

Introduction to Finance

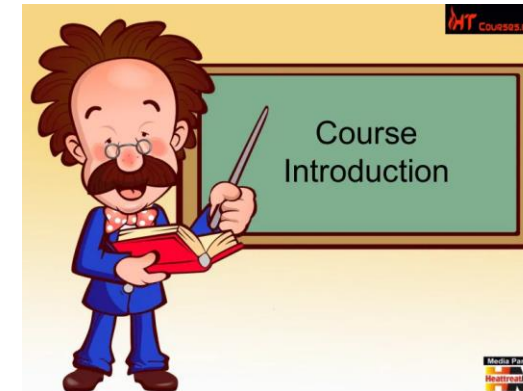
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Lecture 1

Introduction to finance



Introduction to the course



Chapter

1

Learning Platform

- IT MUST be checked frequently
- Include All course material and information
 - Lectures' Videos and PDF/PPT files
 - Course grades distribution
 - Quizzes/Assignments/Exams Dates
 - Regulations for accepted excuses
 - weekly meeting link (same link is used for all meetings)



Chapter

1

Brief Description of The Course

- The course provides an overview of financial decision-making from the perspective of the corporate financial manager. Students discover how managers maximize shareholders' wealth by choosing the optimal allocation of capital and the optimal financial structure of the firm. Topics include risk-return relationships, the time value of money, the valuation of stocks and bonds, capital budgeting, the cost of capital and a brief introduction to financial markets. Parts of the material are quantitative.



Chapter

1

Topics

- ❑ Financial Statements
- ❑ Investing and Financing Decisions
- ❑ Operating Decisions and the Income Statement
- ❑ Communicating and Interpreting Accounting Information
- ❑ Cost of Goods Sold and Inventory
- ❑ Property, Plant, and Equipment Natural Resources
- ❑ Reporting and Interpreting Liabilities
- ❑ Reporting and Interpretation



Chapter

1

Course Learning Outcomes

Students will learn how to:

- Evaluate investment opportunities.
- Analyze a company's financial statements to answer business questions.
- Use financial formulas to evaluate cost of capital for decisions related to financing the operations of a corporation.
- Anticipate corporate financial needs through budgeting and forecasting techniques.
- Explain working capital concepts.



Lecture one agenda

1. Describe the primary forms of business organization.
2. Identify the users and uses of accounting information.
3. Explain the three principal types of business activity.
4. Describe the content and purpose of each of the financial statements.
5. Explain the meaning of assets, liabilities, and stockholders' equity, and state the basic accounting equation.
6. Describe the components that supplement the financial statements in an annual report.



Introduction to Financial Statements

Introduction to Financial Statements

Forms of Business Organization

- Sole proprietorship
- Partnership
- Corporation

Users and Uses of Financial Information

- Internal users
- External users
- Ethics in financial reporting

Business Activities

- Financing
- Investing
- Operating

Communicating with Users

- Income statement
- Retained earnings statement
- Balance sheet
- Statement of cash flows
- Interrelationships of statements
- Other elements of an annual report



Forms of Business Organization

Forms of Business Organization

Proprietorship

- ◆ Generally owned by one person
- ◆ Simple to establish
- ◆ Owner controlled
- ◆ Tax advantages

Partnership

- ◆ Simple to establish
- ◆ Shared control
- ◆ Broader skills and resources
- ◆ Tax advantages

Corporation

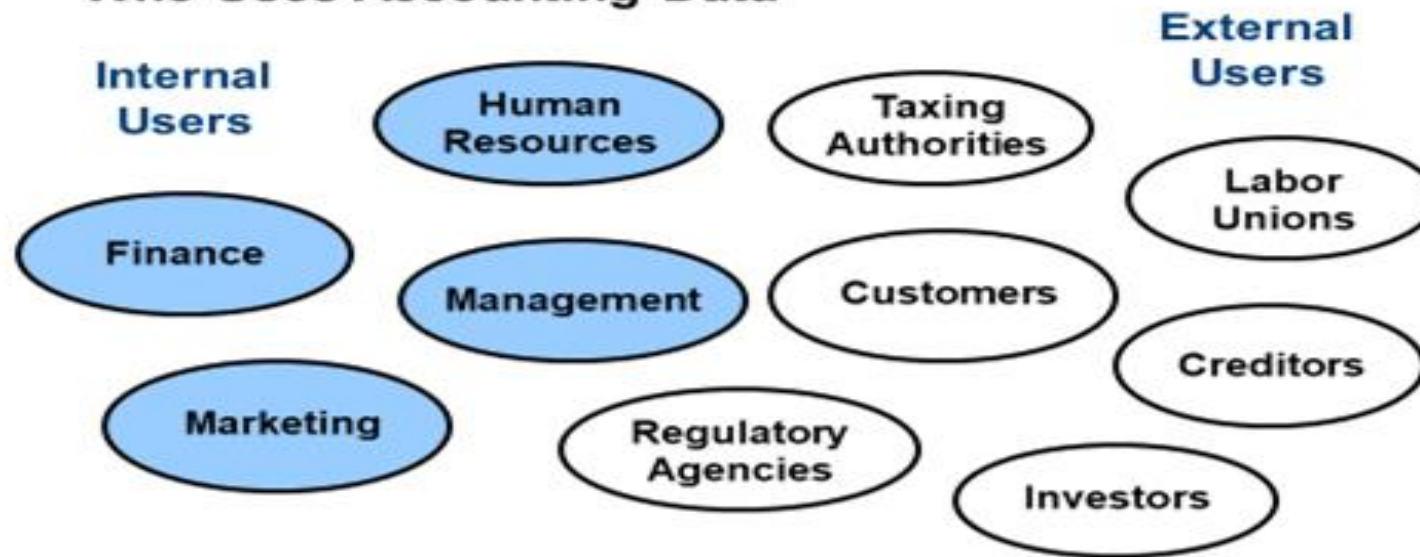
- ◆ Easier to transfer ownership
- ◆ Easier to raise funds
- ◆ No personal liability



Users and Uses of Financial Information

Users and Uses of Financial Information

Who Uses Accounting Data



Users and Uses of Financial Information

Users and Uses of Financial Information

Questions Asked by Internal Users

1. Can we afford to give our employees a pay raise?
2. What price for our product will maximize net income?
3. Which product line is most profitable?
4. Is cash sufficient to pay dividends to the stockholders?



User

Human Resources

Marketing

Management

Finance



Users and Uses of Financial Information

Users and Uses of Financial Information

Questions Asked by External Users

1. Is the company earning satisfactory income?
2. How does Disney compare in size and profitability with Time Warner?
3. Will United Airlines be able to pay its debts as they come due?



User

Investors

Investors

Creditors



Business Activities

Business Activities

All businesses are involved in three types of activity —

- ◆ financing,
- ◆ investing,
- ◆ and operating.

The **accounting information system** keeps track of the results of each of these business activities.



Business Activities

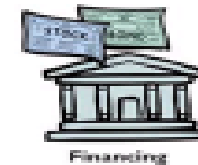
Business Activities

Financing Activities

Two primary sources of outside funds are:

1. Borrowing money

- ◆ Amounts owed are called **liabilities**.
- ◆ Party to whom amounts are owed are **creditors**.
- ◆ **Notes payable** and **bonds payable** are different type of liabilities.



2. Issuing shares of stock for cash.

- ◆ Payments to stockholders are called **dividends**.



Business Activities

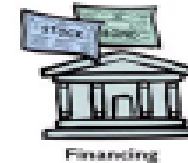
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Business Activities

Business Activities

Investing Activities

Purchase of resources a company needs operate.



- ◆ Computers, delivery trucks, furniture, buildings, etc.
- ◆ Resources owned by a business are called **assets**.



Business Activities

Business Activities

Operating Activities

Once a business has the assets it needs, it can begin its operations.



- ◆ **Revenues** - Amounts earned from the sale of products (sales revenue, service revenue, and interest revenue).
- ◆ **Inventory** - Goods available for sale to customers.
- ◆ **Accounts receivable** - Right to receive money from a customer, in the future, as the result of a sale.



Business Activities

Business Activities

Operating Activities

- ◆ **Expenses** - cost of assets consumed or services used. (cost of goods sold, selling, marketing, administrative, interest, and income taxes expense).
- ◆ **Liabilities** arising from expenses include accounts payable, interest payable, wages payable, sales taxes payable, and income taxes payable.
- ◆ **Net income** – when revenues exceed expenses.
- ◆ **Net loss** – when expenses exceed revenues.

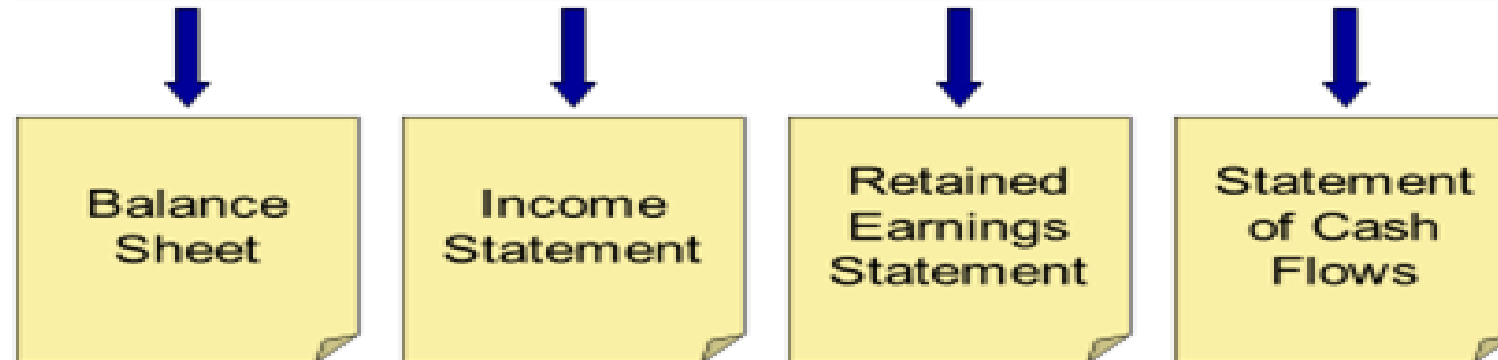


Chapter
1

Communicating with Users

Communicating with Users

Companies prepare four financial statements from the summarized accounting data:



Communicating with Users

Communicating with Users

Income Statement

Illustration 1-4

SIERRA CORPORATION		
Income Statement		
For the Month Ended October 31, 2012		
Revenues		
Service revenue		\$10,600
Expenses		
Salaries expense	\$5,200	
Supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses		<u>7,740</u>
Net income		<u>\$ 2,860</u>

- ◆ Reports revenues and expenses for a specific **period of time**.
- ◆ **Net income** – revenues exceed expenses.
- ◆ **Net loss** – expenses exceed revenues.
- ◆ Past net income provides information for **predicting future net income**.



Communicating with Users

Communicating with Users

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Retained Earnings Statement

Illustration 1-5

SIERRA CORPORATION	
Retained Earnings Statement	
For the Month Ended October 31, 2012	
Retained earnings, October 1	\$ 0
Add: Net income	<u>2,860</u>
	2,860
Less: Dividends	<u>500</u>
Retained earnings, October 31	<u>\$2,360</u>

Net income is needed to determine the **ending balance** in retained earnings.



Communicating with Users

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Communicating with Users

Communicating with Users

- ◆ Statement shows amounts and **causes of changes** in retained earnings during the period.
- ◆ **Time period is the same** as that covered by the income statement.
- ◆ Users can **evaluate dividend** payment practices.

Retained Earnings Statement

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Communicating with Users

Communicating with Users

Balance Sheet

Illustration 1-7

SIERRA CORPORATION Balance Sheet October 31, 2012			
<u>Assets</u>			
Cash			\$15,200
Accounts receivable			200
Supplies			1,000
Prepaid insurance			550
Equipment, net			<u>4,960</u>
Total assets			<u>\$21,910</u>
<u>Liabilities and Stockholders' Equity</u>			
<u>Liabilities</u>			
Notes payable	\$ 5,000		
Accounts payable	2,500		
Salaries payable	1,200		
Unearned service revenue	800		
Interest payable	<u>50</u>		
Total liabilities		\$ 9,550	
<u>Stockholders' equity</u>			
Common stock	10,000		
Retained earnings	<u>2,360</u>		
Total stockholders' equity		<u>12,360</u>	
Total liabilities and stockholders' equity			<u>\$21,910</u>

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Ending balance in retained earnings is needed in preparing the balance sheet.



Communicating with Users

Communicating with Users

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Common stock	10,000	
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Total stockholders' equity		<u>12,360</u>
Total liabilities and stockholders' equity		<u>\$21,910</u>

- ◆ Reports assets and claims to assets at a specific **point in time**.
- ◆ **Assets = Liabilities + Stockholders' Equity**.
- ◆ Lists **assets first**, followed by liabilities and stockholders' equity.



Chapter

1

Communicating with Users

Communicating with Users

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Statement of Cash Flows

Illustration 1-8

SIERRA CORPORATION Statement of Cash Flows For the Month Ended October 31, 2012		
Cash flows from operating activities		
Cash receipts from operating activities	\$11,200	
Cash payments for operating activities	<u>(5,500)</u>	
Net cash provided by operating activities		\$ 5,700
Cash flows from investing activities		
Purchased office equipment	<u>(5,000)</u>	
Net cash used by investing activities		(5,000)
Cash flows from financing activities		
Issuance of common stock	10,000	
Issued note payable	5,000	
Payment of dividend	<u>(500)</u>	
Net cash provided by financing activities		<u>14,500</u>
Net increase in cash		15,200
Cash at beginning of period		0
Cash at end of period		<u>\$15,200</u>



Communicating with Users

Communicating with Users

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Net cash provided by operating activities		\$ 5,700
Cash flows from investing activities		
Purchased office equipment	(5,000)	
Net cash used by investing activities		(5,000)
Cash flows from financing activities		
Issuance of common stock	10,000	
Issued note payable	5,000	
Payment of dividend	(500)	
Net cash provided by financing activities		14,500
Net increase in cash		15,200
Cash at beginning of period		0
Cash at end of period		\$15,200

Answers:

- ◆ Where did cash come from during the period?
- ◆ How was cash used during the period?
- ◆ What was the change in the cash balance during the period?



Other Elements of an Annual Report

Other Elements of an Annual Report

U.S. companies that are publicly traded must provide shareholders with an **annual report**.

The annual report always includes:

- ◆ Financial statements.
- ◆ Management discussion and analysis.
- ◆ Notes to the financial statements.
- ◆ Independent auditor's report.



Other Elements of an Annual Report

Other Elements of an Annual Report

Auditor's Report

Auditor's opinion as to the **fairness** of the presentation of the financial position and results of operations and their conformance with generally accepted accounting standards.





Thank You