

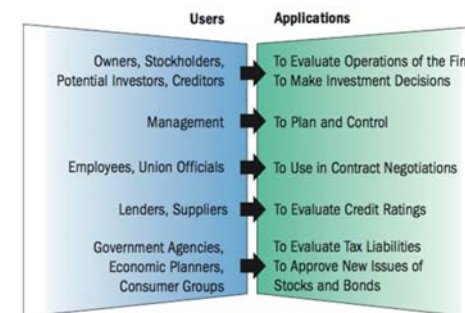
## BA 291 – ACCOUNTING AND FINANCIAL STATEMENT

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## Accounting

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**Accounting:** Process of measuring, interpreting, and communicating financial information to support internal and external business decision making.



## User of accounting information

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Accounting information

- helps managers to plan and control daily and long-range operations.
- shows how well managers are operating the organizations.
- are used by union officials in contract negotiating.
- helps employee to understand how their work affects the bottom line.
- helps potential investor (external user) to evaluate investment opportunities, whether to invest or buy firm's securities.
- helps bankers and creditors to evaluate a potential borrowers' financial soundness.

## Managerial accounting

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Managerial accounting refers to the internal use of accounting statements by managers in planning and directing the organization activities.

- Cash flow – movement of money through organization over a daily, weekly, or monthly basis. For any business to succeed, it needs to generate enough cash to pay its bills as they fall due.
- Budget – the internal financial plan that forecasts expenses and income (cash outflow and inflow) over a set period of time.



# Financial accounting

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Financial accounting is a field of accountancy concerned with the preparation of financial statements for decision makers, such as stockholders, suppliers, banks, employees, government agencies, owners, and other stakeholders.

Financial accountancy is governed by both local and international accounting standards.



# The foundation of accounting system

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## Local GAAP

- Germany (HGB – Handelsgesetzbuch)
- Thailand (พระราชบัญญัติการบัญชี Account Acts B.E. 2543)

## International accounting standards

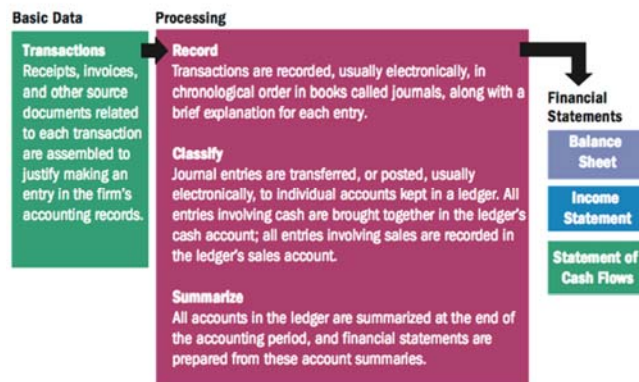
- US GAAP (Generally accepted accounting standards)
  - widely used in USA
  - The US GAAP provisions differ somewhat from International Financial Reporting Standards (IFRS)
  - all U.S. companies to drop GAAP by 2016, with the largest companies switching to IFRS as early as 2009
- IFRS (International Financial Reporting Standards)
  - adopted by the International Accounting Standards Board (IASB)
  - tends to be global standard for accounting



# The accounting process

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A set of activities involved in converting information about individual transactions into financial statements



# The accounting process

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## Double-entry bookkeeping

A system of recording and classifying business transactions in separate accounts in order to maintain the balance of the accounting equation

	Assets			=	Liabilities		+	Owners' Equity
	Cash	Equipment	Inventory		Debt to suppliers	Loans		Equity
Cash invested by Anna	\$2,500.00							\$2,500.00
Loan from SBA	\$5,000.00					\$5,000.00		
Purchase of furnishings	-\$3,000.00	\$3,000.00						
Purchase of inventory	-\$2,000.00		\$2,000.00					
Purchase of roses			\$3,250.00		\$3,250.00			
First month sales	\$2,000.00		-\$1,500.00					\$500.00
Totals	\$4,500.00	\$3,000.00	\$8,250.00	=	\$3,250.00	\$5,000.00		\$3,000.00
	\$8,325			=	\$5,325		+	\$3,000
	\$8,325 Assets			=	\$8,325 Liabilities + Owners' Equity			



## The accounting process

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The accounting equation

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

- **Assets** - anything of value owned or leased by a business.
- **Liability** - claim against a firm's assets by a creditor.
- **Owner's equity** - all claims of the proprietor, partners, or stockholders against the assets of a firm, equal to the excess of assets over liabilities.



## Financial statement

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Financial statements provide managers with essential information needed to evaluate liquidity position of an organization – its ability to meet current obligations and needs by converting assets into cash, the firm's profitability and its overall financial health.

Important financial statements are:

- The balance sheet
- Income statement
- Statement of cash flow



## Financial statement

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Who has to provide the financial statement according to Thai law?

Type of business	Balance sheet	Income statement	Statement of changes in shareholders	Statement of cash flows	Financial statement notes
Registered partnership	X	X			X
Limited liability company	X	X	X		X
Public company	X	X	X	X	X
Legal entity based on foreign law	X	X	X		X
Joint venture	X	X	X	X	X



## The balance sheet

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- A "snapshot" of an organization's financial position
- The balance sheet indicate what the organization owns or controls and the various source of funds used to pay for these assets.
- The balance sheet takes its name from its reliance on the accounting equation.

ASSETS		LIABILITIES	
<b>Current Assets</b>		<b>Current Liabilities</b>	
Cash	\$ 100,000	Accounts payable	\$ 90,000
Short-term investments	50,000	Salaries payable	10,000
Accounts receivable	75,000	Interest payable	15,000
Inventories	200,000	Taxes payable	5,000
Prepaid insurance	25,000	Current portion of note	40,000
	\$ 450,000		\$ 150,000
<b>Long-term Investments</b>		<b>Long-term Liabilities</b>	
Stock investments	\$ 40,000	Note payable	\$ 190,000
Cash value of insurance	10,000	Mortgage liability	300,000
	50,000		110,000
<b>Property, Plant &amp; Equip.</b>		<b>Total Liabilities</b>	
Land	\$ 25,000		\$ 450,000
Building and equipment	\$ 150,000		
Less: Accumulated depreciation	(50,000)		
	100,000		
	125,000	<b>STOCKHOLDERS' EQUITY</b>	
<b>Intangible Assets</b>		Capital stock	\$ 300,000
Goodwill	275,000	Retained earnings	160,000
<b>Other Assets</b>		<b>Total Stockholders' Equity</b>	
Receivable from employee	10,000		460,000
	10,000		
<b>Total Assets</b>	<b>\$ 910,000</b>	<b>Total Liabilities and Equity</b>	<b>\$ 910,000</b>

Shasta Outfitters		
Balance Sheet		
Year Ending January 31		
(\$ millions)	2007	2006
<b>Current Assets</b>		
Cash and equivalents	23.50	20.40
Short-term investments	65.50	52.30
Accounts receivable	13.90	12.30
Inventory	100.50	90.00
Total current assets	203.40	175.00
<b>Fixed assets</b>		
Fixed assets	382.00	285.00
(Accumulated depreciation)	(142.30)	(104.00)
Net fixed assets	239.70	181.00
<b>Total Assets</b>	<b>443.10</b>	<b>356.00</b>
<b>Current Liabilities</b>		
Accounts payable	32.50	18.50
Accruals	22.56	19.40
Short-term debt	45.23	38.00
Total current liabilities	100.29	75.90
Long-term debt	20.31	10.80
Total Liabilities	120.60	86.70
Owner's Equity	322.50	269.30
Total Assets and Equity	443.10	356.00

## The balance sheet

**Assets:** The major category for all physical, monetary or intangible goods that have some value

**Current assets:** Assets that are either cash or are expected to be turned into cash within the next 12 months.

- Cash and cash equivalent: cash or checking account
- Marketable securities: Short-term investment in securities that can be converted into cash quickly (liquid asset)
- Accounts receivable: Cash due from customers in payment for goods received. (sales on credit)
- Inventory: Finished goods ready for sale, goods in process, or raw materials
- Prepaid expense: A future expense item that has already been paid.

## The balance sheet

**Non-current assets (fix assets):** Assets that are long term in nature or have a minimum life expectancy that exceeds one year

- Long-term investment: assets held as investment in bonds or small ownership in other companies
- Gross property, plant and equipment: Land, buildings and other fix assets listed at original cost
- Intangible assets: non-monetary assets that cannot be seen, touched or physically measured (trade secret, copyright, patents, trademarks, knowhow, goodwill)
- Other assets: any other asset that is long term and does not fit into above categories

## The balance sheet

### Liabilities and stockholders' equity

Liabilities refer to all indebtedness and loans of both long-term and short-term nature. Stockholders' equity is all money that has been contributed to the company over the life of the firm by the owners

### Current liabilities

- Accounts payable: money owed to suppliers for goods ordered. Firms usually have between 30-90 days to pay this account.
- Wages payable: money owed to employees for hours worked or salary.
- Note payable: short-term loans from banks or other lenders.
- Unearned revenue for services paid for by customers but not yet provided
- Accrued expense: all unpaid financial obligations incurred by the organization
- Other current liabilities: other short-term debts that do not fit above categories



## The balance sheet

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**Long-term liabilities:** All long-term debt that will not be paid in the next 12 months

- Long term debt: loans of more than one year from banks, pension funds, insurance companies or other lenders (debenture, loan, mortgage)

**Stockholders' equity:** owners' initial amount of investment in the company

- Common stock: The tangible evidence of ownership is a security called common stock. The par value is stated value and does not indicate the company's worth.
- Capital in excess of par
- Retain earnings: reinvestment of earnings into company assets



## The income statement

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The income statement is a financial record of a company's revenues, expenses, and profits over a period of time (month, quarter, year)

<b>Shasta Outfitters</b>		
<b>Income Statement</b>		
Year Ending January 31, 2007		
<b>(\$ millions)</b>	<b>2007</b>	<b>2006</b>
Net sales	713.00	615.00
Cost of sales	410.00	375.30
Gross profit	303.00	239.70
Operating expenses	175.60	152.30
Operating profit	127.40	87.40
Depreciation	38.30	32.00
Net interest	3.70	2.70
Taxable income	85.40	52.70
Taxes	25.62	15.81
Net income	59.78	36.89
Dividends	6.58	5.30



## The income statement

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**Revenues (sales):** Total amount of products and service sold over a specific period of time

**Cost of goods sold:** the cost of producing the goods and services, including the cost of labor and raw material and other expenses associated with production

**Operating expense:** the cost of promoting, advertising and selling products as well as the overhead cost of managing the company.

**Interest expense:** A cost of borrowing money

**Taxes:** The tax rate is specified in the tax law

**Depreciation:** The process of spreading the costs of long-lived assets over the total number of accounting periods

**Net income:** Sales minus total expenses, profit after tax



## The statement of cash flows

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Statement of cash flow provides the information about firm's cash receipts and cash payments for its operations, investments and financing activities during an accounting period.

Many investors and other users of financial statements want more information about the cash flowing into and out of the firm in order to better understand the company's financial health.





## The statement of cash flows

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### Cash from operating activities:

This section shows how much cash comes from sales of the company's goods and services. Operating cash flows include:

- Receipts from the sale of goods or services
- Receipts for the sale of loans, debt or equity instruments in a trading portfolio
- Interest received on loans
- Payments to suppliers for goods and services.
- Payments to employees or on behalf of employees
- Interest payments
- Buying Merchandise



## The statement of cash flows

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### Cash from investing activities

This section largely reflects the amount of cash the company has spent on capital expenditures to keep the business going.

Examples of Investing activities are

- Purchase or Sale of an asset (assets can be land, building, equipment, marketable securities, etc.)
- Loans made to suppliers or received from customers
- Payments related to mergers and acquisitions
- Dividends Received



## The statement of cash flows

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### Cash from financing activities

This section describes the goings-on of cash associated with outside financing activities. Typical sources of cash inflow and outflow in financial activities are:

- Proceeds from issuing short-term or long-term debt
- Payments of dividends
- Payments for repurchase of company shares
- Repayment of debt principal, including capital leases



## The statement of cash flows

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<b>Shasta Outfitters</b>	
<b>Statement of Cash Flows</b>	
Year Ending January 31, 2007	
	(\$ millions)
<b>Cash Flow from Operations</b>	
Net income	59.78
Depreciation	38.30
Decrease (increase) in inventory	(10.50)
Decrease (increase) in accounts receivable	(1.60)
Increase (decrease) in current liabilities	24.39
<b>Total cash flow from operations</b>	<b>110.37</b>
<b>Cash Flow from Investing Activities</b>	
Capital expenditures	(97.00)
Short-term investments	(13.20)
<b>Total cash flow from investing activities</b>	<b>(110.20)</b>
<b>Cash Flow from Financing Activities</b>	
Cash dividends	(6.58)
Long-term debt	9.51
<b>Total cash flow from financing activities</b>	<b>2.93</b>
<b>Total cash flow</b>	<b>3.10</b>
Cash and equivalents (beginning of period)	20.40
Cash and equivalents (end of period)	23.50

Which company would you like to invest?

	Company A	CompanyB	Company C
Cash from operating activities	500000	0	0
Cash from investing activities	0	500000	0
Cash from financing activities	0	0	500000
Total cash-flow	500000	500000	500000

The process of evaluating businesses, projects, budgets and other finance-related entities to determine their suitability for investment. Financial analysis is used to analyse whether an entity is stable, solvent, liquid, or profitable enough to be invested in. It indicates the past performance of an organization, the ability to gain profits and ability to manage organizational assets. It helps investors to predict the risks within an organization.



- **Trend analysis:** analysis that tries to predict the future movement of a stock based on past data. Trend analysis is based on the idea that what has happened in the past gives traders an idea of what will happen in the future.

- **Ratio analysis** Tool for measuring a firm's liquidity, profitability, and reliance on debt financing, as well as the effectiveness of management's resource utilization.

Liquidity ratio is used to measure the ability of a firm to meet its short-term obligations when they must be paid.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\text{Quick ratio} = \frac{\text{Current assets} - \text{inventory}}{\text{Current liabilities}}$$



## Case 3

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### Liquidity ratio

Ratio	2000	2001	2002	2003
Current ratio	2.61	2.94	1.69	2.3
Quick ratio	0.13	0.11	0.07	0.08



## Profitability Ratios

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Ratio that measure the ability to generate revenues in excess of operating costs and other expenses.

$$\text{Profit margin} = \frac{\text{Net income}}{\text{Sales}}$$

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Assets}}$$

$$\text{Return on equity} = \frac{\text{Net income}}{\text{Equity}}$$



## Case 2

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### Profitability ratios

Ratio	2001	2002	2003	2004
Gross margin	46	44	39	39
Net profit margin	26	24	18	12
ROE	23	14	11	8
ROA	9	6	4	6



## Asset Utilization Ratios (Activity ratio)

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Ratios that measure how well a firm uses its assets to generate each 1\$ of sales

$$\text{Receivables turnover} = \frac{\text{Sales}}{\text{Receivables}}$$

$$\text{Inventory turnover} = \frac{\text{Sales}}{\text{Inventory}}$$

$$\text{Total asset turnover} = \frac{\text{Sales}}{\text{Total assets}}$$

## Debt Utilization Ratios (Leverage ratio)

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Ratios that measure how much debt an organization is using relative to other sources of capital. It shows the extent to which a firm relies on debt financing.

$$\text{Debt to total assets} = \frac{\text{Total debt}}{\text{Total assets}}$$

$$\text{Times interest earned} = \frac{\text{Income before interest \& taxes}}{\text{Interest expense}}$$

## Budget

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- Planning and control tool that reflects a firm's expected sales revenues, operating expenses, and cash receipts and outlays.
- Management estimates of expected sales, cash inflows and outflows, and costs.
- Budgets are a financial blueprint that serves as a financial plan.

## Budget

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