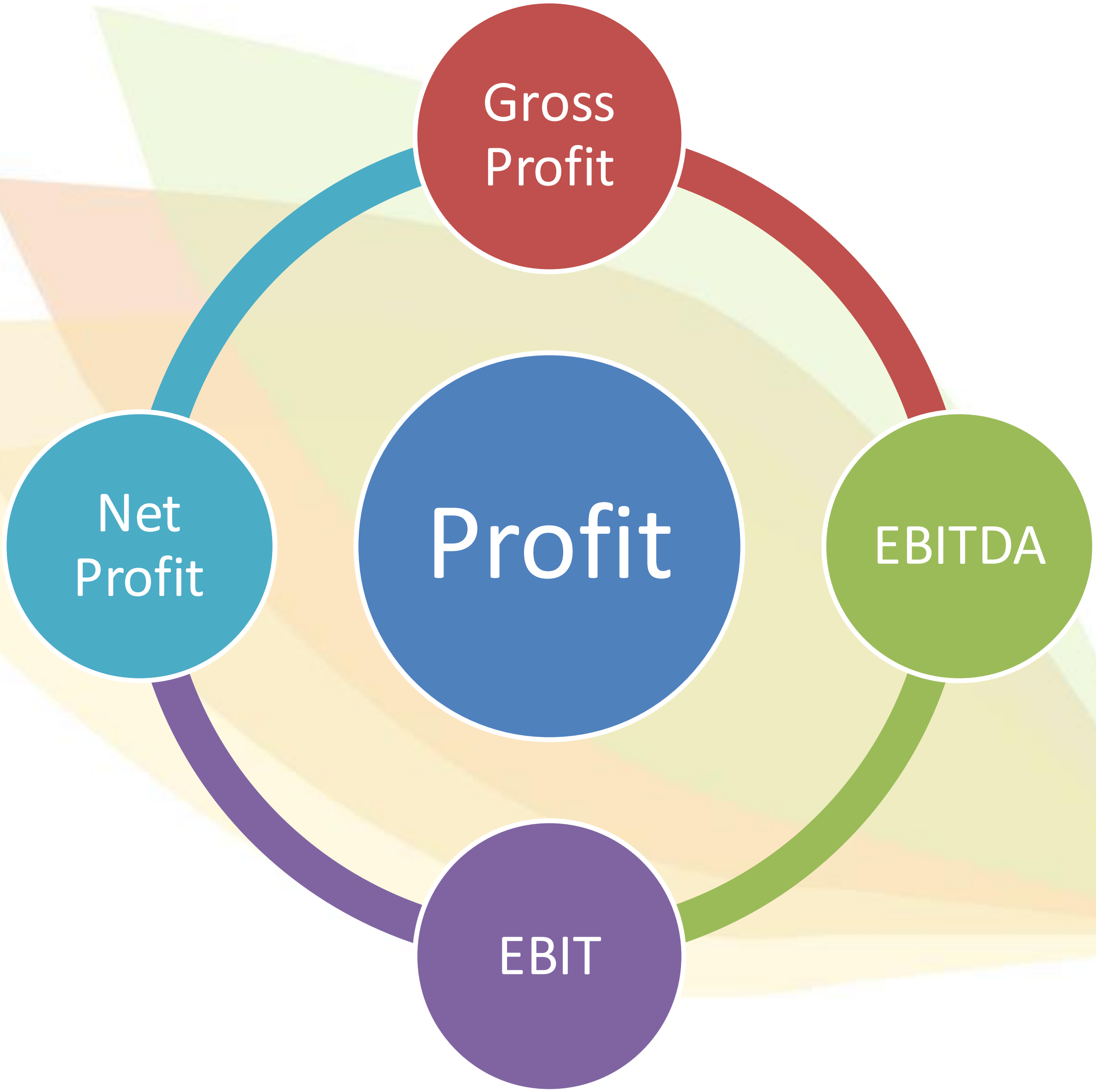
Profit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Types of Profit

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Gross Profit	$ 50
Operating Expenses	$ 30
Operating Profit, EBIT	$ 20
Interest	$ 3
Taxes	$ 5
Net Profit	$ 12

Gross Profit

- Gross profit is the total revenue less only those expenses directly related to the production of goods for sale, called the cost of goods sold (COGS). These include expenses for raw materials and the labor to build or assemble a product but exclude other wages and overhead expenses, such as rent.

- Gross profit = Revenue - Cost of Goods Sold

EBITDA

- **Earnings before interest, tax, depreciation and amortization (EBITDA)** is a measure of a company's operating performance. Essentially, it's a way to evaluate a company's performance **without having to factor in financing decisions, accounting decisions or tax environments.**

- EBITDA is calculated by adding back the non-cash expenses of depreciation and amortization to a firm's operating income.

- Alternatively, you can also calculate EBITDA by taking a company's net income and adding back interest, taxes, depreciation, and amortization.

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	Company A	Company B
EBITDA	$20,000,000	$17,5000,000
Depreciation Amortization	-$2,000,000	-$2,500,000
Interest Expense	-$8,000,000	-$5,000,000
Taxes	-$2,000,000	-$2,000,000
Net Income	**$6,000,000**	**$6,000,000**

- Read more: https://www.investopedia.com/terms/e/ebitda.asp

WHY EBITDA MATTERS:

- EBIDTA allows analysts to focus on the outcome of operating decisions while excluding the impacts of non-operating decisions like interest expenses (a financing decision), tax rates (a governmental decision), or large non-cash items like depreciation and amortization (an accounting decision).

- By minimizing the non-operating effects that are unique to each company, EBITDA allows investors to focus on operating profitability as a singular measure of performance. Such analysis is particularly important when comparing similar companies across a single industry, or companies operating in different tax brackets.

- More: https://investinganswers.com/financial-dictionary/financial-statement-analysis/earnings-interest-tax-depreciation-and-amortizatio

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Operating Profit (EBIT)

- Operating profit is an accounting figure that measures the profit earned from a company's ongoing core business operations, thus excluding deductions of interest and taxes. This value also does not include any profit earned from the firm's investments, such as earnings from firms in which the company has partial interest.
- Operating profit can be calculated using the following formula:
- **Operating Profit = Operating Revenue - Cost of Goods Sold (COGS) - Operating Expenses - Depreciation - Amortization**

- Operating profit – gross profit minus operating expenses or SG&A, including depreciation and amortization – is also known by the peculiar acronym EBIT (pronounced EE-bit).

- EBIT stands for earnings before interest and taxes. (Remember, earnings is just another name for profit.) What has not yet been subtracted from revenue is interest and taxes. Why not? Because operating profit is the profit a business earns from the business it is in – from operations. Taxes don’t really have anything to do with how well you are running your company. And interest expenses depend on whether the company is financed with debt or equity. But the financial structure of the company doesn’t say anything about how well it is run from an operational perspective.

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EBIT

- So operating profit, or EBIT, is a good gauge of how well a company is being managed. It is watched closely by all stakeholders, because it measures both overall demand for the company’s products or services (sales) and the company’s efficiency in delivering those products or services (costs).

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Balance Sheet

Basic Terminology

Purpose and Benefits

- Companies prepare balance sheets to summarize their **financial position at a given point in time**, usually at the end of the month, the quarter, or the fiscal year.

- Also referred to as the **statement of financial position**.

- The **balance sheet** shows what the company *owns* (its assets), what it *owes* (its liabilities), and its book value, or net worth (also called owners' equity, or shareholders' equity).

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Snapshot

- The balance sheet presents a company's financial position at the end of a specified date.
- Some describe the balance sheet as a "**snapshot**" of the company's financial position at a point (a moment or an instant) in time.
- For example, the amounts reported on a balance sheet dated December 31, 2017 reflect that instant when **all the transactions through December 31 have been recorded**.

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- Because the balance sheet informs the reader of a company's financial position as of one moment in time, it allows someone—like a creditor—to see what a company *owns* as well as what it *owes* to other parties as of the date indicated in the heading.

- This is valuable information to the banker who wants to determine whether or not a company qualifies for additional credit or loans.

- Others who would be interested in the balance sheet include current investors, potential investors, company management, suppliers, some customers, competitors, government agencies, and labor unions.

- The balance sheet shows assets on one side of the ledger, liabilities and owners’ equity on the other.

- It’s called a balance sheet because the two sides must always balance.

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The fundamental accounting equation:

- ***Assets – Liabilities = Owners’ Equity***

Or

- ***Assets = Liabilities + Owners’ Equity***

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- Liabilities are obligations of the company; they are amounts owed to creditors for a past transaction and they usually have the word "payable" in their account title.

- For example, a company's balance sheet reports assets of $100,000 and Accounts Payable of $40,000 and owner's equity of $60,000. The source of the company's assets are creditors/suppliers for $40,000 and the owners for $60,000.

- The creditors/suppliers have a claim against the company's assets and the owner can claim what remains after the Accounts Payable have been paid.

My company Balance Sheet
As of August 31, 2011

Assets:		Liabilities:	
Cash	5,000	Accounts Payable	900
Accounts Receivable	600	Loan Payable	3,500
Inventory	900		
Equipment	1,000	**Total Liabilities**	**4,400**
		Equity:	
Total Assets	**7,500**	Owner's equity	2,700
		Retained earnings	400
		Total Equity	**3,100**

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- The difference between what a company owns and what is owes represents equity.

- The goal of the company is to increase:
  - Profit
  - Equity

- The amounts reported in the asset accounts and on the balance sheet reflect **actual costs recorded at the time of a transaction**, NOT the current market value of assets.

Assets

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- Things that are resources owned by a company and which have future economic value that can be measured and can be expressed in dollars.
- Assets also include costs paid in advance that have not yet expired, such as prepaid advertising, prepaid insurance, prepaid legal fees, and prepaid rent.

Assets

- Cash
- Petty Cash
- Temporary Investments
- Accounts Receivable
- Inventory
- Supplies
- Prepaid Insurance
- Land
- Land Improvements
- Buildings
- Equipment
- Goodwill

Classified balance sheets.

- Balance sheet accounts are presented in distinct groupings, categories, or classifications.

- Current Assets
- Investments
- Property, Plant, and Equipment
- Intangible Assets
- Other Assets

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- **Current Assets:**
  - Anything that can be turned into cash in less than a year
- **Long-term Assets:**
  - Have a useful life for more than a year

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Types of Assets

- **Cash and cash equivalents:**
  - Turn into cash in a day or less if you need to

- **Account Receivables:**
  - Promises that have not been collected yet
  - Managers need to watch closely
  - **Allowance for Bad Debt:** an estimate – based on past experience- of the amounts which might not be collected. There is a room for subjectivity

- **Inventory:**
  - Finished goods inventory
  - Work-in-process inventory
  - Raw material inventory

Inventory is created at the expense of cash.

A company want to carry “enough inventory” that improves cash, keep the raw material available for production, and product ready to fulfill customer order.

A Demand Planning Process is needed

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- **Physical Assets: Property, Plant and Equipment (PPE)**
  - The total number of dollars it cost to buy all the PPE to operate the business
  - The cost is the purchase price: the cost of acquiring the assets
  - Principle of conservatism, avoid biases
- **Less: Accumulated Depreciation**
  - Add up all the charges for depreciation they have taken since the day an asset was bought

- **Prepaid Assets**
  - Like prepaid rent for the whole year: $ 60,000
  - Each month you record $5000 in the income statement
  - The remaining amount: $55000 is recorded on the balance sheet
  - Each month you will have to move $5000 out of the prepaid asset line in the balance sheet and put it in the income statement as an expense for rent

Liabilities

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- <u>Current Liabilities:</u>
  - have to be paid in less than a year
- <u>Long Term Liabilities:</u>
  - Come due over a long time frame
- Listed on the balance sheet from shortest-term to longest-term, so it tells about what is due when

- If a company has a loan payable that requires it to make monthly payments for several years, only the *principal* due in *the next twelve months* should be reported on the balance sheet as a current liability.

- The remaining principal amount should be reported as a long-term liability. The interest on the loan that pertains to the future is not recorded on the balance sheet; only unpaid interest up to the date of the balance sheet is reported as a liability.

- A current liability is an obligation that is
  - 1) due within one year of the date of a company's balance sheet and
  - 2) will require the use of a current asset or will create another current liability.
  - If a company's operating cycle is longer than one year, current liabilities are those obligation's due within the operating cycle.

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Examples of Current Liabilities

- **Accounts payable**. These are the trade payables due to suppliers, usually as evidenced by supplier invoices.

- **Notes payable**: The amount of principal due on a formal written promise to pay. Loans from banks are included in this account.

- **Sales taxes payable**. This is the obligation of a business to remit sales taxes to the government that it charged to customers on behalf of the government.

- **Income taxes payable.** This is income taxes owed to the government but not yet paid.

- **Interest payable.** This is interest owed to lenders but not yet paid.

- **Bank account overdrafts**. These are short-term advances made by the bank to offset any account overdrafts caused by issuing checks in excess of available funding.

- **Accrued expenses.** These are expenses not yet payable to a third party, but already incurred, such as wages payable.

- **Customer deposits.** These are payments made by customers in advance of the completion of their orders for goods or services.

- **Dividends declared.** These are dividends declared by the board of directors, but not yet paid to shareholders.

- **Short-term loans.** This is loans that are due on demand or within the next 12 months.

Equity

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- **Owner's Equity**—along with liabilities—can be thought of as a source of the company's assets.

- Owners' equity is what is left after we subtract liabilities from assets

- It includes:
  - The capital provided by investors
  - The profits retained by the company over time

Examples of Balance Sheets

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Example Company
Balance Sheet
December 31, 2012

ASSETS

Current assets	
Cash	$ 2,100
Petty cash	100
Temporary investments	10,000
Accounts receivable - net	40,500
Inventory	31,000
Supplies	3,800
Prepaid insurance	1,500
Total current assets	89,000
Investments	36,000
Property, plant & equipment	
Land	5,500
Land improvements	6,500
Buildings	180,000
Equipment	201,000
Less: accum depreciation	(56,000)
Prop, plant & equip - net	337,000
Intangible assets	
Goodwill	105,000
Trade names	200,000
Total intangible assets	305,000
Other assets	3,000
Total assets	$ 770,000

LIABILITIES

Current liabilities	
Notes payable	$ 5,000
Accounts payable	35,900
Wages payable	8,500
Interest payable	2,900
Taxes payable	6,100
Warranty liability	1,100
Unearned revenues	1,500
Total current liabilities	61,000
Long-term liabilities	
Notes payable	20,000
Bonds payable	400,000
Total long-term liabilities	420,000
Total liabilities	481,000

STOCKHOLDERS' EQUITY

Common stock	110,000
Retained earnings	229,000
Less: Treasury stock	(50,000)
Total stockholders' equity	289,000
Total liabilities & stockholders' equity	$ 770,000

The notes to the sample balance sheet have been omitted.

The Statement of Cash flow

The movement of cash, in and out

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Agenda

- Purpose and benefits
- Components – what does it include
- How to read it
- How to tailor it
- How to analyze it

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Purpose and Benefits

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- This statement shows where the cash came from and how it was spent during the period of reporting

- Reports the *cash* generated and used during the time interval specified in its heading

- The cash flow statement is concerned with the flow of cash in and out of the business

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- The statement of financial position is a snapshot of a firm's financial resources and obligations at a single point in time, and the income statement summarizes a firm's financial transactions over an interval of time.

- These two financial statements reflect the **accrual basis accounting** .

- Because the income statement is prepared under the **accrual basis of accounting**, the revenues reported may not have been collected.

- Similarly, the expenses reported on the income statement might not have been paid.

- You could review the balance sheet changes to determine the facts, but the cash flow statement already has integrated all that information.

- The cash flow statement is a **cash basis report** on three types of financial activities: operating activities, investing activities, and financing activities.

- The cash flow statement includes only inflows and outflows of cash and cash equivalents; it excludes transactions that do not directly affect cash receipts and payments.

- These non-cash transactions include depreciation or write-offs on bad debts.

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Components –
what does it include


Investing Activities
Operating Activities
Financing Activities
Cash Flow Statement

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- The statement of cash flows has the following sections:

- Cash involving operating activities

- Cash involving investing activities

- Cash involving financing activities

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Statement of Cash Flow - Simple Example	
for the period 1 Jan 2006 to 31 Dec 2006	
Cash flow from operations	$4,000
Cash flow from investing	($1,000)
Cash flow from financing	($2,000)
Net cash flow	$1,000
	Parentheses indicate negative values

Cash Receipts from Customers = Revenues from Sales

+ Decrease in Accounts Receivables

- Increase in Accounts Receivables

Cash Payment to Suppliers = Cost of Goods Sold

+ Increase in Inventory
- Decrease in Inventory

+ Decrease in Accounts Payable
- Increase in Accounts Payable

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How to read it

Cash flows from (used in) operating activities				
Cash receipts from customers	9,500			
Cash paid to suppliers and employees	-2,000			
Cash generated from operations (sum)	7,500			
Interest paid	-2,000			
Income taxes paid	-3,000			
Net cash flows from operating activities		2,500		
Cash flows from (used in) investing activities				
Proceeds from the sale of equipment	7,500			
Dividends received	3,000			
Net cash flows from investing activities		10,500		
Cash flows from (used in) financing activities				
Dividends paid	-2,500			
Net cash flows used in financing activities		-2,500		
.				
Net increase in cash and cash equivalents		10,500		
Cash and cash equivalents, beginning of year		1,000		
Cash and cash equivalents, end of year		$11,500		

Change Zone
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Good Deal Co.
Statement of Cash Flows
For the *Five Months* Ended May 31, 2017

Operating Activities	
Net income	$ 300
Increase in inventory	(200)
Increase in supplies	(150)
Cash provided (used) in operating activities	(50)
Investing Activities	
Purchase of office equipment	(1,100)
Financing Activities	
Investment by owner	2,000
Net increase in cash	850
Cash at the beginning of the year	0
Cash at May 31, 2017	$ 850

Change Zone
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Statement of Cash Flows Format

Cash Flows from Operating Activities		
Net income		$XXX
Add: Depreciation, amortization	$XXX	
Increases in current liabilities	XXX	
Decreases in current assets	XXX	
Less: Increases in current assets	(XXX)	
Decreases in current liabilities	(XXX)	
Add: Losses from investing/financing activities	XXX	
Less: Gains from investing/financing activities	(XXX)	XXX
Net cash provided by (used by) operating activities		XXX
Cash Flows from Investing Activities		
Sale of property/investments	XXX	
Purchase of property/investments	(XXX)	
Net cash provided by (used by) investing activities		XXX
Cash Flows from Financing Activities		
Sale of debt or equity securities	XXX	
Repurchase/Payment of debt or equity securities	(XXX)	
Payment of dividends	(XXX)	
Net cash provided by (used by) financing activities		XXX
Net increase in cash		XXX
Beginning cash		XXX
Ending cash		$XXX

How to analyze it

www.MBAbullshit.com

Net Income Statement (Accounting)

Cash Sales + Accrued Sales Combined	$200
Less: Cost of Sales, Cash Expenses & Accrued Expenses	-70
Less: Depreciation Expense	-10
Net Income Before Tax (NIBT)	$120
Tax at 35%	**-$42**
Net Income After Tax (NIAT)	$78

Cash Flow Statement (Finance)

Cash Sales (No accrued sales)	$190
Less: Cash Expenses and Payments of accrued exp.	-80
Less: Taxes Paid in the Income Statement*	-42
Cash Flow from Operations	$68
Cash Flow of Investment (+/- working capital, equipment, etc.)*	-27
Free Cash Flow (FCF or OCF)	**$41**

- When an asset (other than cash) increases, the Cash account *decreases*.
- When an asset (other than cash) decreases, the Cash account *increases*.
- When a liability increases, the Cash account *increases*.
- When a liability decreases, the Cash account *decreases*.
- When owner's equity increases, the Cash account *increases*.
- When owner's equity decreases, the Cash account *decreases*.
- **(reference: accountingcoach.com)**

- For a change in assets (other than cash)—the change in the Cash account is in the *opposite* direction.

- For a change in liabilities and owner's equity—the change in the Cash account is in the *same* direction.

- **(reference: accountingcoach.com)**

A change in this <u>balance sheet category</u>	...is reported in this section <u>of the cash flow statement</u>
Current Assets*	Operating Activities
Current Liabilities	Operating Activities
Long-term Assets	Investing Activivties
Long-term Liabilities	Financing Activities
Stockholders' Equity	Financing Activities

* This refers to current assets other than Cash.

Change Zone
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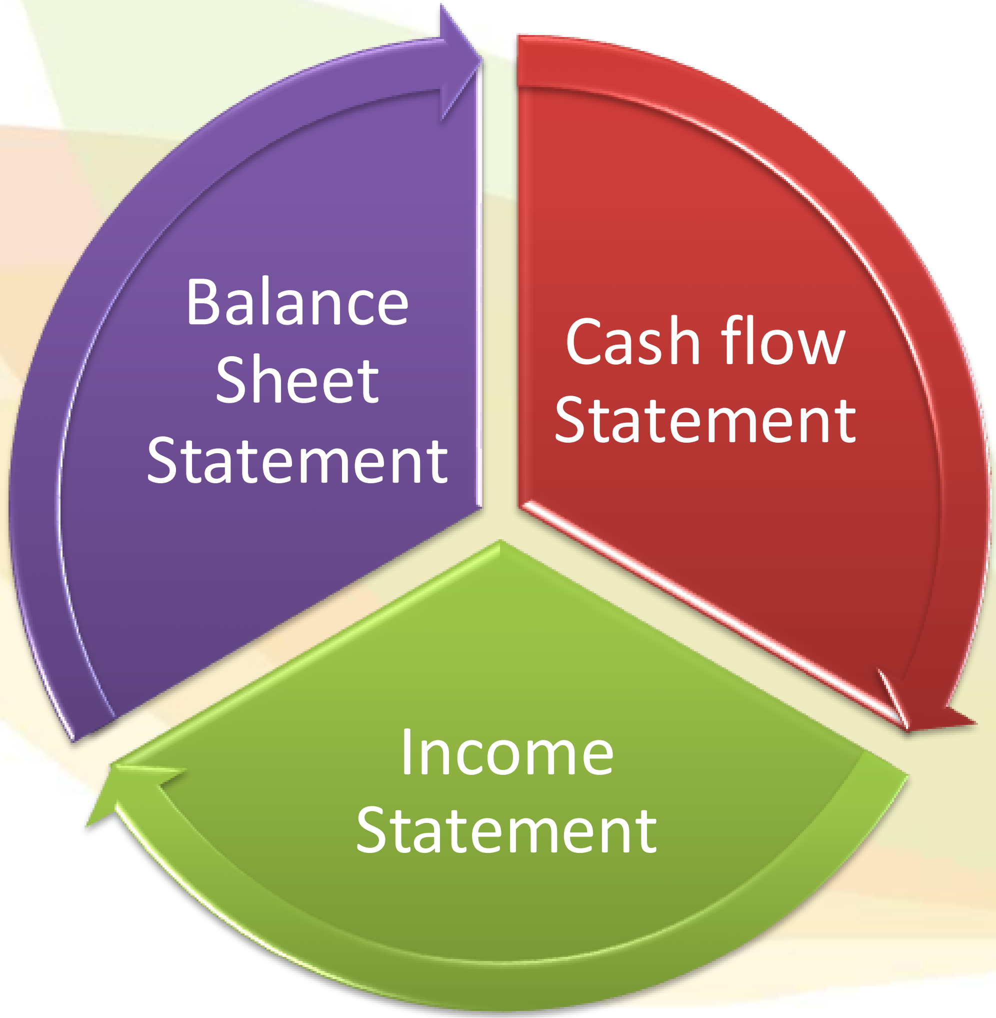
Interrelationships


Balance Sheet Statement
Cash flow Statement
Income Statement

Change Zone
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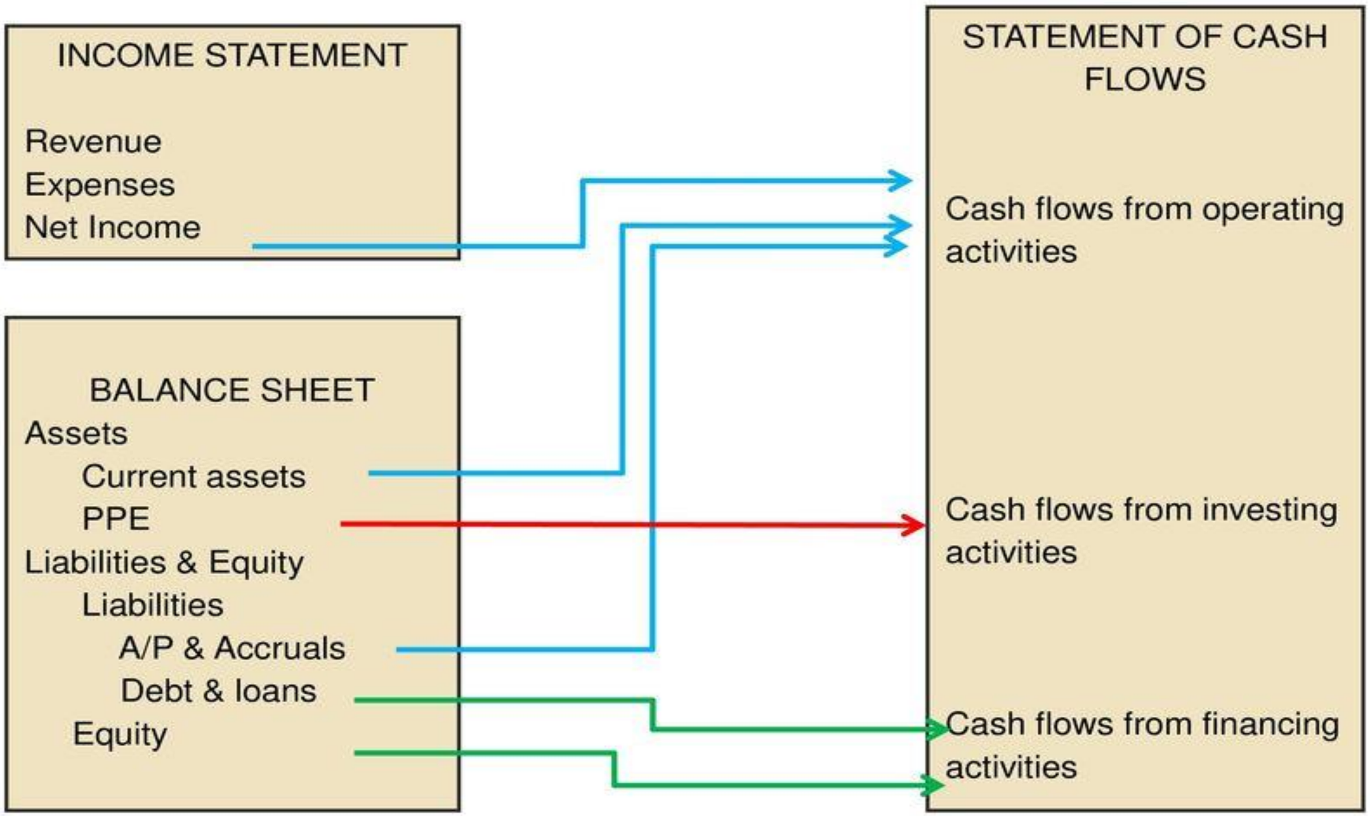
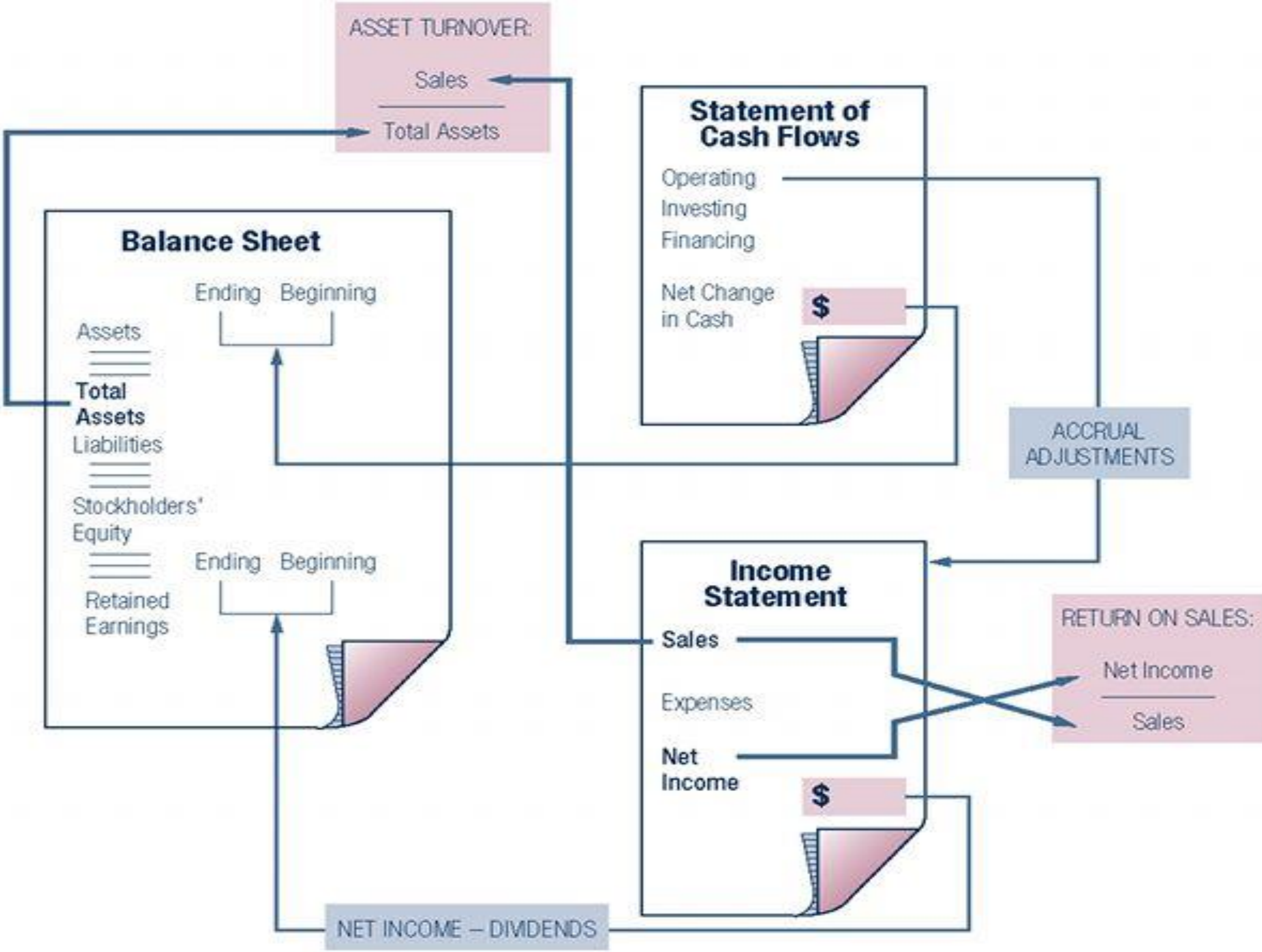
RELATIONSHIPS BETWEEN FINANCIAL STATEMENTS




ASSET TURNOVER:
Sales
Total Assets
Statement of Cash Flows
Operating
Investing
Financing
Net Change in Cash
$
Balance Sheet
Ending Beginning
Assets
Total Assets
Liabilities
Stockholders' Equity
Ending Beginning
Retained Earnings
ACCRUAL ADJUSTMENTS
Income Statement
Sales
Expenses
Net Income
$
RETURN ON SALES:
Net Income
Sales
NET INCOME – DIVIDENDS

Change Zone
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Examples

Income Statement								
Revenue	102,007	118,086	131,345	142,341	150,772	158,311	165,435	172,052
Cost of Goods Sold (COGS)	39,023	48,004	49,123	52,654	56,710	58,575	61,211	61,939
Gross Profit	62,984	70,082	82,222	89,687	94,062	99,736	104,224	110,113
Expenses								
Salaries and Benefits	26,427	22,658	23,872	23,002	25,245	26,913	28,124	29,249
Rent and Overhead	10,963	10,125	10,087	11,020	11,412	10,000	10,000	10,000
Depreciation & Amortization	19,500	18,150	17,205	16,544	16,080	15,008	15,005	15,003
Interest	2,500	2,500	1,500	1,500	1,500	1,500	1,500	500
Total Expenses	59,390	53,433	52,664	52,066	54,237	53,421	54,629	54,752
Earnings Before Tax	3,594	16,649	29,558	37,622	39,825	46,314	49,595	55,361
Taxes	1,120	4,858	8,483	10,908	11,598	12,968	13,887	15,501
Net Earnings	2,474	11,791	21,075	26,713	28,227	33,346	35,708	39,860

Balance Sheet								
Assets								
Cash	167,971	181,210	183,715	211,069	239,550	272,530	307,632	327,097
Accounts Receivable	5,100	5,904	6,567	7,117	7,539	7,807	8,158	8,485
Inventory	7,805	9,601	9,825	10,531	11,342	11,715	12,242	12,388
Property & Equipment	45,500	42,350	40,145	38,602	37,521	37,513	37,508	37,505
Total Assets	226,376	239,065	240,252	267,319	295,951	329,564	365,540	385,474
Liabilities								
Accounts Payable	3,902	4,800	4,912	5,265	5,671	5,938	6,205	6,279
Debt	50,000	50,000	30,000	30,000	30,000	30,000	30,000	10,000
Total Liabilities	53,902	54,800	34,912	35,265	35,671	35,938	36,205	16,279
Shareholder's Equity								
Equity Capital	170,000	170,000	170,000	170,000	170,000	170,000	170,000	170,000
Retained Earnings	2,474	14,265	35,340	62,053	90,280	123,627	159,335	199,195
Shareholder's Equity	172,474	184,265	205,340	232,053	260,280	293,627	329,335	369,195
Total Liabilities & Shareholder's Equit	226,376	239,065	240,252	267,319	295,951	329,564	365,540	385,474

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Interest	2,500	2,500	1,500	1,500	1,500	1,500	1,500	500
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Total Liabilities	53,902	54,800	34,912	35,265	35,671	35,938	36,205	16,279
Shareholder's Equity								
Equity Capital	170,000	170,000	170,000	170,000	170,000	170,000	170,000	170,000
Retained Earnings	2,474	14,265	35,340	62,053	90,280	123,627	159,335	199,195
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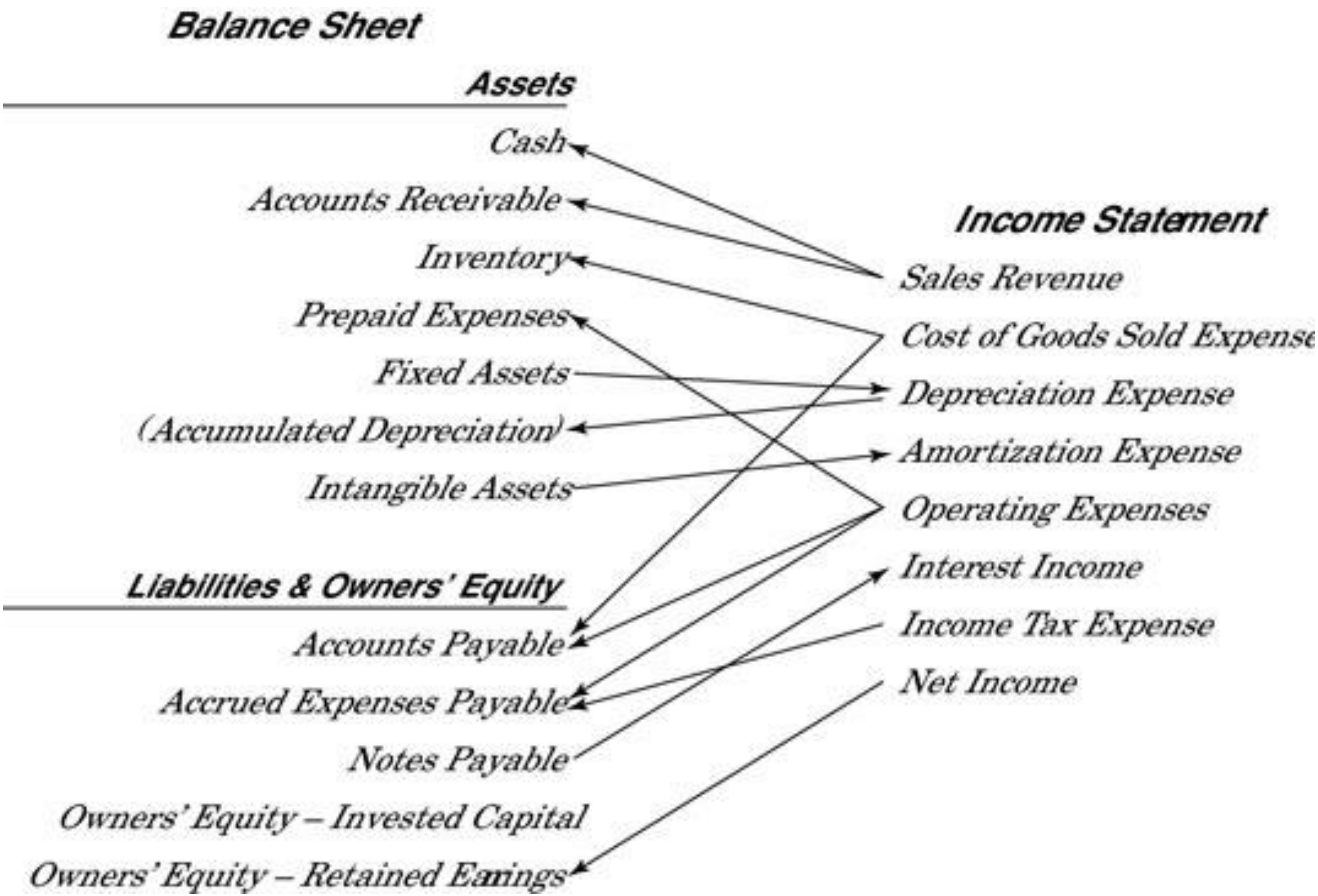
Total Liabilities & Shareholder's Equ	226,376	239,065	240,252	267,319	295,951	329,564	365,540	385,474
Check	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*	*0.000*

Cash Flow Statement								
Operating Cash Flow								
Net Earnings	2,474	11,791	21,075	26,713	28,227	33,346	35,708	39,860
Plus: Depreciation & Amortization	19,500	18,150	17,205	16,544	16,080	15,008	15,005	15,003
Less: Changes in Working Capital	9,003	1,702	775	903	827	375	611	398
Cash from Operations	12,971	28,239	37,505	42,354	43,480	47,980	50,102	54,465
Investing Cash Flow								
Investments in Property & Equipment	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000
Cash from Investing	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000

Balance Sheet & Income Statement


Balance Sheet
Assets
Cash
Accounts Receivable
Inventory
Prepaid Expenses
Fixed Assets
(Accumulated Depreciation)
Intangible Assets
Liabilities & Owners' Equity
Accounts Payable
Accrued Expenses Payable
Notes Payable
Owners' Equity – Invested Capital
Owners' Equity – Retained Earnings
Income Statement
Sales Revenue
Cost of Goods Sold Expense
Depreciation Expense
Amortization Expense
Operating Expenses
Interest Income
Income Tax Expense
Net Income

Change Zone
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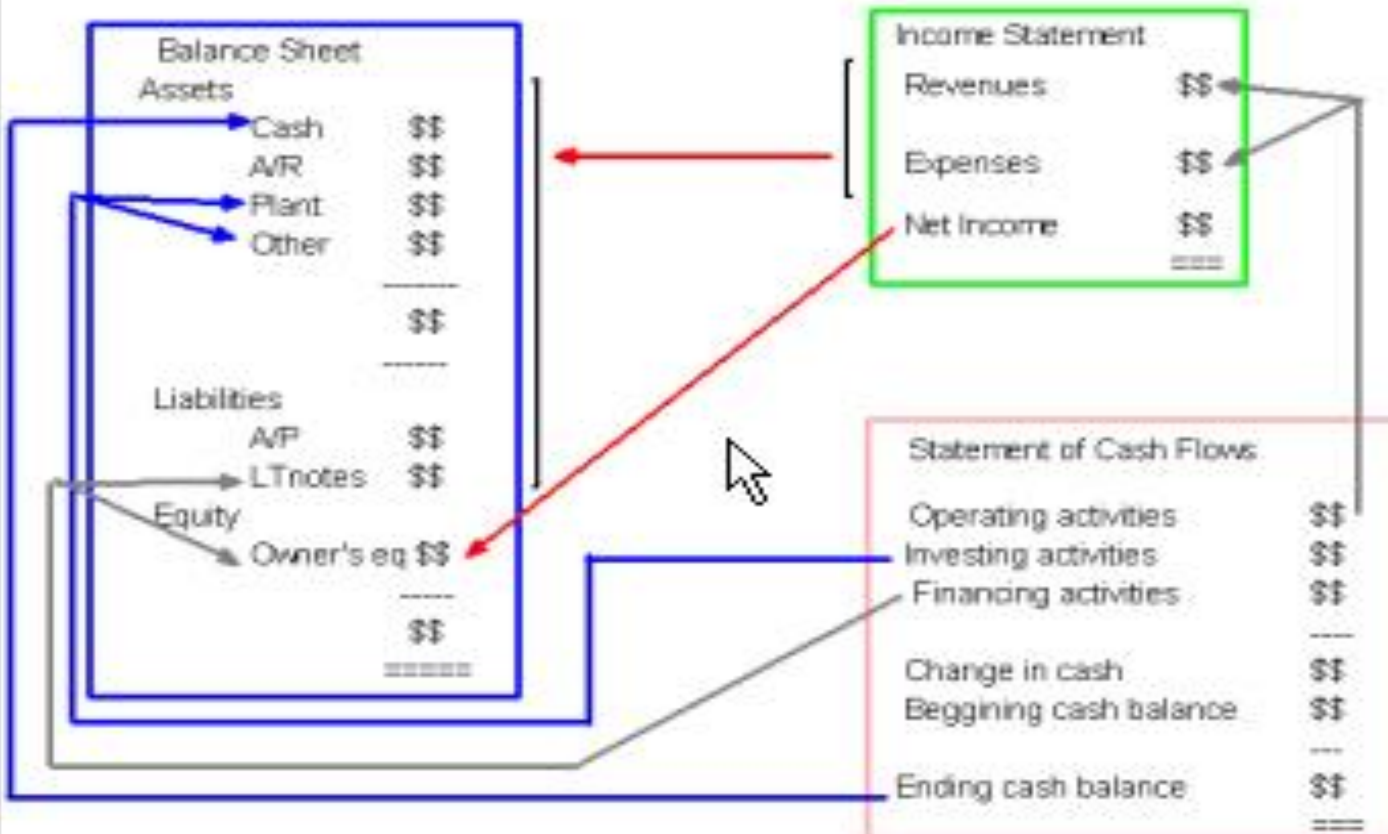
- Making sales on credit generates accounts receivable.
- Selling products requires the business to carry an inventory (stock) of products.
- Acquiring products involves purchases on credit that generate accounts payable.
- Operating expenses is a broad category of costs encompassing selling, administrative, and general expenses:
  - Some of these operating costs are prepaid before the expense is recorded, and until the expense is recorded, the cost stays in the prepaid expenses asset account.
  - Some of these operating costs involve purchases on credit that generate accounts payable.
  - Some of these operating costs are from recording unpaid expenses in the accrued expenses payable liability.
- Borrowing money on notes payable causes interest expense.
- A portion (usually relatively small) of income tax expense for the year is unpaid at year-end, which is recorded in the accrued expenses payable liability.
- Earning net income increases retained earnings.

	Balance Sheet									Income Statement				
Transaction	Cash Asset	+	Noncash Assets	=	Liabil-ities	+	Contrib. Capital	+	Earned Capital	Rev-enues	−	Expen-ses	=	Net Income
				=							−		=	

Hi please explain the relationships among financial statements

Hi thanks for your question, we are going to use a diagram to indicate relationships among the three basic financial statements (Balance Sheet, Income Statement, and Statement of Cash Flows)



As we can see in the diagram financial statements are based on the same underlying transactions

Change Zone
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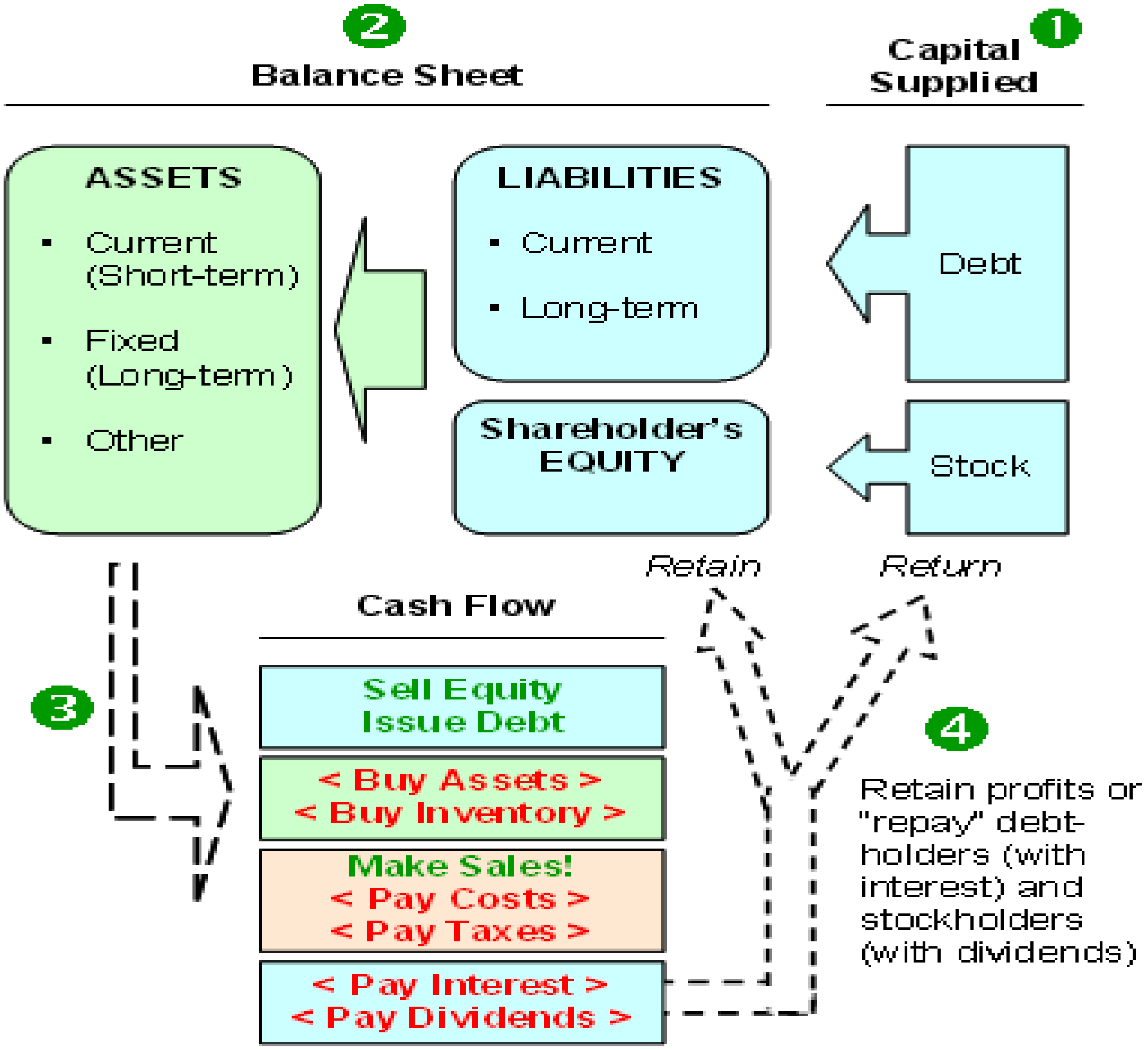

Receivable Days

Change Zone
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- **Management**
  - Collection Plan
  - Financial Terms – Fast Means
  - Dedicated Collection Role – Role overload
  - Automatic Notification
  - Legal Advisor – Case Management
  - Bad debt risk account

- **Incentives:**
  - Pointing System – Credit Ceiling System
  - Cash discount

Change Zone
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Break-Even Analysis

Change Zone
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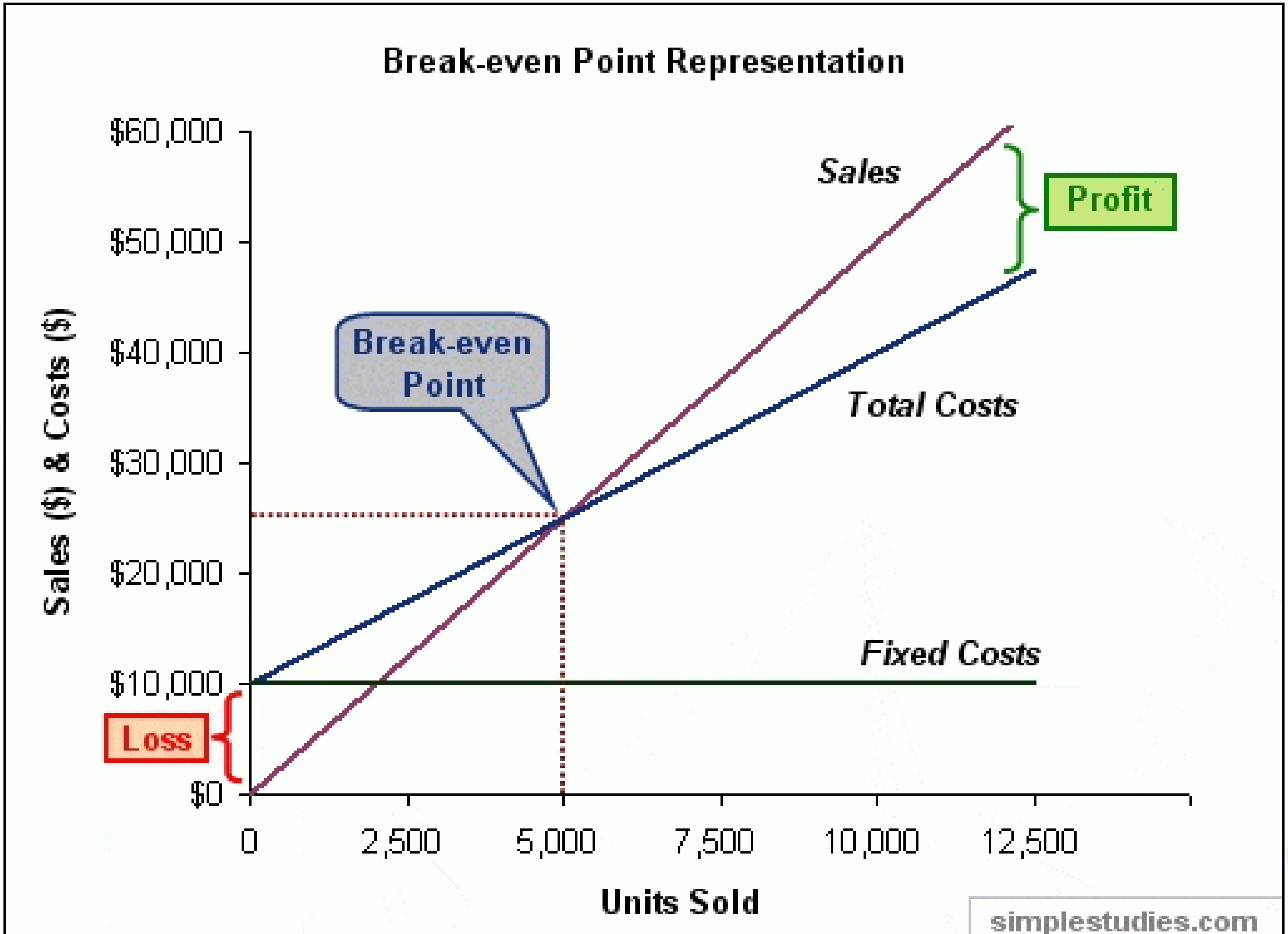
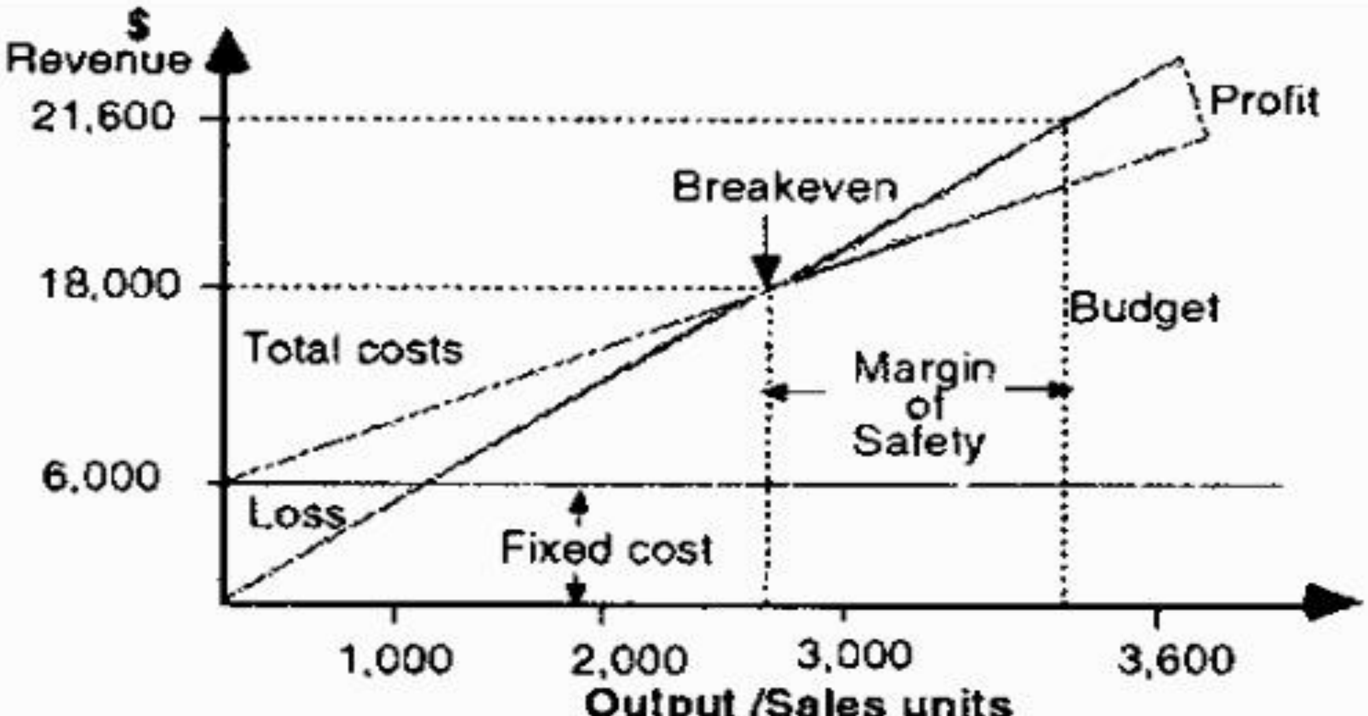


Break even chart



Change Zone

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