Financial Statements, Cash Flow, and Taxes

Pertemuan ke-5

Sumber Pustaka:
Brigham, E.F. dan J.F. Houston, 2009. *Fundamental of Financial Management*, 12th edition. South-Western Cengage Learning, USA

Kompetensi

- Setelah mengikuti pertemuan ini mahasiswa akan mampu:

  Memahami masing-masing laporan keuangan kunci dan mengidentifikasi jenis informasi yang dibutuhkan manajer perusahaan dan investor.

Pendahuluan

- A manager's primary goal is to maximize the value of his or her firm's stock, and value is based on the firm's future cash flows. But how do managers decide which actions are most likely to increase those flows, and how do investors estimate future cash flows?
- The answers to both questions lie in a study of financial statements that publicly traded firms must provide to investors.
- Here investors include both institutions (banks, insurance companies, pension funds, and the like) and individuals like you.

Financial Statements and Reports

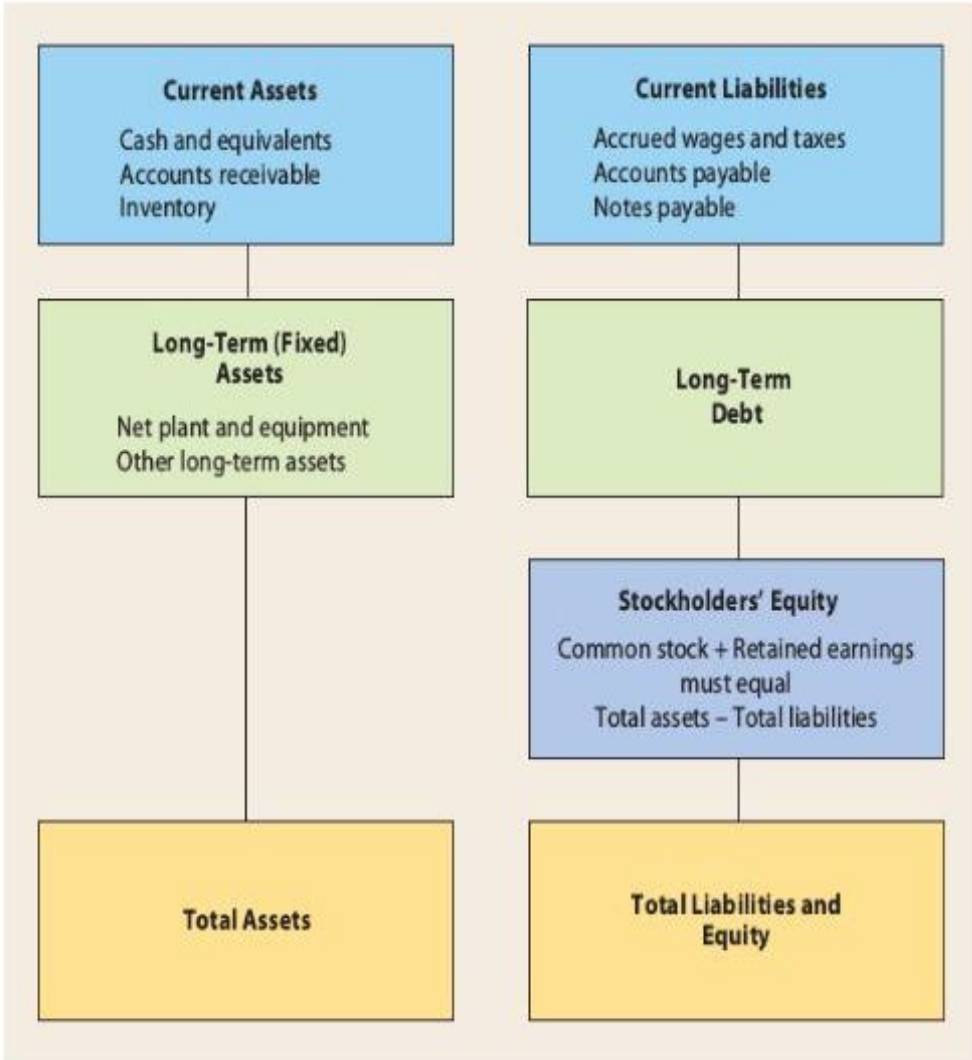
- The annual report is the most important report that corporations issue to stock-holders, and it contains two types of information.
- *First*, there is a verbal section, often presented as a letter from the chairperson, which describes the firm's operating results during the past year and discusses new developments that will affect future operations.
- *Second*, the report provides these four basic financial statements:

1. The balance sheet, which shows what assets the company owns and who has claims on those assets as of a given date—for example, December 31, 2013.
2. The income statement, which shows the firm's sales and costs (and thus profits) during some past period—for example, 2013.
3. The statement of cash flows, which shows how much cash the firm began the year with, how much cash it ended up with, and what it did to increase or decrease its cash.
4. The statement of stockholders' equity, which shows the amount of equity the stockholders had at the start of the year, the items that increased or decreased equity, and the equity at the end of the year.

- These statements are related to one another; and taken together, they provide an accounting picture of the firm’s operations and financial position.

The Balance Sheet

- The balance sheet is a "snapshot" of a firm's position at a specific point in time



- The left side of the statement shows the assets that the company owns, while the right side shows the firm’s liabilities and stockholders’ equity, which are claims against the firm’s assets.
- Assets are divided into two major categories: current assets and fixed, or long-term, assets

- The claims against assets are of two basic types—liabilities (or money the company owes to others) and stockholders' equity. Liabilities consist of claims that must be paid off within one year (current liabilities), including accounts payable, accruals (total of accrued wages and accrued taxes), and notes payable to banks that are due within one year. Long-term debt includes bonds that mature in more than a year.

- Stockholders’ equity can be thought of in two ways. First, it is the amount that stockholders paid to the company when they bought shares the company sold to raise capital, in addition to all of the earnings the company has retained over the years:

Stockholders' equity = Paid -in capital + Retained earnings

- The retained earnings are not just the earnings retained in the latest year—they are the cumulative total of all of the earnings the company has earned during its life.
- Stockholders’ equity can also be thought of as a residual:

Stockholders' equity = Total assets -- Total liabilities

Allied Food Products: December 31 Balance Sheets (Millions of Dollars)

	2008	2007
Assets		
Current assets:		
Cash and equivalents	$ 10	$ 80
Accounts receivable	375	315
Inventories	615	415
Total current assets	$1,000	$ 810
Net fixed assets:		
Net plant and equipment (cost minus depreciation)	1,000	870
Other assets expected to last more than a year	0	0
Total assets	$2,000	$1,680
Liabilities and Equity		
Current liabilities:		
Accounts payable	$ 60	$ 30
Accruals	140	130
Notes payable	110	60
Total current liabilities	$ 310	$ 220
Long-term bonds	750	580
Total debt	$1,060	$ 800
Common equity:		
Common stock (50,000,000 shares)	$ 130	$ 130
Retained earnings	810	750
Total common equity	$ 940	$ 880
Total liabilities and equity	$2,000	$1,680

Several additional points about the balance sheet should be noted

1. Cash versus other assets.

- Although assets are reported in dollar terms, only the cash and equivalents account represents actual spendable money.
- Accounts receivable represents credit sales that have not yet been collected.
- Inventories show the cost of raw materials, work in process, and finished goods.
- Net fixed assets represent the cost of the buildings and equipment used in operations minus the depreciation that has been taken on these assets.
- At the end of 2008, Allied has $10 million of cash; hence, it could write checks totaling that amount.
- The noncash assets should generate cash over time, but they do not represent cash in hand. And the cash they would bring in if they were sold today could be higher or lower than the values reported on the balance sheet.

2. Working capital

- Current assets are often called working capital because these assets “turn over”; that is, they are used and then replaced throughout the year

3. Net working capital

- When Allied buys inventory items on credit, its suppliers, in effect, lend it the money used to finance the inventory items. Allied could have borrowed from its bank or sold stock to obtain the money, but it received the funds from its suppliers.
- These loans are shown as accounts payable, and they typically are “free” in the sense that they do not bear interest

Net working capital = Current assets - (Payables + Accruals)
= \$1,000 - (\$60 + \$140) = \$800

4. Other sources of funds

- Most companies (including Allied) finance their assets with a combination of current liabilities, long-term debt, and common equity.
- Some companies also use “hybrid” securities such as preferred stock, convertible bonds, and long-term leases.
- Preferred stock is a hybrid between common stock and debt, while convertible bonds are debt securities that give the bondholder an option to exchange their bonds for shares of common stock.
- In the event of bankruptcy, debt is paid off first, then preferred stock. Common stock is last, receiving a payment only when something remains after the debt and preferred stock are paid off

5. Depreciation

- Most companies prepare two sets of financial statements—one is based on Internal Revenue Service (IRS) rules and is used to calculate taxes; the other is based on generally accepted accounting principles (GAAP) and is used for reporting to investors. Firms often use accelerated depreciation for tax purposes but straight line depreciation for stockholder reporting. Allied uses accelerated depreciation for both.

6. Market values versus book values

- Companies generally use GAAP to determine the values reported on their balance sheets. In most cases, these accounting numbers (or “book values”) are different from what the assets would sell for if they were put up for sale (or “market values”)

7. The time dimension

- The balance sheet is a snapshot of the firm's financial position at a point in time—for example, on December 31, 2008. Thus, we see that on December 31, 2007, Allied had $80 million of cash; but that balance fell to $10 million by year-end 2008.

Balance Sheet Self Test

1. What is the balance sheet, and what information does it provide?
2. How is the order in which items are shown on the balance sheet determined?
3. What was Allied’s net working capital on December 31, 2007?

Next Week: The Income Statement

- See You