Finance for the Non-Financial Manager

Women's Leadership Series
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Where to Find Financial Reports

Publicly traded companies who have their shares listed on stock exchanges are required to file regular financial statements and disclosures with regulators, such as the Securities and Exchange Commission (SEC).

Types of Reports

- **10-K** (annual filing)
- **10-Q** (quarterly filing)
- **8-K** used to notify investors in public companies of specified events that may be important to shareholders or the SEC. This is one of the most common types of forms filed with the SEC.

Annual report - tells investors and analysts:

- Company performance over the previous fiscal year (FY)
- How the company looks going forward
- Company financials for use in ratio analysis through scrutinizing the balance sheet, income statement, and statement of cash flows.

How to find:

- Investor Relations link on company's website
- SEC filings

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Primary Financial Statements

Financial Statement	Balance Sheet	Income Statement	Statement of Stockholders' Equity	Statement of Cash Flows
Purpose	Reports the financial position of an accounting entity ***at a point in time***.	Reports the accountant's primary means of economic performance ***during the accounting period.***	**Reports changes in common stock and retained earnings *during the accounting period.***	Reports inflows and outflows of cash ***during the accounting period*** in categories of operating, financing and investing
Structure	**Assets= Liabilities + Stockholders' Equity**	**Revenue - Expenses Income**	**Beginning Balance + Increases - Decreases Ending balance**	**± CFO ± CFF ± CFI = Change in Cash**
Example of Content	• Cash • Accounts Receivable • Inventory • Plant & Equipment • Accounts Payable • Long-Term Debt • Common Stock	• Sales Revenue • Cost of Goods Sold • Selling Expenses • Interest Expense	• Beginning stockholders' equity • Ending stockholders' equity • Stock issuance • Dividends	• Cash collected from customers • Cash paid to suppliers • Cash borrowed from banks

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The Balance Sheet

- **Reports the financial position of an accounting entity at a point in time.**

ASSETS	=	**LIABILITIES**	+	**STOCKHOLDER'S EQUITY**
Economic resources with probable future benefits owned or controlled by the entity.		Debts or obligations (claims to a company's resources) that result from a company's past transactions and will be paid with assets or services.		The financing provided by the owners and the operations of the business.

The Income Statement

Reports economic performance during the accounting period.

Revenues
Increases in assets or settlements of liabilities from the major or central ongoing operations.

Expenses
Decreases in assets or increases in liabilities from ongoing operations incurred to generate revenues.

Gains
Increases in assets or settlements of liabilities from peripheral transactions.

Losses
Decreases in assets or increases in liabilities from peripheral transactions.

The Statement of Cash Flows

Reports cash inflows (+) and cash outflows (–) over a period.

Operating Activities

Relate directly to income and expenses reported on the income statement.

- \+ Cash received from customers
- \+ Dividends and interest on investments
- \- Salaries & Wages
- \- Income Taxes
- \- Purchases of services and goods for resale

Investing Activities

- \- Purchasing long-term assets and investments for cash
- \+ Selling long-term assets and investments for cash
- \- Lending cash to others
- \+ Receiving principal payments on loans made to others

Financing Activities

- \+ Borrowing cash from banks
- \- Repaying principal on bank loans
- \+ Issuing stock for cash
- \- Repurchasing stock with cash
- \- Paying cash dividends

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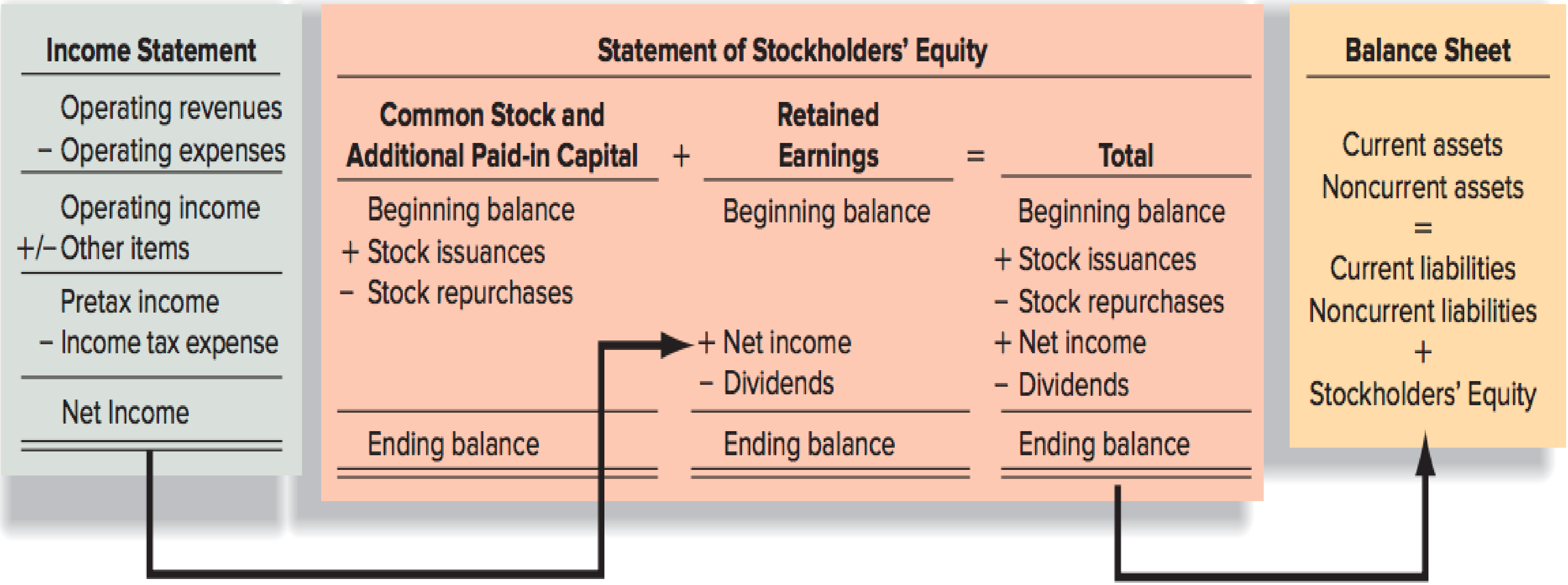
Relationships Among Financial Statements



Class Exercise – Financial Statement Effect of Transactions

For each transaction, complete the tabulation, indicating + for increase or – for decrease of each transaction. Write NE if no effect. Remember A=L+SE, R-E=NI, and NI affects SE through RE.

1. Issued common stock to investors for $21.40 cash (example).
2. Purchased $1626.60 of additional inventory on account.
3. Paid $43.10 on long-term debt principal and $3.70 in interest on the debt.
4. Sold $2350.00 of products to customers on account; cost of the products sold was $1426.60.
5. Paid cash dividends of $23.00 to shareholders.
6. Purchased for cash $32.40 in additional property, plant, and equipment.
7. Incurred $713.60 in selling expenses, paying three-fourths in cash, and the rest on account.
8. Earned $.50 in interest on investments, receiving 80% in cash.

(E3-6)

Exercise - cont'd.
Financial Statement Effect of Transactions

Transaction	Balance Sheet			Income Statement		
	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
(1) example	+ 21,400,000		+ 21,400,000			

Notes for Class Exercise 1

Group Breakout #1 - Financials

Find the following items in your assigned company's financials:

- Starbucks 10-K
- Donegal Group Inc. 10-K
- Independence Blue Cross Annual Report
- PFIZER 10-K

Group Breakout Exercise #1

Find the following items in your assigned company's financials:

1. What period is covered by the financial statements?
2. Name of the external audit firm
3. External auditor's opinion
4. Total Income
5. Income taxes paid
6. Total Assets
7. Total Liabilities
8. Number of common stock shares outstanding
9. Two risk factors

Notes for Group Breakout Exercise #1

Summary of Key Ratios

Ratio	Question Answered	Formula
Current	Does the company have enough current assets to cover its current liabilities?	▪ **Current Assets/Current Liabilities**
Net Profit Margin	How effective is management in generating profit on every dollar of sales?	▪ **Net Income/Net Sales**
Total Asset Turnover	How efficient is management in using its resources to generate sales?	▪ **Net Sales/Avg Total Assets**
Return on Assets	How efficient is management in using its resources to generate income?	▪ **Net Income/Avg Total Assets**
Earnings Per Share	How much money did we make per share of stock outstanding?	▪ **Net Profit/Number of Common Stock Shares Outstanding**

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Summary of Key Calculations

Ratio	Question Answered	Formula
Gross Profit	What are our earnings after deducting costs?	▪ **Revenue – Cost of Goods Sold**
Gross Profit Margin "gross margin"	What portion of revenue did we retain as profit?	▪ **(Revenue – Cost of Goods Sold)/ Revenue X 100**
Working Capital	Can we meet our short-term obligations with the current assets?	▪ **Current Assets – Current Liabilities**
Opportunity Cost	What is the potential loss when choosing one alternative over another?	▪ **Compare various metrics like income or contribution margin (sales –variable expenses) of each option**

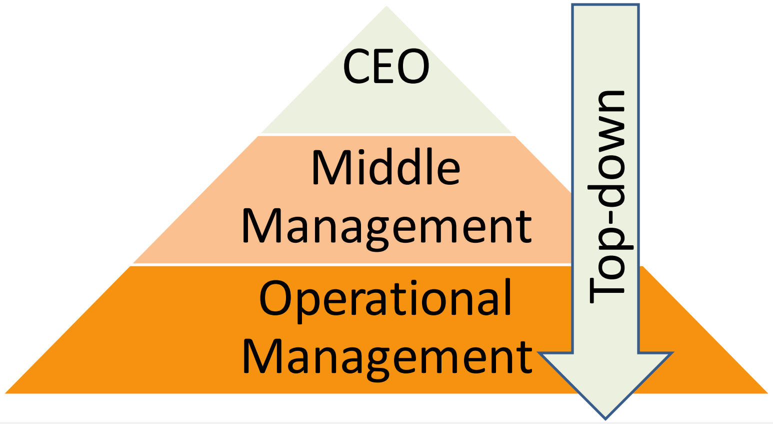
Group Breakout Exercise #2

For your assigned company, answer the following questions:

1. Does the company have adequate current assets to cover its short-term liabilities?
2. What is the amount of working capital?
3. What is the gross profit?
4. How much is earnings per share?

Notes for Group Breakout Exercise #2

Top-down Budgets



ADVANTAGES

- Increase probability that strategic plans will be incorporated in planned activities
- Enhance coordination among divisional plans and objectives
- Use top management's knowledge of overall resource availability
- Reduce the time frame for the budgeting process

DISADVANTAGES

- May result in dissatisfaction, defensiveness, and low morale among individuals who must work under the budget
- Reduces the feeling of teamwork
- May limit the acceptance of the stated goals and objectives
- May create a view of the budget as a punitive device

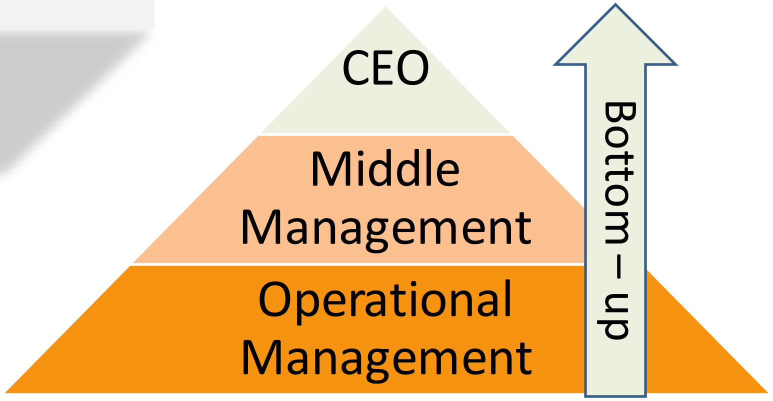
Bottom-up Budgets

ADVANTAGES

- Gathers information from persons most familiar with the needs and constraints of organizational units
- Allow organizational units to coordinate with one another
- Lead to better morale and higher motivation
- Develop a high degree of acceptance of and commitment to organizational goals and objectives by operating management

DISADVANTAGES

- Requires significantly more time
- Effects of managerial participation may be negated by top-management changes
- Managers may be ambivalent or unqualified to participate, creating an unachievable budget
- May cause managers to introduce slack into the budget



Common Budgeting Models

"Companies that use only one or two budgeting models across all business units and functions would likely make better spending decisions if they used three or all four of the most common budgeting models." https://www.cfo.com/budgeting/2016/08/budgeting-inflexibility-cripples-bottom-line/

Four Common Budgeting Models:

- **Historical budgeting**, or a mix of **top-down** and **bottom-up** budgeting based on historical data, with adjustments made for factors such as expected growth and market expectations.
- **Driver-based budgeting**, a less-detailed approach that identifies the organization's key business drivers and mathematically models how they will impact resourcing and, hence, expenses in future period.
- **Rolling-forecast-based budgeting**, where a forecast from the previous year is used to set the current year's budget one to two quarters in advance.
- **Zero-based budgeting**, in which any expense in a particular cost center, department, or business unit needs to be justified for every new period.

Group Breakout Exercise #3

Refer to case distributed separately and answer the following questions:

1. Which budget model is used?
2. Is there an opportunity to use an alternate budget model which may be more appropriate for the business?
3. What was the disadvantage of using top-down budgeting in the case?
4. What target percentages were used (e.g., decrease costs by x%, increase sales by x%)?
5. Do budget targets align with corporate priorities and strategic initiatives?
6. Why would Max Green, Director of the Southeast Region, care about the level of budgeted income?
7. What does Duvall stand to gain from his actions? Does he have anything to lose?

Group Breakout Exercise #3 - Case

Faced with three young children who were always complaining "I'm bored," Ann Newton looked for an interesting after-school activity. Finding nothing available in the community, she decided to solve her problem by renting an old bakery and turning it into Kiddie Kitchen. Three afternoons a week, Ann, her children, and several other children gathered to learn the art of cooking. In less than five years, Ann's business grew to over 30 franchised kitchens located throughout the state. In 2005, she retired from active management of the company and sold the majority of her stock to Bernice Mayfield, who now runs the firm.

Today, Kiddie Kitchen has 100 franchised locations and 50 corporate locations up and down the East Coast. The company is organized into five regional territories, each run by a director who reports to the vice president of operations. In addition to the vice president of operations, executive management includes the CFO, the vice president of marketing, and the vice president of human resources. All executive personnel work at the corporate headquarters, now located in Raleigh, North Carolina. Each director maintains a regional office, complete with an administrative staff.

Shortly after taking over the company, Mayfield revamped the budgeting process, replacing a bottom-up process that had been in place since the early 1990s with a top-down process. Since the new budget process influences the bonus compensation a director can earn, directors have a great deal of interest in developing the budget. At the beginning of the budget cycle, regional directors receive corporate directives concerning the coming year's budget. These directives include projected growth in locations and revenue, salary increases, and allocated corporate expenses. Directors prepare three budgets—one for franchised locations, one for corporate locations, and one for administrative costs associated with the regional offices. These budgets are passed up to the corporate office for consolidation into the corporate budget.

Max Green is director of the southeast region. His approach to preparing the budget for the coming year budget is a typical example of budget preparation. He passed the corporate budget directives to his accountant, Henri Duvall, who prepared the first draft of the budget. When Green reviewed the draft, he did not like what he saw. Budgeted net income was too high—so high that his region would never meet the target. He asked Duvall to make some adjustments.

The corporate directive had projected a general price level increase of 2–4%. The range was intended to allow higher cost-of-living areas, such as Boston and New York, to budget higher levels of cost increases than lower cost-of-living areas. But even though Green's office was located in the lowest cost-of-living area in the country, he told Duvall to budget an across-the-board increase of 4%. Green knew that as long as he was within the directive's guidelines, the corporate office wouldn't question the increase.

Green also told Duvall that the region would open ten new stores during the coming year and that the budget should reflect enough start-up expenses to cover the new locations. Green knew that no region had ever opened more than seven stores in a single year. In fact, he thought he would be lucky to open five new stores in the coming year.

Since Green had a reputation for retaliating against employees who chose to ignore his requests, Duvall made the changes without questioning them. The result was a $250,000 reduction in budgeted net income.

Duvall, a certified management accountant, had a wife and three children, and could not afford to lose his job and his generous benefit package. Besides, his wife was in line to become owner of one of the new franchised stores in in the coming year.

Notes for Group Breakout Exercise #3

Thank You!