Income Statement. In fact, account balances are not used in the Cash Flow statement. The accounts are analyzed to determine the Sources (inflows) and Uses (outflows) of cash over a period of time.

There are 3 types of cash flow (CF):
Operating - CF generated by normal business operations

Investing - CF from buying/selling assets: buildings, real estate, investment portfolios, equipment.

Financing - CF from investors or long-term creditors

The SEC (Securities and Exchange Commission) requires companies to follow GAAP in their financial statements. That doesn't mean companies do what they are supposed to do. Enron executives had millions of reasons ($$) to falsify financial information for their own personal gain. Auditors are independent CPAs hired by companies to determine whether the rules of GAAP and full disclosure are being followed in their financial statements. In the case of Enron and Arthur Andersen, auditors sometimes fail to find problems that exist, and in some cases might have also failed in their responsibilities as accounting professionals.

Retained Earnings

The ***Retained Earnings*** (RE) account has a special purpose. It is used to accumulate the company's earnings, and to pay out dividends to the company's stockholders. Let's look at the first part of that for a moment.

At the end of the fiscal year, all Revenue and Expense accounts are closed to Income Summary, and that account is closed to Retained Earnings. Profits increase RE; losses will decrease RE. So the RE account might go up or down from year to year, depending on whether the company had a profit or loss that year.

The changes in the RE accounts are called "Changes in Retained Earnings" and are presented in the financial statements. This information can be included in the Income Statement, in the Balance Sheet, or in a separate statement called the Statement of Changes in Retained Earnings. Each company can decide how to present the information, but it must be presented in one of those three places.

Most financial statements today include a Statement of Retained Earnings. Some companies prepare a Statement of Stockholders' Equity to give a more comprehensive picture of their financial events. This statement includes information about how many shares of stock were outstanding over the year, and provides other valuable information for large companies with a complex capital structure. The changes in RE are included in the Stockholders' Equity statement.

Net Cash Flow:

Chapter#3
Financial Statement Analysis

Financial statement analysis can be referred as a process of understanding the risk and profitability of a company by analyzing reported financial info, especially annual and quarterly reports.

Reasons for Analysis

Financial statements analysis may be carried out by either internal or external users.

What do internal users use it for?

Internal users (Management) analyze financial statements for the following reasons.

- Evaluating the financial statements
- Planning according to the past performance.
- And controlling company operations

What do external users use it for?

- To check long term solvency for Investment decisions
- Creditors to check the liquidity for Credit decisions
- Investors for Valuation for investment decisions.
- Government for regulations and tax purposes.

Advantages of financial statement analysis

The different advantages of financial statement analysis are listed below:

- The most important benefit if financial statement analysis is that it provides an idea to the investors about deciding on investing their funds in a particular company.
- Another advantage of financial statement analysis is that regulatory authorities like IASB can ensure the company following the required accounting standards.
- Financial statement analysis is helpful to the government agencies in analyzing the taxation owed to the firm.

Shows that it takes 36.5 days for an average debtor to be collected

Fixed assets turnover Ratio

- This ratio shows that how efficiently the firm uses their fixed assets.
- Greater the fixed assets turnover greater is their efficiency.

Formula

Sales/Net fixed Assets

Total Assets Turnover ratio

- Shows the turnover of total assets with respect of sales.
- Shows the efficiency of total assets, that how much of revenue is generated by total assets
- Greater turnover shows that assets produce greater sales with respect to their value.

Formula

Sales/ Total Assets

(C) Debt Management Ratio

- Debt management ratios show how the firm is financed and how better the firm van pay their long term debt and interest payment.
- Investors, creditors and banks are often interested in calculating these ratios
- Three important debt management ratios are

Total Liabilities to total assets ratio

- This ratio compares total liabilities of the firm with total assets
- Shows the percentage of assets purchased by taking liabilities
- Higher the ratio greater will be the leverage, which shows that most of the assets are financed through debt.
- If most assets are financed through debt solvency risk will be high and will be less attractive for investors and long term creditors.

Formula

Total liabilities/ Total assets

= 150,000/250,000

= 0.6 or 60%

Which means that 60% of the assets are financed through liabilities?

Times Interest earned Ratio

Trend Analysis, Common Size Analysis and Percent Change Analysis

Trend Analysis

An aspect of technical 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.

Trend analysis
Trend analysis Is one of the tools for the analysis of the company's monetary statements for the investment purposes. Investors use this analysis tool a lot in order to determine the financial position of the business. In a trend analysis, the financial statements of the company are compared with each other for the several years after converting them in the percentage. In the trend analysis, the sales of each year from the 2008 to 2011 will be converted into percentage form in order to compare them with each other. In order to convert the figures into percentages for the comparison purposes, the percentages are calculated in the following way:
Trend analysis percentage = (figure of the previous period – figure of the current period)/total of both figures

The percentage can be found this way and if the current-year percentages were greater than previous year percentage, this would mean that current-year result is better than the previous year result.

Common-Size Analysis

Common-size analysis (also called vertical analysis) expresses each line item on a single year's financial statement as a percent of one line item, which is referred to as a base amount. The base amount for the balance sheet is usually total assets (which is the same number as total liabilities plus stockholders' equity), and for the income statement it is usually net sales or revenues. By comparing two or more years of common-size statements, changes in the mixture of assets, liabilities, and equity become evident. On the income statement, changes in the mix of revenues and in the spending for different types of expenses can be identified.

Percentage Change Analysis

A percent change analysis shows how two items changed as a percentage from one period to another period. Used on a balance sheet, a percent change analysis shows how a balance sheet account changes from year to year, or quarter to quarter. The balance sheet accounts are assets, liabilities and stockholders' equity. Percent change analysis is important for managers and investors to see how a company is growing or retracting from year-to-year.

End of Chapter

Chapter#4

Financial Planning and Forecasting Financial Statements

Financial Planning - Definition, Objectives and Importance

Definition of Financial Planning

Financial Planning is the process of estimating the capital required and determining its competition. It is the process of framing financial policies in relation to procurement, investment and administration of funds of an enterprise.

Objectives of Financial Planning

Financial Planning has got many objectives to look forward to:

a. Determining capital requirements- This will depend upon factors like cost of current and fixed assets, promotional expenses and long- range planning. Capital requirements have to be looked with both aspects: short- term and long- term requirements.
b. Determining capital structure- The capital structure is the composition of capital, i.e., the relative kind and proportion of capital required in the business. This includes decisions of debt- equity ratio- both short-term and long- term.
c. Framing financial policies with regards to cash control, lending, borrowings, etc.
d. A finance manager ensures that the scarce financial resources are maximally utilized in the best possible manner at least cost in order to get maximum returns on investment.

Importance of Financial Planning

Financial Planning is process of framing objectives, policies, procedures, programmes and budgets regarding the financial activities of a concern. This ensures effective and adequate financial and investment policies. The importance can be outlined as-

1. Adequate funds have to be ensured.
2. Financial Planning helps in ensuring a reasonable balance between outflow and inflow of funds so that stability is maintained.
3. Financial Planning ensures that the suppliers of funds are easily investing in companies which exercise financial planning.
4. Financial Planning helps in making growth and expansion programmes which helps in long-run survival of the company.

5. Financial Planning reduces uncertainties with regards to changing market trends which can be faced easily through enough funds.
6. Financial Planning helps in reducing the uncertainties which can be a hindrance to growth of the company. This helps in ensuring stability and profitability in concern.

Forecasting Financial Statements

Introduction:

Financial Forecasting describes the process by which firms think about and prepare for the future. The forecasting process provides the means for a firm to express its goals and priorities and to ensure that they are internally consistent. It also assists the firm in identifying the asset requirements and needs for external financing.

For example, the principal driver of the forecasting process is generally the sales forecast. Since most Balance Sheet and Income Statement accounts are related to sales, the forecasting process can help the firm assess the increase in Current and Fixed Assets which will be needed to support the forecasted sales level. Similarly, the external financing which will be needed to pay for the forecasted increase in assets can be determined.

Strategic Planning:

Strategic planning provides the vision, direction and goals for the business. Strategic planning is an organization's process of defining its strategy, or direction, and making decisions about allocating its resources to pursue this strategy. In order to determine the direction of the organization, it is necessary to understand its current position and the possible avenues through which it can pursue a particular course of action. A financial forecast is an estimate of future financial outcomes for a company. Using historical internal accounting and sales data, in addition to external market and economic indicators, a financial forecast is an economist's best guess of what will happen to a company in financial terms over a given time period—which is usually one year.

Operating Plans:

Operational planning is a subset of strategic work planning which describes short-term ways of achieving milestones and explains how. The strategic plan will be put into operation during a given operational period. An operational plan draws directly from agency and program strategic plans to describe agency and program missions and goals, program objectives, and program activities.

Like a strategic plan, an operational plan addresses four questions:

- Where are we now?
- Where do we want to be?
- How do we get there?

hypothetical practice was summarized, and the financial model used to test out various alternatives available to the practice was described

Sales Forecasts:

Sales forecasting is estimating what a company's future sales are likely to be based on sales records as well as market research. The information used in them must be well organized and may include information on the competition and statistics that affect the businesses' customer base. Companies try to forecast sales in hopes of identifying patterns so that revenue and cash flow can be maximized.

Before the forecasting process begins, marketing, sales, or other managers should determine how far ahead the estimate should be done. Short-term forecasting is a maximum of three months and is often effective for analyzing budgets and markets. Intermediate forecasting is between a period of three months and two years and may be used for schedules, inventory and production. Long-term forecasting is for a minimum of two years and is good for dealing with growth into new markets or new products. Sales forecasts should be conducted regularly and all results need to be measured so that future methods can be adjusted if necessary.

Basically, sales forecasting is analyzing all parts of a business from total inventory to the strengths and weaknesses of salespeople. Managers must think about changes in customer sales or other changes that could affect the estimated figures. They must be competitive when assessing the competition and how they can surpass others in the marketplace to better meet the needs of the target market.

Financial Statement Forecasting Methods

To forecast financial data, corporate leadership and department heads rely on various methods and tools. These include appraisal methodologies, such as vertical and horizontal analyses, as well as financial ratios, such as net profit margin and return on equity. Forecasted financial information is also known as pro forma or projected accounting information.

Following are some methods of forecasting Financial Statements

Statistical Forecasting

- Statistical forecasting enables department heads to project financial statements based on assumptions and internally derived factors. For example, supervisors may review the state of the economy and take government-published GDP metrics to estimate how much the company might grow sales in the future -- say, in one, two or 10 years. Gross domestic product, or GDP, is the total market value of goods and services produced within a nation's borders during a given period.

Ratio Method

- In ratio analysis, a company uses previously calculated metrics to forecast financial statement data. Financial ratios indicate everything from efficiency and profitability to solvency and liquidity. Examples include net profit margin, asset-turnover ratio and

Chapter # 06

Risk and Return

What is Risk?

The probability or threat of quantifiable damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive action.

In Finance: The probability that an actual return on an investment will be lower than the expected return. Financial risk can be divided into the following categories: Basic risk, Capital risk, Country risk, Default risk, Delivery risk, Economic risk, Exchange rate risk, Interest rate risk, Liquidity risk, Operations risk, Payment system risk, Political risk, Refinancing risk, risk, Settlement, Sovereign risk, and Underwriting risk.

What Are the Different Types of Risk?

***Systematic Risk** - Systematic risk influences a large number of assets. A significant political event, for example, could affect several of the assets in your portfolio. It is virtually impossible to protect yourself against this type of risk.

***Unsystematic Risk** - Unsystematic risk is sometimes referred to as "specific risk". This kind of risk affects a very small number of assets. An example is news that affects a specific stock such as a sudden strike by employees. Diversification is the only way to protect you from unsystematic risk.

Now that we've determined the fundamental types of risk, let's look at more specific types of risk, particularly when we talk about stocks and bonds.

Credit or Default Risk - Credit risk is the risk that a company or individual will be unable to pay the contractual interest or principal on its debt obligations. This type of risk is of particular concern to investors who hold bonds in their portfolios.

Country Risk - Country risk refers to the risk that a country won't be able to honor its financial commitments. When a country defaults on its obligations, this can harm the performance of all other financial instruments in that country as well as other countries it has relations with. Country risk applies to stocks, bonds, mutual funds, options and futures that are issued within a particular country.

Foreign-Exchange Risk - When investing in foreign countries you must consider the fact that currency exchange rates can change the price of the asset as

Measurements: measures can be summed and amalgamated, target and actual data can be collected and reported automatically, and early indicators of variance can be displayed. Appropriate VBM drivers can be linked to each metric.

Investor communication: disclosure of relevant information, the goal being to avoid unnecessary surprises and minimize the uncertainty. Top level views can give management an overall view of VBM performance.
Continuous improvement: highlight key areas that need improvement through drill down and analysis, correlation of drivers with outcomes and personalized information portals.

Corporate Governance and shareholders wealth

Corporate Governance is "the system by which an organization is directed and controlled." In particular, corporate governance is concerned with the potential abuse of power and the need for openness, integrity and accountability in corporate decision making. The main objective of the firm is always to maximize shareholders wealth. The major decisions that have an influence on shareholder wealth maximization are investment, financing and dividend decisions. This study was carried out to clearly show the extent to which corporate governance contributes to shareholder wealth maximization. It delineates the role, duties and obligations of all Board of Directors and therefore helps avoid agency conflicts. The researcher looked at the various variables of corporate governance i.e. the Board composition, Number of Board meetings, attributes of board members and directors' remuneration strategy and showed the extent to which they contribute towards shareholder wealth maximization.

End of Chapter

Chapter #10

Capital Structure Decisions

Capital Structure

A mix of a company's long-term debt, specific short-term debt, common equity and preferred equity. The capital structure is how a firm finances its overall operations and growth by using different sources of funds.

Debt comes in the form of bond issues or long-term notes payable, while equity is classified as common stock, preferred stock or retained earnings. Short-

- If the SEC determines that your registration materials are complete and accurate, approval of your application will be provided in writing. The next step is to begin selling your company's stock. If the SEC does not approve your application, you will receive a letter with comments on the incomplete or inaccurate information in your prospectus. Your company should respond to the SEC's comments in writing with amendments to your registration that explain or otherwise address these comments.

Begin your road show.

- Distribute your prospectus with information about the amount of stock to be released and the preliminary price in meetings with potential investors. This is called a road show. A road show typically lasts around 2 weeks and it involves managers having multiple meetings in many cities.
- Decide on the final price for your stock on the last day of your road show.

Make the initial public offering of your company's stock on the stock market at the end of your road show.

- To list your stock with the New York Stock Exchange (NYSE) your company must meet the basic criteria for listing your stock: earnings of $40 million or greater; shares priced at a minimum of $4.
- Complete the application and accompanying documents for listing your stock. You can download these forms from the NYSE website.
- Pay the listing and annual fees. Information on the NYSE website offers details about how to calculate fees.
- On the 4th day after the initial offering, underwriters are allowed to purchase their agreed upon number of shares at a discounted rate as "payment" for their service in taking your company public.

Chapter #13

LEASE FINANCING

Definition of Lease:

A legal document outlining the terms under which one party agrees to rent property from another party. A lease guarantees the lessee (the renter) use of an asset and guarantees the lessor (the property owner) regular payments from the lessee for a specified number of months or years. Both the lessee and the lessor must uphold the terms of the contract for the lease to remain valid.

Leases are the contracts that lay out the details of rental agreements in the real estate market. For example, if you want to rent an apartment, the lease will describe how much the monthly rent is, when it is due, what will happen if you don't pay, how much of a security deposit is required, the duration of the lease, whether you are allowed to have pets, how many occupants may live in the unit and any other essential information. The landlord will require you to sign the lease before you can occupy the property as a tenant.

The Two Parties to Leasing:

The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent.

Types of Leases:

The most common types of leases are as Follows:

Operating Lease:

Operating leases, also called service leases, are agreements between two parties in which one provides rent to the other for using an asset. In an operating lease, the borrower uses an asset for only a fixed portion of the assets life. The owner of the asset is responsible for all maintenance costs and other operating costs associated with the leased asset.

Finance or Capital Lease:

Capital leases, also called finance leases, are those in which the borrower has full control over the use of the asset(s) during its lease period, is responsible for all maintenance and other associated costs and is directly affected by its associated advantages and disadvantages.