# Chapter 3 Statements and Ratios

# The Stockholders’ Report

# Generally accepted accounting principles (GAAP) are the practice and procedure guidelines used to prepare and maintain financial records and reports;

# The Sarbanes-Oxley Act of 2002, passed to eliminate the many disclosure and conflict of interest problems of corporations

# More Countries Adopt International Financial Reporting Standards

# International Financial Reporting Standards (IFRS) are established by the International Accounting Standards Board (IASB).

# Focus on Ethics

# Take Earnings Reports at Face Value

# Near the end of each quarter, many companies unveil their quarterly performance.

# Firms that beat analyst estimates often see their share prices jump, while those that miss estimates by even a small amount, tend to suffer price declines.

# The practice of manipulating earnings in order to mislead investors is known as earnings management.

# Why might financial managers be tempted to manage earnings?

# Is it unethical for managers to manage earnings if they disclose their activities to investors?

# The Income Statement

# The income statement provides a financial summary of a company’s operating results during a specified period.

# Although they are prepared quarterly for reporting purposes, they are generally computed monthly by management and quarterly for tax purposes.

# Concentrate on control issue

# Gross profit – control expenses of production

# Operating profit – control of the expenses of “running” the company

# Net income – remaining profits after all expenses pai

# Personal Finance Example

#

# The Balance Sheet

# The balance sheet presents a summary of a firm’s financial position at a given point in time.

# The statement balances the firm’s assets (what it owns) against its financing, which can be either debt (what it owes) or equity (what was provided by owners).

# Represents the assets that management has purchased and uses to achieve it’s mission and goals.



# Represents the sources of financing used by management to purchase the assets of the firm.

# Personal Finance

#

# Personal Finance: Cash

#  Worksheet: Cash Management and Budget

# This part of the worksheet is used to identify major levels of revenue and expenditure.

#  Debts include only loans, not utilities etc.

# Individual personal expenses are considered in the next slide.

# In this application, Living Expenses identifies remaining cash for other monthly expenses.

# Breakdown into specific areas of spending

# Discretionary Spending

# after all revenues and expenses are accounted for this is the amount that should be left in the checkbook at the end.

# What should you do with a surplus (+)?; a deficit (-)?

# Personal Finance: Net Worth

# Balance sheet looks very similar to a corporate balance sheet.

# Net worth = Total Assets – Total Liabilities

# If you retired and sold everything you owned and paid off everyone you owed; this is what you would have to live off the rest of your life.

# When we are young this number is frequently negative. Especially if you have a student loan.

# Why?

# worksheet Personal Finance go to Cash Management area.

# Statement of Retained Earnings

# The statement of retained earnings reconciles the net income earned during a given year, and any cash dividends paid, with the change in retained earnings between the start and the end of that year.

# Statement of Cash Flows

# The statement of cash flows provides a summary of the firm’s operating, investment, and financing cash flows and reconciles them with changes in its cash and marketable securities during the period.

# This statement not only provides insight into a company’s investment, financing and operating activities, but also ties together the income statement and previous and current balance sheets.



Chapter 3 Group Assignment (82 points)

 (use financial analysis workbook / financial ratios)

Using the data from problem 3.23 in the text

 Calculate DPS and EPS using this number (2 pts)

 EPS =

 DPS =

Input data into the financial analysis input section.

1) Create a table with the industry median ratio in column 2and the company’s ratio in column 3. (30 pts)

|  |  |  |  |
| --- | --- | --- | --- |
| Ratio | 2011 | 2012 | Industry |
| CR |  |  |  |
| QR |  |  |  |
| DR |  |  |  |
| TIE |  |  |  |
| GPM |  |  |  |
| NPM |  |  |  |
| ROA |  |  |  |
| ROE |  |  |  |

2) Define these types of ratios. In general, how is the company performing with each category?

 (25 points)

 Liquidity

 Leverage

 Profitability

3) Provide a brief description of the firm’s position relative to the industry. (25 pts)

**Chapter 3 Web exercises (40)**

**Go to** [**www.reuters.com/finance/stocks**](http://www.reuters.com/finance/stocks) **to obtain financial ratios**

 **Stocks / input ticker symbol / ratios on the left**

* + **Liquidity (10)**
		- **Current and quick ratio**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Industry** | **Company**  | **Sector** |
| **CR** |  |  |  |
| **QR** |  |  |  |

**What can you say about your company’s liquidity compared to the industry and sector?**

* + **Asset Mgt Ratios (10)**
		- **DSO = 365/ Rec turnover**
		- **DCI = 365 / Inv turnover**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Industry** | **Company** | **Sector** |
| **DSO** |  |  |  |
| **DCI** |  |  |  |

**How is your company handling accounts receivable and inventory compared to the industry and the sector?**

* + **Profitability (10)**
		- **GPM, OPM, NPM**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Industry** | **Company** | **Sector** |
| **GPM** |  |  |  |
| **OPM** |  |  |  |
| **NPM** |  |  |  |

**What can you tell me about your company’s profitability relative to the industry and the sector?**

* + **Leverage ratios (10)**
		- **LT Debt to Equity , TIE (interest coverage)**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Industry** | **Company** | **Sector** |
| **Debt Equity (%)** |  |  |  |
| **TIE** |  |  |  |

**Describe your company’s level of debt relative to the industry and the sector.**