TEST FOR PREVIOUS LEARNING MATERIALS UNDERSTANDING

Answer the questions about international activities of the enterprise:

1. The system of economic relations, characterized by the penetration of some countries into the economies of others through commodity circulation is named ______________________________

2. Visible international trade flows are the services provided to foreign nationals both domestically (such as tourism), and abroad (such as banking services, insurance services) (TRUE/FALSE)

3. Neutral strategy can be translated into a small incentive that can make a huge impact psychologically on customers. Customers are more willing to buy the necessary products at $4,99 than products costing $5. (TRUE/FALSE)

In 5 minutes in one message write your name and answer to the test on the piece of paper or in Zoom chat personally to the teacher (NOT IN COMMON CHAT!!!), and your attendance would be assessed at 0,5 point

Financial accounting.
Enterprise' risks and bankruptcy

Content

1. What is financial accounting and reporting
2. Analysis of financial results of the enterprise
3. Enterprise’ bankruptcy

1. Financial accounting

Financial accounting is a specialized branch of accounting that keeps track of a company's financial transactions. Using standardized guidelines, the transactions are recorded, summarized, and presented in a financial report or financial statement such as an income statement or a balance sheet.

Companies issue financial statements on a routine schedule. The statements are considered *external* because they are given to people outside of the company, with the primary recipients being owners/stockholders, as well as certain lenders. If a corporation's stock is publicly traded, however, its financial statements (and other financial reports) tend to be widely circulated, and information will likely reach secondary recipients such as competitors, customers, employees, labor organizations, and investment analysts.

Under the accrual basis, revenues are reported when they are *earned*, not when the money is received. Similarly, expenses are reported when they are *incurred*, not when they are paid. For example, although a magazine publisher receives a $24 check from a customer for an annual subscription, the publisher reports as revenue a monthly amount of $2 (one-twelfth of the annual subscription amount). In the same way, it reports its property tax expense each month as one-twelfth of the annual property tax bill.

1. Financial accounting

It's important to point out that the purpose of financial accounting is <u>not to report the value of a company</u>. Rather, **its purpose is to provide enough information for others to assess the value of a company for themselves**.

Because external financial statements are used by a variety of people in a variety of ways, financial accounting has common rules known as **accounting standards** and as **generally accepted accounting principles (GAAP).** In the U.S., the Financial Accounting Standards Board (FASB) is the organization that develops the accounting standards and principles. Corporations whose stock is publicly traded must also comply with the reporting requirements of the Securities and Exchange Commission (SEC), an agency of the U.S. government.

Double Entry and the Accrual Basis of Accounting

At the heart of financial accounting is the system known as double entry bookkeeping (or "double entry accounting"). Each financial transaction that a company makes is recorded by using this system.

The term "double entry" means that <u>every transaction affects at least two accounts</u>.

For example, if a company borrows $50,000 from its bank, the company's **Cash account** increases, and the company's **Notes Payable account** increases. Double entry also means that one of the accounts must have an amount entered as a debit, and one of the accounts must have an amount entered as a credit. For any given transaction, the debit amount must equal the credit amount.

Double Entry and the Accrual Basis of Accounting

The advantage of double entry accounting is: at any given time, the balance of a company's asset accounts will equal the balance of its liability and stockholders' (or owner's) equity accounts.

The financial statements used in financial accounting present the five main classifications of financial data: revenues, expenses, assets, liabilities and equity. Revenues and expenses are accounted for and reported on the income statement. They can include everything from R&D to payroll.

Financial accounting results in the determination of net income at the bottom of the income statement. Assets, liabilities and equity accounts are reported on the balance sheet. The balance sheet utilizes financial accounting to report ownership of the company's future economic benefits.

Accounting Principles

1. Economic Entity Assumption

The accountant keeps all of the *business* transactions of a sole proprietorship separate from the business owner's *personal* transactions. For *legal* purposes, a sole proprietorship and its owner are considered to be one entity, but for accounting purposes they are considered to be two separate entities.

2. Monetary Unit Assumption

Economic activity is measured in U.S. dollars, and only transactions that can be expressed in U.S. dollars are recorded.

Because of this basic accounting principle, it is assumed that the dollar's purchasing power has not changed over time. As a result accountants ignore the effect of inflation on recorded amounts. For example, dollars from a 1960 transaction are combined (or shown) with dollars from a 2019 transaction.

Accounting Principles

3. Time Period Assumption assumes that it is possible to report the complex and ongoing activities of a business in relatively short, distinct time intervals such as the five months ended May 31, 2020, or the 5 weeks ended May 1, 2020. It is *imperative* that the time interval (or period of time) be shown in the heading of each income statement, statement of stockholders' equity, and statement of cash flows. Labeling one of these financial statements with "December 31" is not good enough–the reader needs to know if the statement covers the *one week* ended December 31, 2019 the *month* ended December 31, 2019 the *three months* ended December 31, 2019 or the *year ended* December 31, 2019.

4. Cost Principle From an accountant's point of view, the term "cost" refers to the amount spent (cash or the cash equivalent) when an item was *originally* obtained, whether that purchase happened last year or thirty years ago. For this reason, the amounts shown on financial statements are referred to as *historical* cost amounts.

Because of this accounting principle asset amounts are *not* adjusted upward for inflation. In fact, as a general rule, asset amounts are not adjusted to reflect *any* type of increase in value. Hence, an asset amount does not reflect the amount of money a company would receive if it were to sell the asset at today's market value. (An exception is certain investments in stocks and bonds that are actively traded on a stock exchange.)

Accounting Principles

5. Full Disclosure Principle

If certain information is important to an investor or lender using the financial statements, that information should be disclosed within the statement or in the notes to the statement. It is because of this basic accounting principle that numerous pages of "footnotes" are often attached to financial statements.

A company usually lists its significant accounting policies as the first note to its financial statements.

6. Going Concern Principle

This accounting principle assumes that a company will continue to exist long enough to carry out its objectives and commitments and will not liquidate in the foreseeable future. If the company's financial situation is such that the accountant believes the company will *not* be able to continue on, the accountant is required to disclose this assessment.

The going concern principle allows the company to defer some of its prepaid expenses until future accounting periods.

7. Matching Principle requires companies to use the accrual basis of accounting. The expenses are matched with revenues. Because we cannot measure the future economic benefit of things such as advertisements (and thereby we cannot match the ad expense with related future revenues), the accountant charges the ad amount to expense in the period that the ad is run.

Accounting Principles

8. Revenue Recognition Principle Under the accrual basis of accounting (as opposed to the cash basis of accounting), revenues are recognized as soon as a product has been sold or a service has been performed, regardless of when the money is actually received. Under this basic accounting principle, a company could earn and report $20,000 of revenue in its first month of operation but receive $0 in actual cash in that month.

9. Materiality An accountant might be allowed to violate another accounting principle if an amount is insignificant. Professional judgement is needed to decide whether an amount is insignificant or immaterial. An example of an obviously immaterial item is the purchase of a $150 printer by a highly profitable multi-million dollar company. Because the printer will be used for five years, the matching principle directs the accountant to expense the cost over the five-year period. The materiality guideline allows this company to violate the matching principle and to expense the entire cost of $150 in the year it is purchased. The justification is that no one would consider it misleading if $150 is expensed in the first year instead of $30 being expensed in each of the five years that it is used.

10. Conservatism If a situation arises where there are two acceptable alternatives for reporting an item, conservatism directs the accountant to choose the alternative that will result in less net income and/or less asset amount. Conservatism helps the accountant to "break a tie." It does not direct accountants to be conservative. Accountants are expected to be unbiased and objective.

Financial Statements

Balance Sheet	Income Statement	Statement of Cash Flows (Direct or Indirect Method)
Assets • Current Assets • Property, Plant & Equipment • Other Assets	**Operating Income** • Sales • Cost of Goods Sold • Gross Profit • Operation Expenses • Operating Income	**Operating Activities** • Operating cash flows • Investing cash flows
Liabilities • Current Liabilities • Long-term Liabilities	**Other** • Other Revenue • Other Expense	**Investing Activities**
Equity	**Continuing Operations** • Income Before Taxes • Income Taxes • Income from Continuing Operations	**Financing Activities**
	Discontinued operations net of tax	**Change in Cash**
	Extraordinary Item (net of tax)	
	Net Income	

Financial Statements

Balance Sheet

The balance sheet is organized into three parts: (1) assets, (2) liabilities, and (3) stockholders' equity at a specified date (typically, this date is the last day of an accounting period).

The first section of the balance sheet reports the company's assets and includes such things as cash, accounts receivable, inventory, prepaid insurance, buildings, and equipment. The next section reports the company's liabilities; these are obligations that are due at the date of the balance sheet and often include the word "payable" in their title (Notes Payable, Accounts Payable, Wages Payable, and Interest Payable). The final section is stockholders' equity, defined as the difference between the amount of assets and the amount of liabilities.

Financial Statements

Income Statement reports a company's profitability during a specified period of time. The period of time could be one year, one month, three months, 13 weeks, or any other time interval chosen by the company.

The main components of the income statement are revenues, expenses, gains, and losses. Revenues include such things as sales, service revenues, and interest revenue. Expenses include the cost of goods sold, operating expenses (such as salaries, rent, utilities, advertising), and nonoperating expenses (such as interest expense). If a corporation's stock is publicly traded, the earnings per share of its common stock are reported on the income statement.

Financial Statements

Statement of Comprehensive Income covers the same period of time as the income statement, and consists of two major sections:

Net income (taken from the income statement)

Other comprehensive income (adjustments involving foreign currency translation, hedging, and postretirement benefits)

The sum of these two amounts is known as *comprehensive income*.

The amount of *other comprehensive income* is added/subtracted from the balance in the stockholders' equity account Accumulated Other Comprehensive Income.

Financial Statements

Statement of Cash Flows explains the change in a company's cash (and cash equivalents) during the time interval indicated in the heading of the statement. The change is divided into three parts: (1) operating activities, (2) investing activities, and (3) financing activities.

The *operating activities* section explains how a company's cash (and cash equivalents) have changed due to operations. *Investing activities* refer to amounts spent or received in transactions involving long-term assets. The *financing activities* section reports such things as cash received through the issuance of long-term debt, the issuance of stock, or money spent to retire long-term liabilities.

Statement of Stockholders' (or shareholders') Equity lists the changes in stockholders' equity for the same period as the income statement and the cash flow statement. The changes will include items such as net income, other comprehensive income, dividends, the repurchase of common stock, and the exercise of stock options.

Introduction to Chart of Accounts

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.

Within the categories of operating revenues and operating expenses, accounts might be further organized by business function (such as producing, selling, administrative, financing) and/or by company divisions, product lines, etc.

A company's **organization chart** can serve as the outline for its accounting chart of accounts. For example, if a company divides its business into ten departments (production, marketing, human resources, etc.), each department will likely be accountable for its own expenses (salaries, supplies, phone, etc.). Each department will have its own phone expense account, its own salaries expense, etc.

A chart of accounts will likely be as large and as complex as the company itself. An international corporation with several divisions may need thousands of accounts, whereas a small local retailer may need as few as one hundred accounts.

Introduction to Chart of Accounts

Some general rules about debiting and crediting the accounts are:

- **Expense** accounts are *debited* and have *debit balances*
- **Revenue** accounts are *credited* and have *credit balances*

- **Asset** accounts normally have *debit balances*

To increase an **asset** account, *debit* the account
To decrease an **asset** account, *credit* the account

- **Liability** accounts normally have *credit balances*

To increase a **liability** account, *credit* the account
To decrease a **liability** account, *debit* the account

To learn more about accounting: https://www.accountingcoach.com/

Chart of Accounts (example)

Asset Accounts

No.	Account Title	To Increase	Description/Explanation of Account
101	Cash	Debit	Checking account balance (as shown in company records), currency, coins, checks received from customers but not yet deposited.
120	Accounts Receivable	Debit	Amounts owed to the company for services performed or products sold but not yet paid for.
140	Merchandise Inventory	Debit	Cost of merchandise purchased but has not yet been sold.
150	Supplies	Debit	Cost of supplies that have not yet been used. Supplies that have been used are recorded in Supplies Expense.
160	Prepaid Insurance	Debit	Cost of insurance that is paid in advance and includes a future accounting period.
170	Land	Debit	Cost to acquire and prepare land for use by the company.
175	Buildings	Debit	Cost to purchase or construct buildings for use by the company.
178	Accumulated Depreciation – Buildings	Credit	Amount of the buildings' cost that has been allocated to Depreciation Expense since the time the building was acquired.
180	Equipment	Debit	Cost to acquire and prepare equipment for use by the company.
188	Accumulated Depreciation – Equipment	Credit	Amount of equipment's cost that has been allocated to Depreciation Expense since the time the equipment was acquired.

Chart of Accounts (example)

Liability Accounts

No.	Account Title	To Increase	Description/Explanation of Account
210	Notes Payable	Credit	The amount of principal due on a formal written promise to pay. Loans from banks are included in this account.
215	Accounts Payable	Credit	Amount owed to suppliers who provided goods and services to the company but did not require immediate payment in cash.
220	Wages Payable	Credit	Amount owed to employees for hours worked but not yet paid.
230	Interest Payable	Credit	Amount owed for interest on Notes Payable up until the date of the balance sheet. This is computed by multiplying the amount of the note times the effective interest rate times the time period.
240	Unearned Revenues	Credit	Amounts received in advance of delivering goods or providing services. When the goods are delivered or services are provided, this liability amount decreases.
250	Mortgage Loan Payable	Credit	A formal loan that involves a lien on real estate until the loan is repaid.

Chart of Accounts (example)

Owner's Equity Accounts

No.	Account Title	To Increase	Description/Explanation of Account
290	Mary Smith, Capital	Credit	Amount the owner invested in the company (through cash or other assets) plus earnings of the company not withdrawn by the owner.
295	Mary Smith, Drawing	Debit	Amount that the owner of the sole proprietorship has withdrawn for personal use during the current accounting year. At the end of the year, the amount in this account will be transferred into Mary Smith, Capital (account 290).

Operating Revenue Accounts

No.	Account Title	To Increase	Description/Explanation of Account
310	Service Revenues	Credit	Amounts earned from providing services to clients, either for cash or on credit. When a service is provided on credit, both this account and Accounts Receivable will increase. When a service is provided for immediate cash, both this account and Cash will increase.

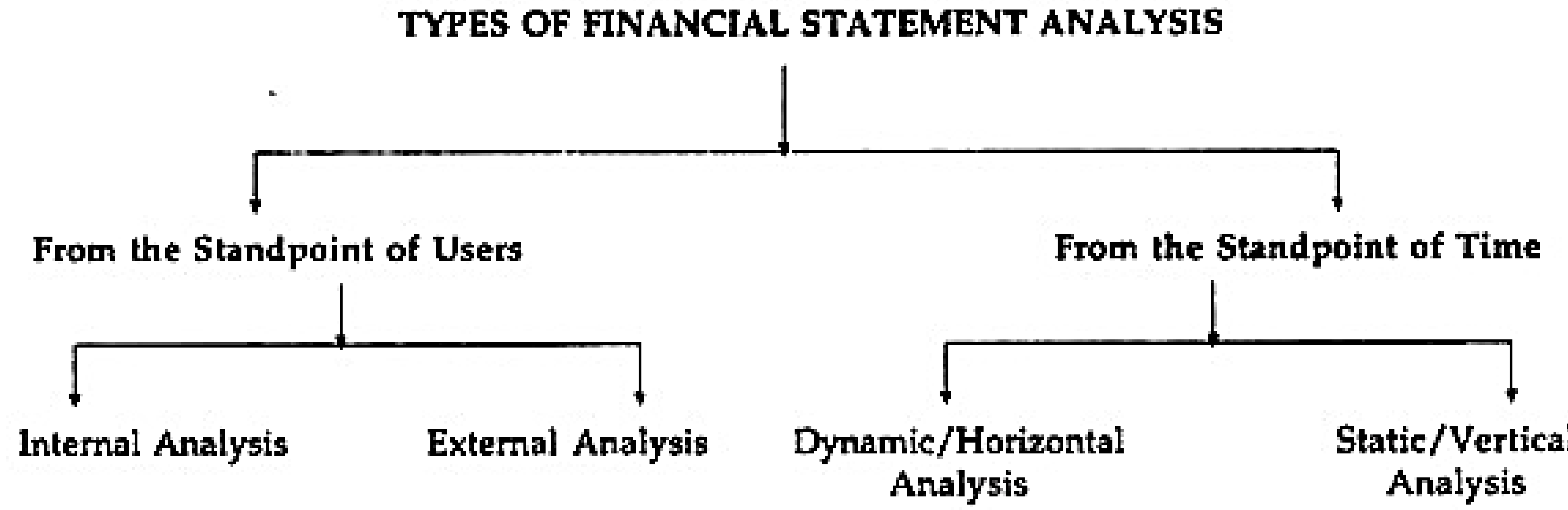
Chart of Accounts (example)

Operating Expense Accounts

No.	Account Title	To Increase	Description/Explanation of Account
500	Salaries Expense	Debit	Expenses incurred for the work performed by salaried employees during the accounting period. These employees normally receive a fixed amount on a weekly, monthly, or annual basis.
510	Wages Expense	Debit	Expenses incurred for the work performed by non-salaried employees during the accounting period. These employees receive an hourly rate of pay.
540	Supplies Expense	Debit	Cost of supplies used up during the accounting period
560	Rent Expense	Debit	Cost of occupying rented facilities during the accounting period.
570	Utilities Expense	Debit	Costs for electricity, heat, water, and sewer that were used during the accounting period.
576	Telephone Expense	Debit	Cost of telephone used during the current accounting period.
610	Advertising Expense	Debit	Costs incurred by the company during the accounting period for ads, promotions, and other selling and expenses (other than salaries).
750	Depreciation Expense	Debit	Cost of long-term assets allocated to expense during the current accounting period.

Non-Operating Revenues and Expenses, Gains, and Losses

No.	Account Title	To Increase	Description/Explanation of Account
810	Interest Revenues	Credit	Interest and dividends earned on bank accounts, investments or notes receivable. This account is increased when the interest is earned and either Cash or Interest Receivable is also increased.
910	Gain on Sale of Assets	Credit	Occurs when the company sells one of its assets (other than inventory) for more than the asset's book value.
960	Loss on Sale of Assets	Debit	Occurs when the company sells one of its assets (other than inventory) for less than the asset's book value.



(a) Internal Analysis: is done by the management who desires to know the financial health and operational efficiency, management efficiency of the firm.

(i) It is based on internal books of accounts and internal information.

(ii) In order to evaluate the management efficiency and other necessary information internal analysis is done by the management.

(iii) Progress or otherwise of the firm can be assessed

(iv) It discovers the weakness of the firm and takes proper remedial steps to overcome such weakness and for future courses of action.

(v) Internal analysis of financial statements helps the management to make plans and also to take decision on the basis of performances.

(vi) Operational efficiency can be measured by the Operating Ratio (Operating Ratio = Cost of goods sold + Operating Expenses / Sales x 100) which is an important indicator for measuring operational efficiency of a firm.

(b) External Analysis: is conducted by the outsiders, viz. creditors, bankers, investors, etc. These outsiders neither have any access to internal accounts of the firm nor have any right to inspect the books of accounts, method of accounting etc. They are to depend primarily on the published annual report of the company as well as on the reports of directors and auditors.

(i) This analysis is conducted by the external users of financial statements.

(ii) This analysis is done on the basis of published annual reports.

(iii) Liquidity and solvency positions can be measured with the help of financial ratios.

(iv) Investors are interested to know the long-term solvency positions and the return on their investment from the analysis of external financial statements.

(v) External analysis are done by the various interested group after computing the required ratios which serves the valuable information.

(c) **Dynamic/Horizontal Analysis**: is practically a Time Series Analysis of data contained in financial statements. It throws light on the companion of financial data for a number of years against a base year. It indicates the progress or otherwise of the firm over a number of years by a comparative time series analysis.

In this type of analysis, comparative financial statements and trend percentage analysis are the common tools for measuring the comparison. The data are taken from the Income Statements, Balance Sheets and other relevant information. The comparison is made between two years or over a number of years.

The data are arranged horizontally in a statement, one column being used for each year. These figures can also be graphically presented. Since it covers a number of years for such analysis it is also called Dynamic Analysis. This analysis helps to understand the trend of the firm. This proves particularly very meaningful and significant when it is supported by comparative statements.

(d) Static/Vertical Analysis: is done usually at a particular point of time, say at the closing day of the year/year end i.e. when financial statements are analyzed and interpreted on a single set of statement. Practically it presents the structural relationship of different items contained in the financial statements.

It provides the structural balance and financial soundness or otherwise of a firm.

For example, Current Ratio (Current Assets / Current Liabilities), Net Profit Ratio (Net Profit / Sales x 100) etc. Since it considers only one year's financial statement it is called static analysis. Accounting ratios and Common Size statements are two tools that are used for this analysis.

This method has some **<u>advantages</u>**:

(i) It is very easy to analyse and interpret since only single set of financial statement is taken;

(ii) It is a short period analysis of data;

(iii) Usually it relates to current year's financial statement analysis etc.

Similarly, it has got some **<u>limitations</u>**:

(i) It does not recognize the past and future data for comparison;

(ii) It throws light on the current financial position taken the data from the Income Statement and Balance Sheet.

Traditional Financial Statement Analysis

Traditional financial statement analysis is the analysis of financial/accounting data taken from financial statements by the use of traditional tools of analysis of simple technique viz. Accounting ratios, Percentage of Inter-firm Comparison, Intra-firm Comparison, Common Size Statement etc. to ascertain the relationship amongst the various related factors for ordinary investigation (and not for specific purposes) and information.

Its main features:

(a) Application of Tools: No advanced or modern techniques or tools (viz. mathematical application, statistical application etc.) are applied for the purpose of analysis of financial statements, usually, the ratios/percentage are used for the purpose.

(b) Depending on Past Data: The technique depends on the past financial data contained in the past financial statement, which looks backward and not forward.

Traditional Financial Statement Analysis

Traditional financial statement analysis main features (extension):

(c) Type of Analysis: The analysis depends on the available information presented by the financial statement.

(d) Purpose of Use: The analysis is not made with the object of supplying a specific information to the users but the same supplies general information as a whole.

(e) Prediction of Future: Prediction of future for general information is made on the basis of past activities assuming that the same trend will continue in future i.e. Past-based future.

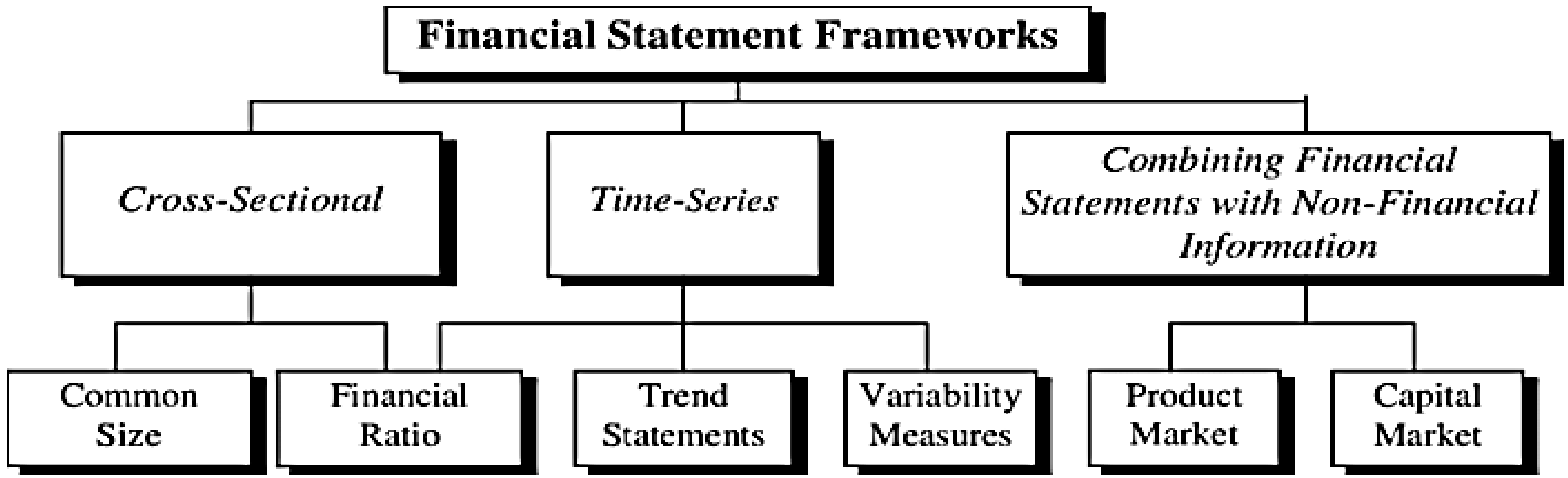
(f) Limited Scope: Since the analysis depend on the traditional financial statements only, the scope of supplying more meaningful information is limited i.e. it cannot always supply the required information of the users.

Traditional Financial Statement Analysis

Traditional financial statement analysis main features (extension):

(g) Change in Price-level: This analysis does not recognize the effect of changing price-level as it is based on past data i.e. past data are not converted into market value basis.

(h) Helpful for General Information: An analyst or any user of accounting information may have a financial picture in general with the application of traditional tools which will help him to take decisions about the future.



Traditional Financial Statement Analysis

has the following advantages:

(a) Since very simple techniques or tools are used for the purpose of analysis, it is very simple and easy to understand i.e. ratio /percentage analysis, common-size statement are easily comparable.

(b) The required data for the purpose of analysis are easily available from the published annual report of an enterprise which helps the analyst to take required information after applying various tools.

(c) The financial statements are prepared on the basis of historical cost and following the standing accounting principles, concept and convention. Thus, these are objectively useful, as possibility of applying personal judgment or bias is limited here.

(d) Inter-firm comparison among the companies is possible since all the companies usually follow the GAAP. Thus, comparison among them becomes meaningful and significant for the purpose of analysis.

(e) Since the financial statements are prepared and analysed with the help of a good number of people, scope for manipulating accounts is limited.

Traditional Financial Statement Analysis

has the following limitations:

(a) Since only old techniques and tools are applied here, critical and important information are not available from the analysis

(b) Since it is based on past data, prediction on the basis of such past data does not prove to be quite meaningful and significant for the prediction of future activities.

(c) The analysis does not recognise the effect of changing price-level as it is based on historical cost basis.

(d) Financial decision cannot be made by the analysis of traditional financial statements as it is not meant for decision-making.

(e) Since this analysis presents only the general information, specific information, if required by an analyst, is not possible.

(f) It does not recognise the non-financial factors (e.g. human resources, customers' relation etc.) which also play a very significant role.

(g) The effect of window dressing in financial statements actually distorted the accounting data. As such, analysis on the basis of distorted facts proves useless and misleading.

Guide to financial statement analysis

#1 Income statement analysis. Most analysts start their analysis of financial statements with the income statement. Intuitively, this is usually the first thing we think about with a business…we often ask questions such as, "how much revenue does it have, is it profitable, what are the margins like?" In order to answer these questions, and much more, we will dive into the income statement to get started. There are two main types of analysis we will perform: vertical analysis and horizontal analysis.

- **Vertical analysis.** We look up and down the income statement (hence, "vertical" analysis) to see how every line item compares to revenue, as a percentage. For example, in the income statement shown below, we have the total dollar amounts and the percentages, which make up the vertical analysis. As you see in the above example, we do a thorough analysis of the income statement by seeing each line item as a proportion of revenue.

Guide to financial statement analysis

The key metrics we look at are:

- Cost of Goods Sold (COGS) as a percent of revenue
- Gross profit as a percent of revenue
- Depreciation as a percent of revenue
- Selling General & Administrative (SG&A) as a percent of revenue
- Interest as a percent of revenue
- Earnings Before Tax (EBT) as a percent of revenue
- Tax as a percent of revenue
- Net earnings as a percent of revenue

	Year ended December 31,			Year ended December 31,		
(in millions)	**2018**	**2017**	**2016**	**2018**	**2017**	**2016**
Revenue	**$5,000**	**$4,000**	**$3,000**	**100%**	**100%**	**100%**
COGS	(3,200)	(3,000)	(2,500)	-64%	-75%	-83%
Gross Profit	**1,800**	**1,000**	**500**	**36%**	**25%**	**17%**
Depreciation	(500)	(450)	(400)	-10%	-11%	-13%
SG&A	(300)	(300)	(300)	-6%	-8%	-10%
Interest	(50)	(50)	(50)	-1%	-1%	-2%
Earnings Before Tax	**950**	**200**	**(250)**	**19%**	**5%**	**-8%**
Tax	(225)	(20)	0	-5%	-1%	0%
Net Earnings	**725**	**180**	**-250**	**15%**	**5%**	**-8%**

Guide to financial statement analysis

#1 Income statement analysis

- **Horizontal Analysis**. We look across the income statement at the year-over-year (YoY) change in each line item.

In order to perform this exercise, you need to take the value in Period N and divide it by the value in Period N-1 and then subtract 1 from that number to get the percent change.

For example, revenue in 2017 was $4,000 and in 2016 it was $3,000. The YoY change in revenue is equal to $4,000 / $3,000 minus one, which equals 33%.

	Year ended December 31,			Year ended December 31,		
(in millions)	2018	2017	2016	2018	2017	2016
Revenue	**$5,000**	**$4,000**	**$3,000**	**25%**	**33%**	**na**
COGS	(3,200)	(3,000)	(2,500)	7%	20%	na
Gross Profit	**1,800**	**1,000**	**500**	**80%**	**100%**	**na**
				na	na	na
Depreciation	(500)	(450)	(400)	11%	13%	na
SG&A	(300)	(300)	(300)	0%	0%	na
Interest	(50)	(50)	(50)	0%	0%	na
Earnings Before Tax	**950**	**200**	**(250)**	**375%**	**180%**	**na**
				na	na	na
Tax	(225)	(20)	0	1025%	na	na
Net Earnings	**725**	**180**	**-250**	**303%**	**172%**	**na**

Guide to financial statement analysis

#2 Balance sheet and leverage ratios. In this section of financial statement analysis, we will evaluate the operational efficiency of the business. We take several items on the income statement and compare them to the company's capital assets on the balance sheet.

The balance sheet metrics can be divided into several categories, including liquidity, leverage, and operational efficiency.

The main liquidity ratios for a business are:

Quick ratio | Current ratio | Net working capital

The main leverage ratios are:

Debt to equity | Debt to capital | Debt to EBITDA

Interest coverage | Fixed charge coverage ratio

The main operating efficiency ratios are:

Inventory turnover | Accounts receivable days

Accounts payable days | Total asset turnover

Net asset turnover

Using these ratios, we can determine how efficiently a company is generating revenue and how quickly it's selling inventory.

Guide to financial statement analysis

#3 Cash flow statement analysis. With the income statement and balance sheet under our belt, let's look at the cash flow statement and all the insights it tells us about the business.

The cash flow statement will help us understand the inflows and outflows of cash over the time period we're looking at.

Cash flow statement overview

The cash flow statement, or statement of cash flow, consist of three components:

Cash from operations

Cash used in investing

Cash from financing

Each of these three sections tells us a unique and important part of the company's sources and uses of cash during the time period being evaluated.

Many investors consider the cash flow statement the most important indicator of a company's performance and it's hard to imagine that until only recently companies didn't even have to file a cash flow statement.

Today, investors quickly flip to this section to see if the company is actually making money or not, and what its funding requirements are.

It's important to understand how different ratios can be used to properly assess the operation of an organization from a cash management standpoint.

Guide to financial statement analysis

#4 Rates of return and profitability analysis. In this part of our analysis of financial statements, we unlock the drivers of financial performance. By using the pyramid of ratios, we are able to demonstrate how you can determine the profitability, efficiency, and leverage drivers for any business.

The key insights to be derived from the pyramid of ratios include:

Return on equity ratio (ROE)

Profitability, efficiency, and leverage ratios

Primary, secondary, and tertiary ratios

Dupont analysis

Types of financial sustainability

- Absolute – the sources of own working capital are higher than the actual value of stocks and costs;
- Normal – stocks are higher than own working capital, but less than planned sources of their coverage;
- Unstable situation – insufficient solvency, but the restoring the balance of assets and debts is possible by attracting deposit funds and loans;
- Crisis situation – the company finances its expenses accumulating unpaid bills

3. Bankruptcy of the enterprise

Bankruptcy is the legal proceeding involving a person or business that is unable to repay outstanding debts. The bankruptcy process begins with a petition filed by the debtor, which is most common, or on behalf of creditors, which is less common. All of the debtor's assets are measured and evaluated, and the assets may be used to repay a portion of outstanding debt.

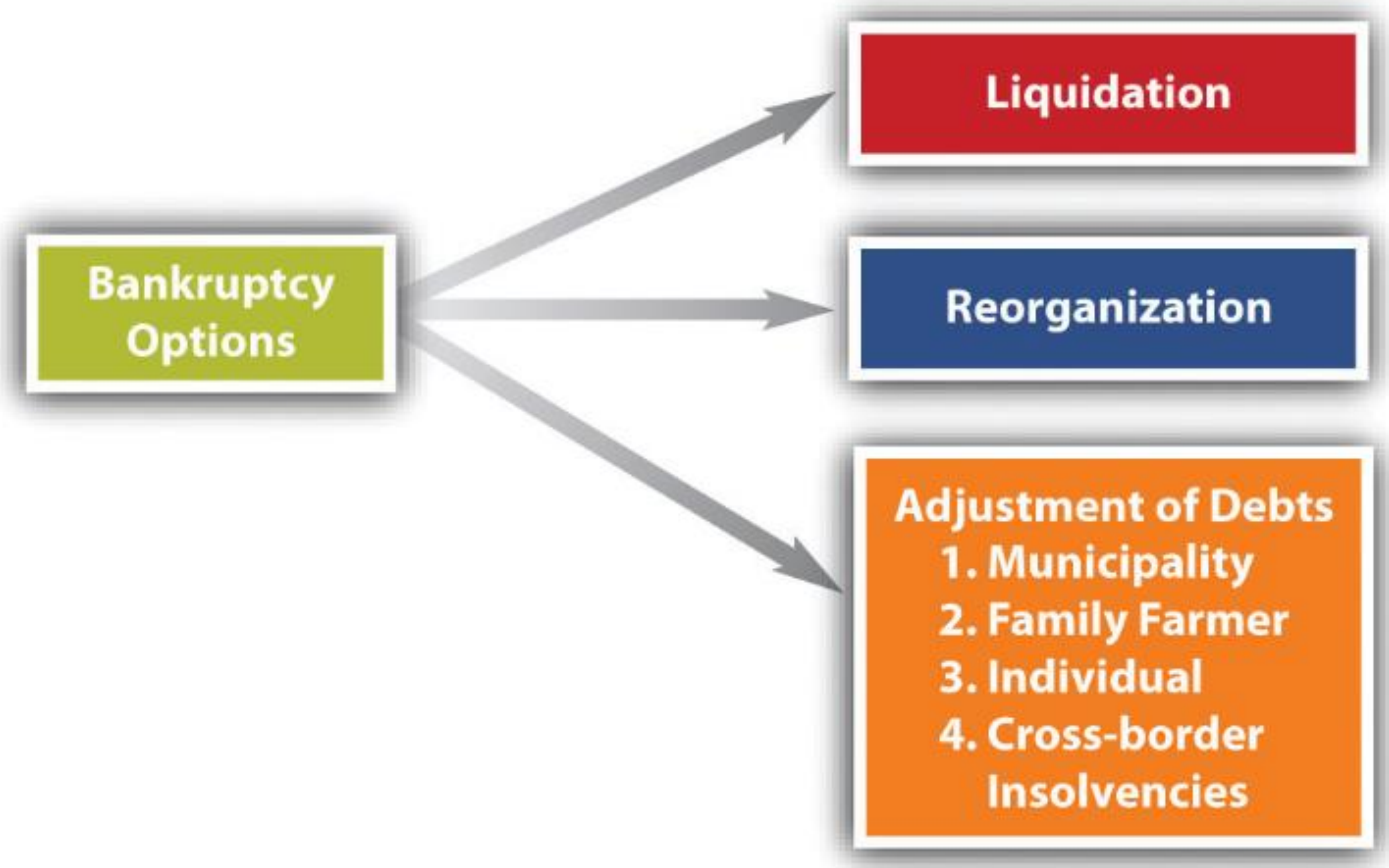
In most jurisdictions, bankruptcy is imposed by a court order, often initiated by the debtor.

Bankrupt is not the only legal status that an insolvent person may have, and the term bankruptcy is therefore not a synonym for insolvency.

3. Bankruptcy of the enterprise

Bankruptcy offers an individual or business a chance to start fresh by forgiving debts that simply cannot be paid while offering creditors a chance to obtain some measure of repayment based on the individual's or business's assets available for liquidation. In theory, the ability to file for bankruptcy can benefit an overall economy by giving persons and businesses a second chance to gain access to consumer credit and by providing creditors with a measure of debt repayment. Upon the successful completion of bankruptcy proceedings, the debtor is relieved of the debt obligations incurred prior to filing for bankruptcy.

Types of bankruptcies (USA example)



Types of bankruptcies (USA example)

There are 6 basic types of bankruptcy cases provided for under the Bankruptcy Code, each of which is discussed in this article. The cases are traditionally given the names of the chapters that describe them.

Chapter 7 bankruptcy (Liquidation) encompasses two main rules. First, Chapter 7 does do away with legal obligations of the debtor to satisfy debts existing when the bankruptcy was filed. Second, the debtor's property will be taken and sold to pay the creditors. In order to qualify to file for a Chapter 7 bankruptcy, there are several stipulations. The debtor must qualify financially using the "Means Test". The debtor must not have had a case dismissed within the last 6 months. Also a person cannot eliminate debt via a Chapter 7 bankruptcy if a Chapter 7 was filed within the last 8 years or a Chapter 13 within the last 6 years.

Chapter 9 bankruptcy, entitled Adjustment of Debts of a Municipality, is designed for "municipalities" such as cities, towns, counties, taxing districts, and school districts. Chapter 9 bankruptcy allows for the reorganization of debt by extending the repayment timeline. This allows the debt to be refinanced or a principal or interest reduction on existing debts.

Chapter 13 bankruptcy, entitled Adjustment of Debts of an Individual with Regular Income, allows individuals with a regular income to devise a plan to satisfy all or a portion of their debt. Debtors offer a repayment plan that allows for installment payments lasting over a typical timeframe of 3 to 5 years

Types of bankruptcies (USA example)

Chapter 11 bankruptcy, entitled Reorganization, is available to partnerships, corporations, and individuals. It is typically the bankruptcy filed by large businesses that wish to restructure debt. There are no limits on the amount of debt, as with Chapter 13 bankruptcy. Due to their simplicity and lower cost, individuals usually file for a Chapter 7 or Chapter 13 bankruptcy, instead of a Chapter 11 bankruptcy.

Chapter 12 bankruptcy, entitled Adjustment of Debts of a Family Farmer or Fisherman with Regular Annual Income, is only available to family farmers or family fishermen. Chapter 12 was put together in response to difficulties faced by farmers and fishermen in the 1980s. While it has some similarities to that of a Chapter 13 bankruptcy, it offers more flexibility with the payments. This helps to understand how nature and seasonal periods affect the uniqueness of these operations. Chapter 12 bankruptcies are typically less expensive that Chapter 11.

Chapter 15 bankruptcy is probably the least known type of bankruptcy. Added to the Bankruptcy Code in 2005, Chapter 15 bankruptcy (Ancillary and Other Cross-Border Cases) offers the opportunity for foreign debtors to access U.S. bankruptcy courts.