

Introduction to Financial Statements

Introduction to Financial Statements

Key concepts, purpose, and the four primary reports

1. Why Financial Statements Matter

Objective	What It Provides	Who Uses It
Decision-making	Quantitative view of a company's performance & position	Managers, investors, creditors, regulators
Accountability	Evidence that resources were used responsibly	Shareholders, tax authorities
Communication	Standardized language for reporting	Analysts, auditors, market participants
Planning & Control	Baselines for budgeting, forecasting, and variance analysis	Internal finance teams, board of directors

2. The Four Core Statements

Statement	Primary Focus	Main Components	Frequency
Balance Sheet (Statement of Financial Position)	Snapshot of resources and claims at a point in time	Assets, Liabilities, Equity	Usually quarterly & annually
Income Statement (Statement of Profit & Loss)	Performance over a period	Revenues, Expenses, Gains, Losses, Net Income	Quarterly, annually
Statement of Cash Flows	Cash generation & usage	Operating, Investing, Financing cash flows	Quarterly, annually
Statement of Changes in Equity (or Statement of Retained Earnings)	How equity changes during the period	Opening equity, net income, dividends, other comprehensive income, share issues/repurchases	Annually (often combined with the Income Statement)

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3. Balance Sheet Details

3.1. Structure

Assets = Liabilities + Equity

- **Assets** (ordered by liquidity)
 - Current assets: cash, marketable securities, accounts receivable, inventory, prepaid expenses.
 - Non-current assets: property, plant & equipment (PP&E), intangible assets, long-term investments.
- **Liabilities** (ordered by due date)
 - Current liabilities: accounts payable, short-term debt, accrued expenses, current portion of long-term debt.
 - Non-current liabilities: long-term debt, deferred tax liabilities, pension obligations.
- **Equity**
 - Contributed capital (common & preferred stock).
 - Retained earnings (cumulative net income less dividends).
 - Other comprehensive income (OCI) items (e.g., foreign-currency translation adjustments).

3.2. Key Ratios (derived from the balance sheet)

- **Current Ratio** = Current Assets ÷ Current Liabilities
 - **Debt-to-Equity Ratio** = Total Liabilities ÷ Total Equity
 - **Working Capital** = Current Assets – Current Liabilities
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4. Income Statement Details

4.1. Typical Layout

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1. **Revenue (Sales)**
2. **Cost of Goods Sold (COGS) ? Gross Profit**
3. **Operating Expenses** (selling, general & admin, R&D) ? **Operating Income (EBIT)**
4. **Other Income/Expenses** (interest, gains/losses) ? **EBITDA** (if disclosed)
5. **Interest Expense ? Earnings Before Tax (EBT)**
6. **Income Tax Expense ? Net Income**

4.2. Important Metrics

- **Gross Margin** = $\text{Gross Profit} \div \text{Revenue}$
 - **Operating Margin** = $\text{Operating Income} \div \text{Revenue}$
 - **Net Profit Margin** = $\text{Net Income} \div \text{Revenue}$
 - **Earnings Per Share (EPS)** = $\text{Net Income} \div \text{Weighted average shares outstanding}$
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5. Statement of Cash Flows Details

5.1. Three Sections