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**P R I S T I N E**

# **Financial Reporting and Analysis - I**

## Financials Statement Elements v/s Accounts

- When a transaction happens it is first recorded **in its related Account**
  - For example each account for each expenditures- wages, postage, stationary etc
- These accounts are then grouped and divided into **5 elements of financial statements namely**
  - Assets
  - Liabilities
  - Owners' equity
  - Revenue
  - Expenses
- **Contra accounts** are used for contra entries which offset some part of the value of another account (like accounts receivable and provision for bad debts)

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# Assets

- Current Assets

- Cash and cash equivalents: includes liquid securities with maturities of < 90 days
- Accounts receivable – adjusted for "allowance for bad debt expense" as contra a/c
- Inventory
- Prepaid expenses. Items that will be expenses on future income statements.
- Financial assets such as marketable securities

- Long Lived Assets and Other assets

- Property, plant, and equipment includes a contra-asset account for accumulated depreciation
- Intangible assets economic resources without physical existence such as patents, trademarks, licenses, and goodwill
- Investment in affiliates (accounted for using the equity method)
- Deferred tax assets

## Liabilities

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- Current Liabilities
  - Accounts payable
  - Short Term Notes payable.
  - Unearned revenue: Revenue received but not earned (related to future periods)
  - Income taxes payable
- Long Term Liabilities
  - Long-term debt such as bonds payable
  - Deferred tax liabilities

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## Owners' equity

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- Capital - Par value of common stock.
- Additional paid-in capital: proceeds received over par value
- Retained earnings - Cumulative net income till date
- Other comprehensive income
  - Changes resulting from foreign currency translation of subsidiary
  - Minimum pension liability adjustments
  - Unrealized gains and losses on investments.

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- **Sales:**
- **Gains:**
  - Increases in assets or equity from transactions incidental to day-to- day activities
  - Like Gain on sale of assets
- Investment income
  - Interest and dividend income.

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## Expenses

- Cost of goods sold
  - Opening inventory + Purchases – Closing Inventory
- Selling, general and administrative expenses
  - Advertising, management salaries, rent and utilities.
- Depreciation and amortization
- Interest expense.
- Losses
  - Decreases in assets / equity from incidental transactions related to normal activities
- Tax expense

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- Basic Equation
  - **Assets = liabilities + owners' equity**
- Can be expanded as
- Equity can be broken into contributed capital (preferred and common both) and retained earnings
  - **Assets = Liabilities + Contributed capital + Retained earnings**
- Retained earnings can be further broken as
  - **Retained earnings = Beginning retained earnings + Net profits during the year – dividends**
    - **Net profits = Revenue – Expenses**

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## Double entry accounting

- **Each transaction effects two accounts** so that assets and liabilities are balanced
- For example:
- A) An increase in an asset account must be balanced by either a
  - Increase in a liability or owners' equity account
  - Decrease in another asset account or
- B) An expenses incurred (causing reduced earning leading to low retained earning to low equity hence lower liability) must be balanced by either
  - Reduction in cash (if expenses is incurred in cash)
  - Increase in liability (if expenses is incurred on credit)

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## Examples

- Purchase furniture for \$1,000 cash.
  - Furniture (an asset) increases by \$1,000
  - Cash (an asset) decreases by \$1,000.
  - Now both assets and liabilities are balanced
- Purchase furniture for \$1,000 through raising \$1,000 notes
  - Furniture (an asset) increases by \$1,000
  - Notes (liability) increases by \$1,000
- Pay \$1000 for salary in cash
  - Salary (expenses) reduces net income, leading to low equity and lower liabilities by \$1000
  - Cash reduces by \$1000 (Now both assets and liabilities are balanced)

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