

# Understanding and Analyzing Financial Statements

## WEBINAR AGENDA

### Introduction

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- Instructor Qualifications
- Method of Training – System Used
- What We Will Cover and When

### Understanding Accounting Basics

- Defining Accounting and Generally Accepted Accounting Principles (GAAP)
- Understanding the Basic Accounting Equation
- Overview of the Basic Financial Statements

### Using the Balance Sheet

- Overview of the Balance Sheet – Understanding the Four Quadrants
- Key Concept: Cash v. Accrual Accounting
- The Order of Liquidity and Priority of Payments or Liquidations
- Assets: (1) Current, (2) Property, Plant & Equip., (3) Other Long-Term Assets
- The Business Operating Cycle: Moving Inventory and Accounts Receivable
- Liabilities: (1) Current and (2) Long-Term
- Equity: (1) Preferred and Common Stock, (2) Par Value, (3) Additional Paid-In Capital, (4) Retained Earnings, (5) Dividends, (6) Treasury Stock and (7) Other
- Special Topics to Understand: (1) Receivables, (2) Inventory, (3) Prepaids, (4) Deferred Revenue and (5) Capitalized Leases Simplified

### Using the Income Statement

- Example: Using Gross Profit and Gross Margin
- Understanding the Other Profit Checkpoints
- Manipulating Gross Profit by Under/Overstating Inventory
- Evaluating Product Line Profitability
- Account Analysis to Uncover Fraud
- Corporate Entity: C-Corporation v. Subchapter-S Corporation
- Five Most Common Managed (Manipulated) Earnings Problems

### Ratio Analysis – Explanation, Formulas, What to Observe and Why

- Horizontal and Vertical Analysis to Troubleshoot Problems
- Net Working Capital – How Was Growth Funded
- (1) Liquidity, (2) Mgmt. Efficiency (3) Debt and (4) Profitability
- Comparisons to Industry Averages
- The Importance of Trends, Risk v. Reward and the “Rule of 72”
- Using the Z-Score to Predict Bankruptcy

## **Using the Statement of Cash Flows – Sources and Uses of Cash**

- Understanding Why This Is the Third GAAP *Required* Financial Statement
- Sources and Uses of Cash From: (1) Operations, (2) Investing and (3) Financing
- Horizontal and Vertical Analysis for Sources and Uses Clarity
- Using the 9 New Cash Flow Ratios – Formulas, What To Observe and Why

## **The Statement of Changes in Shareholder Equity**

- Beginning Balance: Number of Shares and Dollar Amount for Stock at Par and Additional Paid-In Capital (APIC)
- Beginning Balance: Retained Earnings, Treasury Stock and Other Equity Adjustments
- Changes During the Year and Reason for Changes
- Ending Balance: Number of Shares and Dollar Amount for Stock at Par and Additional Paid-In Capital (APIC)
- Ending Balance: Retained Earnings, Treasury Stock and Other Equity Adjustments

## **Annual Reports and the Quality of Financial Statement Information**

- Audit v. Reviewed v. Compiled v. Financial Prepared by Unlicensed Firm/Individual
- Generally Accepted Accounting Principles (GAAP) v. Cleverly Rigged Accounting Principles (CRAP)
- The Critical Importance of Footnotes to the Financial Statements – Checklist
- Interim and Monthly Financial Statements
- Management’s Discussion and Analysis
- Checking the Veracity of Submitted Financial Information – Tax Returns and Bank Statements v. Accrual or Cash Basis Accounting

## **Break-Even Analysis and Capital Expenditure (Cap Ex) Budgeting**

- Break-Even Analysis (Cost-Volume-Profit Analysis) – Should You Add a New Business Division?
  - Calculating Breakeven in both: (1) dollars and (2) volume/units of sales
  - Manufacturing and retail firm
  - Service business such as law firm
  - Calculating Breakeven for a Targeted Profit
- Cap Ex Budgeting and Analysis
  - Present and Future Value with Excel’s Built-In Cap Ex Functions
  - Non Discounted Methods: Payback and Return on Investment (ROI)
  - Discounted Methodologies: (1) Discounted Payback, (2) Discounted Cash Flow (DCF), (3) Net Present Value (NPV), and (4) Internal Rate of Return (IRR)

## **Calculation of the Cost of Capital and Economic Value Added (EVA)**

- Calculate the Return on Invested Capital (ROIC)
- Calculate the Weighted After Tax Average Cost of Capital (WACC) for Debt and Equity
- Understand Corporate Risk, Beta and the Capital Asset Pricing Model (CAPM)
- Calculate Net Operating Profit After Taxes (NOPAT)
- Simple Excel Template to Calculate WACC, CAPM and EVA

### **Economic Value Added (EVA) vs. DuPont Analysis**

- Why the DuPont Analysis Has Been Used By Successful Firms for Over a Century
- Calculating the DuPont Analysis – Understanding What Makes Firms Win
- The DuPont Formula: Net Margin, Asset Efficiency and Return on Assets (ROA)
- Simple Excel Template to Calculate the Winning Dupont Formula
- Does the DuPont Analysis (developed in early 1900s) and EVA Model (developed in 1983) Give Corporate Analysts/Managers the Exact Same Message
- Is ROE the Controlling Metric?

### **The Sarbanes-Oxley Act of 2002**

- Title I through Title X and Title XI – Corporate Fraud Accountability
- Section 302 – Corporate Responsibility for Financial Reports
- Section 402 – Enhanced Conflict of Interest Disclosures
- Section 404 – Management Assessment of Internal Control
- Section 806 – Whistleblower Protections and Compensatory Damages

### **Understanding Corporate Governance**

- The Corporate Governance Quotient (CGQ)
- Eight Major Categories of CGQ and 65 Different Weighted Criteria
- How CGQ Impacts Interest Rate, ROI and Performance

### **Final Review – Comparing Two Competitors**

- Two-year Side-by-Side Financial Ratios, Dollar and Percent Difference
- Two-year Side-by-Side Cash Ratios, Dollar and Percent Difference
- Five year KPI Dashboard Charts
- Comparison of Ten-year Stock Market Performance
- An Overview of Fundamental Analysis vs. Technical Analysis
- Concluding Comments