

# ACCOUNTING EXPLAINED VISUALLY

50 SIMPLE INFOGRAPHICS THAT  
DEMYSTIFY FINANCIAL STATEMENTS



**BRIAN FEROLDI**

# Hello and Welcome!

**Accounting is the language of business,  
but it's an imperfect language.**

**This eBook contains fifty infographics that  
will help you better understand the  
Balance Sheet, Income Statement, and  
Cash Flow Statement.**

**Enjoy!**



**Brian Feroldi**



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## INCOME STATEMENT

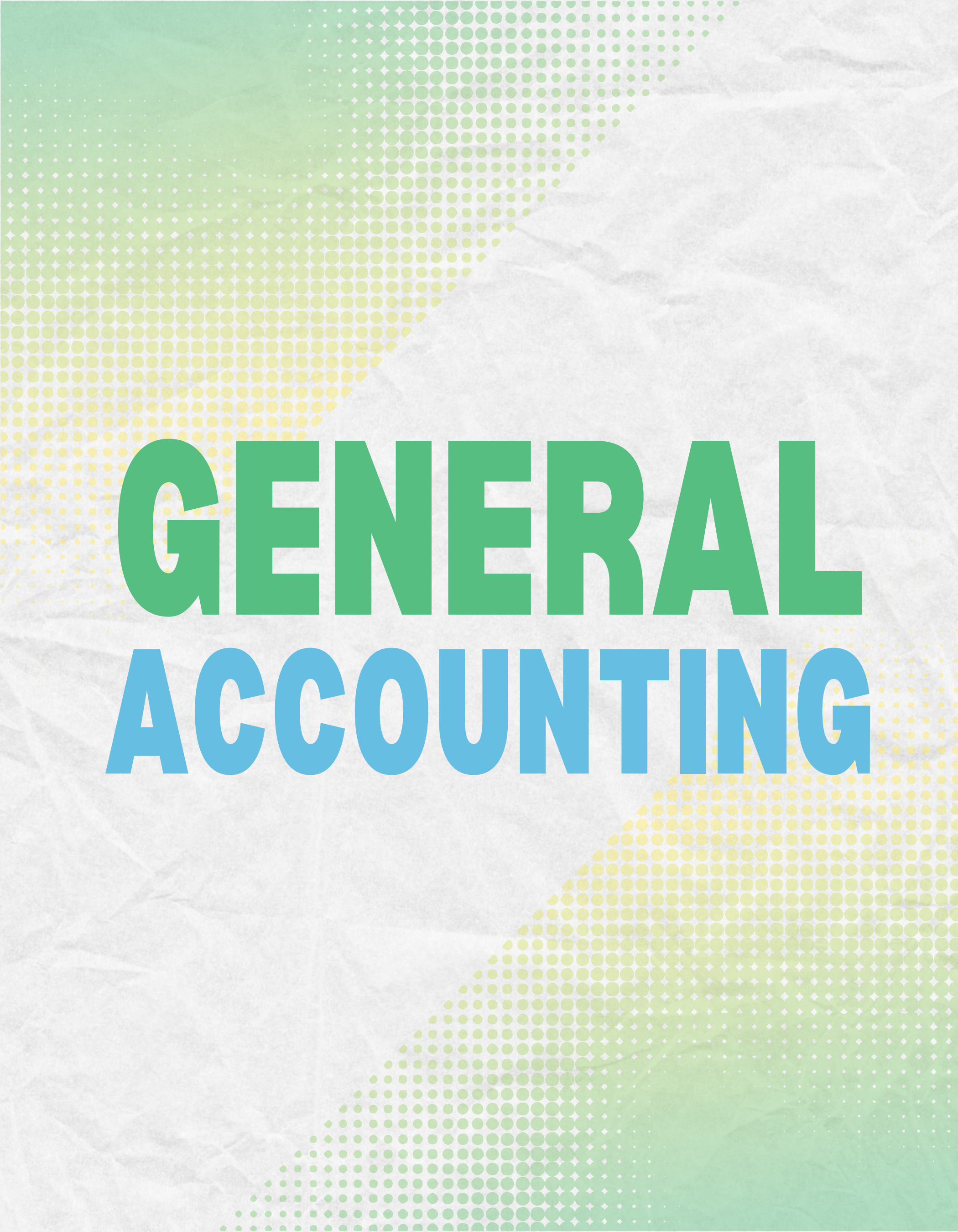
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# **GENERAL ACCOUNTING**



# 13 ACCOUNTING PRINCIPLES



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## ACCOUNTING PRINCIPLES

The rules, benchmarks, and procedures in the accounting field companies should follow while reporting financial statements. In the United States, the common set of accounting standards is GAAP (Generally Accepted Accounting Principles).

### ECONOMIC ENTITY

Owner & business are two different entities with separate liabilities.



### REVENUE RECOGNITION

Revenue should be recognized using the accrual basis of accounting.



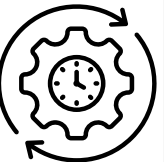
### CONSERVATISM

When there are two acceptable options for reporting, the less favorable option should be chosen.



### CONSISTENCY

The usage of methods and principles should be consistent until another method proves to be better.



### HISTORICAL COST

Assets should be recorded based on their original purchased value.



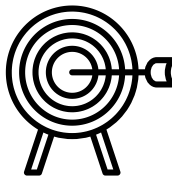
### FULL DISCLOSURE

All important information should be disclosed within the financial statements or as a footnote.



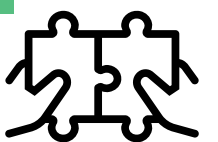
### GOING CONCERN

Business is assumed to carry on forever with no intention of liquidation.



### MATCHING CONCEPT

All debits should have a matching credit, and all credits should have a matching debit.



### MATERIALITY

Any information which will have a significant impact should be reported on the financial statements.



### MONETARY UNIT

Transactions that carry a monetary value should be recorded in terms of a monetary currency (Ex: Dollars)



### RELIABILITY

Transactions should only be recorded that can be proven & have significant evidence.

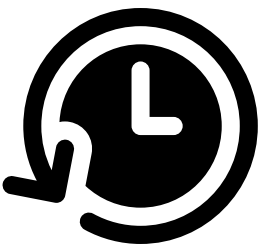


### REVENUE TIMING

Revenues will be recognized at the time of the transactions regardless of whether payment has been made.



### TIME PERIOD



There should be a standardized time period for the reporting of the financial statements (Ex: Monthly, Quarterly, or Annually)



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# FUNDAMENTALS OF ACCOUNTING



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## ACCOUNTING

Is the procedure of data entry and recording, summarizing, analyzing, and then reporting the financial data.

### FIVE BASIC ACCOUNTING PRINCIPLES

REVENUE RECOGNITION	Revenue is recorded at the time of the transaction.
MATCHING PRINCIPLE	Assets are recorded at their acquisition cost.
HISTORICAL COST	Fiscal Year Income is compared with Calendar Year Expense.
FULL DISCLOSURE	Full disclosure of all relevant info is made available.
OBJECTIVITY	Information in books should be true, relevant, & accurate.

### CATEGORIES OF ACCOUNTING

ASSETS	All Tangible & Intangible items owned by the company.
LIABILITY	Amount the company owes to others.
EQUITY	Net Worth of Company, Assets - Liabilities.
EXPENSE	Amount paid for purchases made in the business.
INCOME	Amount earned by company from sale of goods.

### JOURNAL

- Journal Entries consist of Debits & Credits, the totals of which should be equal

Vs

### LEDGER

- Journal are then transferred to appropriate Ledger Accounts

### FINANCIAL STATEMENTS

- Income Statement: shows profit or loss during the period.
- Balance Sheet: a company's assets, liabilities, and equity at a particular time.
- Statement of Cash Flow: shows the inflow and outflow of cash during period.

### DOUBLE ENTRY SYSTEM

- Each Accounting Entry will have two sides - Debit and Credit.
- The accounts used will be from any of above five categories.

### THREE FIELDS OF ACCOUNTING

- Financial Accounting: Preparing the Financial Statements.
- Managerial Accounting: Preparing reports for internal use.
- Cost Accounting: Measuring the performance of resources.



### TYPES OF ACCOUNTS

REAL	Consists of tangible and intangible assets.
PERSONAL	Accounts for individual, group, entity, bank etc.
NOMINAL	Accounts related to Gain, Loss, Expense & Income.

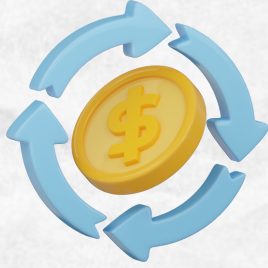


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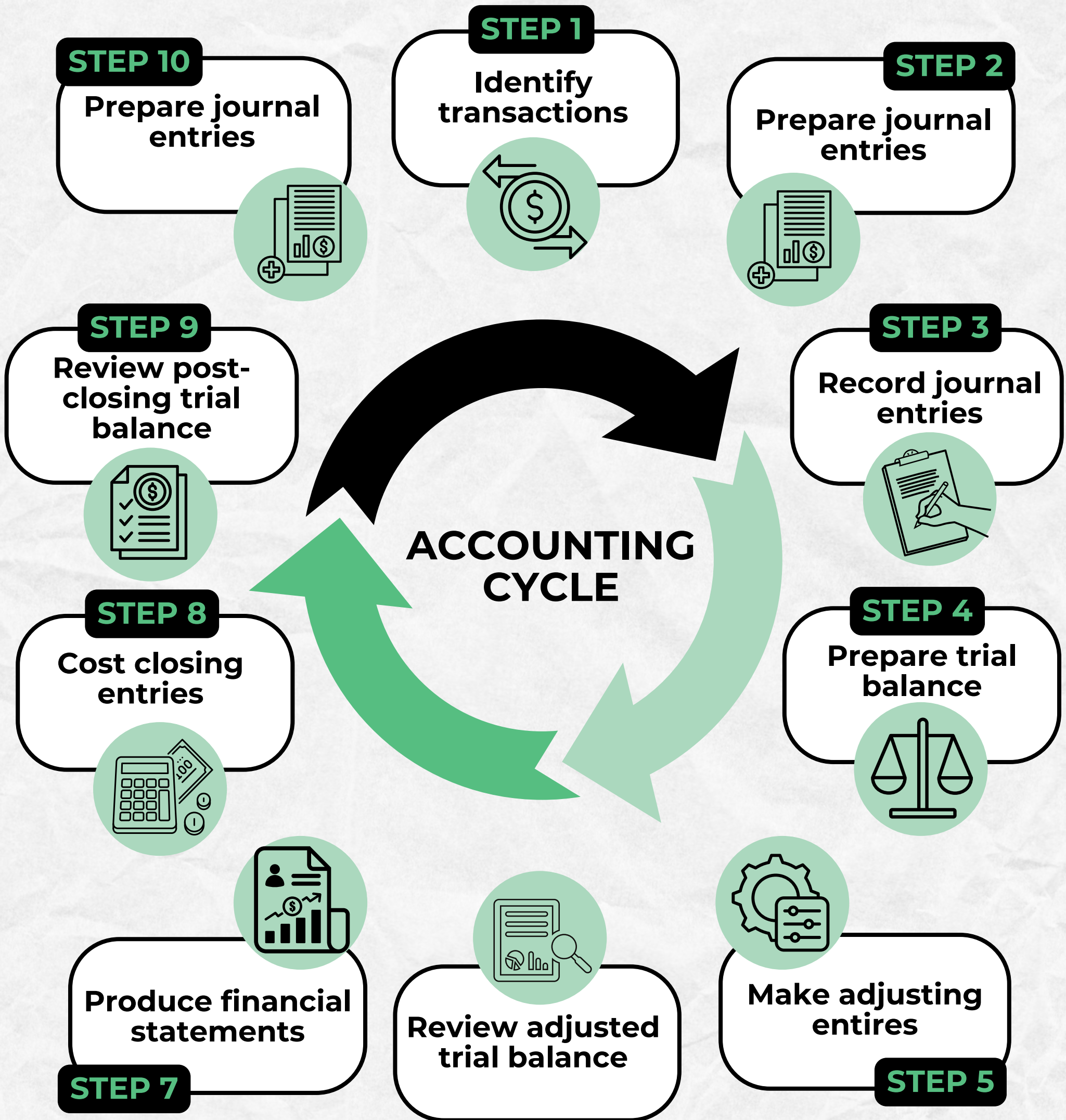


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# ACCOUNTING CYCLE



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# FINANCIAL STATEMENTS



## CHEAT SHEET

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### BALANCE SHEET

Balance Sheet (Specific Date)			
Assets		Liabilities	
Current Assets (<1 Year)	Cash & Cash Equivalents	Current Liabilities (<1 Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt
	Accounts Receivable		Other Current Liabilities
	Inventory	Long-Term Liabilities (>1 Year)	Long-Term Debt
	Other Current Assets		Other Long-Term Liabilities
Long-Term Assets (>1 Year)	Long-Term Investments	Shareholder Equity	Preferred Stock
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill		Retained Earnings
	Other Long-Term Assets		Treasury Stock

#### PURPOSE



Track What it Owns & Owes

#### SIMILAR TO



Your Net Worth

#### TIME



Point in Time Snapshot

#### ACCOUNTING



Accrual Accounting

#### ADDITIONAL DETAILS



- Assets must always exactly equal Liabilities + Shareholder's Equity.
- Cash Balance comes from ending balance on the Cash Flow Statement.
- Retained Earnings balance comes from last period's Balance Sheet + this month's Net Income on your Income Statement.

### INCOME STATEMENT

Income Statement (Period)	
	Revenue
-	Cost of Goods Sold
	Gross Profit
-	Operating Expenses
	Operating Income
-	Non-Operating Income/Expense
	Pre-Tax Income
-	Income Tax
	Net Income
/	Shares Outstanding
	Earnings Per Share

#### PURPOSE



Track Income & Expenses

#### SIMILAR TO



Your Budget

#### TIME



Period of Time

#### ACCOUNTING



Accrual Accounting

#### ADDITIONAL DETAILS



- Also called a "Profit & Loss" statement or "P&L".
- Has a start and end date.
- Net Income is added to Retained Earnings on the Balance Sheet.

### CASH FLOW

Cash Flow Statement (Period)	
	Net Income
+	Non-Cash Charges
+	Changes In Working Capital
	Operating Cash Flow
-	Capital Expenditure for Property, Plant, & Equipment
-	Acquisitions
+	Proceeds From Sale of Investments
	Net Cash From Investing Activities
+	Borrow / Repay debt
+	Issue / Repurchase Stock
-	Pay Dividends
	Net Cash From Financing Activities
+	Changes in Cash During Period
	Cash Start of Period
	Cash End of Period

#### PURPOSE



Track Cash Movement

#### SIMILAR TO



Your Checking Account

#### TIME



Period of Time

#### ACCOUNTING



Cash Accounting

#### ADDITIONAL DETAILS



- Has a start and end date.
- Begins with Net Income from the Income Statement.
- Cash Flow From Operation minus Capital Expenditures equals Free Cash Flow.
- Ends with Cash Balance, which goes on the Balance Sheet.



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# FINANCIAL STATEMENTS CONNECTIONS



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Income Statement (Period)	
	Revenue
-	Cost of Goods Sold
	Gross Profit
-	Operating Expenses
	Operating Income
-	Non-Operating Income/Expense
	Pre-Tax Income
-	Income Tax
→	Net Income ←
/	Shares Outstanding
	Earnings Per Share

Cash Flow Statement (Period)	
	Net Income
+	Non-Cash Charges
±	Changes In Working Capital
	Operating Cash Flow
-	Capital Expenditure for Property, Plant, & Equipment
-	Acquisitions
+	Proceeds From Sale of Investments
	Net Cash From Investing Activities
±	Borrow / Repay debt
±	Issue / Repurchase Stock
-	Pay Dividends
	Net Cash From Financing Activities
±	Changes in Cash During Period
	Cash Start of Period
	Cash End of Period

Balance Sheet (Specific Date)			
Assets		Liabilities	
Current Assets (<1 Year)	Cash & Cash Equivalents	Current Liabilities (<1 Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt
	Accounts Receivable		Other Current Liabilities
	Inventory	Long-Term Liabilities (>1 Year)	Long-Term Debt
	Other Current Assets		Other Long-Term Liabilities
Long-Term Assets (>1 Year)	Long-Term Investments	Shareholder Equity	Preferred Stock
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill		Retained Earnings
	Other Long-Term Assets		Treasury Stock





**BALANCE**

**SHEET**

# BALANCE SHEET



# OVERVIEW



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Balance Sheet (Specific Date)					
Assets			Liabilities		
Current Assets ( $<1$ Year)	Cash & Cash Equivalents	Cash / T-bills / CDs $<3$ Month Maturity	Current Liabilities ( $<1$ Year)	Payables & Accrued Expenses	Interest / Wages / Dividends / Taxes / Accrued Liabilities
	Marketable Securities	Liquid Equity / Bonds Expected To Be Used In $<1$ Year		Short-Term Debt	Interest & Principal On Debt Due $<1$ Year
	Accounts Receivable	Money That Is Owed By Customers		Other Current Liabilities	Catch-All Category Of Liabilities Due $<1$ Year
	Inventory	Raw Materials & Finished Goods Available For Sale	Long-Term Liabilities ( $>1$ Year)	Long-Term Debt	Interest & Principal On Debt Due $>1$ Year
	Other Current Assets	Catch-All Category Of Assets Expected To Last $<1$ Year		Other Long-Term Liabilities	Catch-All Category Of Liabilities Due $>1$ Year
Long-Term Assets ( $>1$ Year)	Long-Term Investments	Investments The Company Intends To Hold For $>1$ Year	Shareholder Equity	Preferred Stock	Equity That Can Claim Income From Earnings
	Fixed Assets	Land / Machinery / Equipment / Buildings / Durable Assets		Common Stock & Additional Paid-In Capital	Money Shareholders Have Invested In The Company
	Goodwill	Premiums Paid To Acquire Other Businesses		Retained Earnings	Accumulated Profits The Business Keeps
	Other Long-Term Assets	Catch-All Category Of Assets Expected To Last $>1$ Year		Treasury Stock*	Stock The Company Has Repurchased (*Not Always Reported)

## PURPOSE

Track What It Owns & Owes



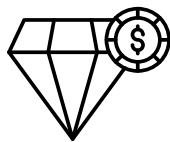
## TIME

Point in Time Snapshot



## SIMILAR TO

Your Net Worth



## ACCOUNTING

Accrual Accounting



## + ADDITIONAL DETAILS

- Assets must always equal Liabilities + Shareholder's Equity.
- Cash Balance comes from the ending balance on the Cash Flow Statement.
- Retained Earnings = last period's Balance Sheet + Net Income - Dividends
- Management teams have discretion of the categories & terms they use.

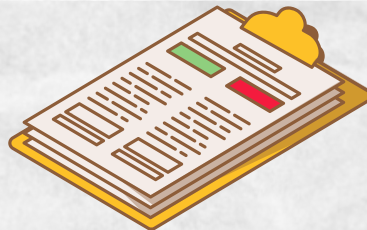


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# BALANCE SHEET SYNONYMS



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• NET WORTH STATEMENT • STATEMENT OF FINANCIAL POSITION  
 • FINANCIAL STATUS REPORT • STATEMENT OF FINANCIAL CONDITION

Balance Sheet (Specific Date)			
Assets		Liabilities	
Current Assets (<1 Year)	Cash & Cash Equivalents	Current Liabilities (<1 Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt
	Accounts Receivable		Other Current Liabilities
	Inventory	Long-Term Liabilities (>1 Year)	Long-Term Debt
Other Current Assets	Other Long-Term Liabilities		
Long-Term Assets (>1 Year)	Long-Term Investments	Shareholder Equity	Preferred Stock
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill		Retained Earnings
Other Long-Term Assets	Treasury Stock		

- Near Cash
- Liquid Assets
- Marketable Securities
- Cash Assets
- Cash Reserves
- Cash on Hand

- Trade Receivables
- Outstanding Invoices
- Debtor Balances
- Bills Receivable
- Trade Debtors
- Receivables

- Stock
- Goods
- Supplies
- Merchandise
- Product Stock
- On-hand Goods
- Warehouse Stock

- CDs
- Bonds
- Stocks
- Private Equity Investments
- Venture Capital Investments
- Long-term Notes Receivable
- Investment in Subsidiaries
- Investment in Joint Ventures
- Pension Funds
- Intellectual Property Investments
- Commodity Holdings
- Infrastructure Funds
- Loans Receivable
- Real Estate Investments

- Deposits
- Recoverable VAT
- Notes Receivable
- Prepaid Expenses
- Assets Held for Sale
- Deferred Tax Assets
- Dividends Receivable
- Advances to Suppliers
- Short-term Investments
- Income Taxes Receivable
- Current Portion of Long-term Investments
- Current Portion of Loans Receivable

- Creditors
- Supplier Debt
- Trade Creditors
- Trade Payables
- Due to Suppliers
- Unpaid Expenses
- Outstanding Bills
- Accounts Payable
- Accrued Expenses
- Outstanding Invoices

- Notes
- Senior Debt
- Current Debt
- Notes Payable
- Bonds Payable
- Short-term Loans
- Convertible Notes
- Convertible Senior Notes
- Fixed Payment Obligations
- Deferred Payment Obligations
- Current Portion of Long-term Debt

- Deferred Revenue
- Dividends Payable
- Unearned Revenue
- Customer Deposits
- Income Taxes Payable
- Accrued Interest Payable
- Accrued Salaries and Wages
- Current Maturities of Capital Lease Obligations
- Other Accrued Liabilities

- Notes
- Senior Debt
- Long-term Loans
- Convertible Notes
- Non-Current Debt
- Subordinated Debt
- Mortgages Payable
- Long-term Financing
- Long-term Borrowings
- Non-Current Liabilities
- Convertible Senior Notes
- Long-term Bonds Payable
- Long-term Notes Payable
- Fixed Payment Obligations
- Long-term Lease Obligations
- Deferred Payment Obligations

- Deferred Credits
- Minority Interest
- Pension Obligations
- Long-term Earn-outs
- Deferred Tax Liabilities
- Post-retirement Health Care Obligations
- Long-term Capital Leases
- Long-term Deferred Revenue
- Long-term Provisions
- Long-term Deferred Compensation
- Other Non-Current Liabilities
- Long-term Contingent Liabilities

- Plant Assets
- Hard Assets
- Fixed Capital
- Capital Assets
- Physical Assets
- Tangible Assets
- Property, Plant, and Equipment (PP&E)
- Non-Current Assets
- Long-term Assets

- Intangible Assets
- Financial Assets
- Deferred Charges
- Natural Resources
- Other Non-Current Assets
- Deferred Tax Assets
- Right-of-Use Assets
- Long-Term Receivables
- Capital Work in Progress
- Retirement Benefit Assets
- Non-Current Prepayments
- Investments in Associates
- Property, Plant, and Equipment (PP&E)

- Capital Stock
- Share Capital
- Equity Shares
- Voting Shares
- Class A Shares
- Class B Shares
- Common Equity
- Common Shares
- Ordinary Shares
- Founders' Shares

- Deficit
- Earned Deficit
- Earned Surplus
- Retained Profit
- Retained Deficit
- Retained Capital
- Retained Losses
- Accumulated Profit
- Undistributed Profits
- Unappropriated Profit
- Accumulated Earnings
- Accumulated Retained Earnings
- Accumulated Income
- Earnings Reserve
- Accumulated Losses
- Accumulated Earnings Deficit
- Negative Retained Earnings
- Accumulated Net Losses
- Retained Earnings Deficit
- Accumulated Operating Losses

- Senior Equity
- Preferred Equity
- Preferred Shares
- Preference Shares
- Preferred Securities
- Cumulative Preferred Stock
- Convertible Preferred Stock
- Non-Convertible Preferred Stock
- Participating Preferred Stock
- Preferred Dividend Stock

- Own Shares
- Buyback Shares
- Treasury Shares
- Treasury Equity
- Share Repurchase
- Reacquired Shares
- Repurchased Shares
- Company's Own Shares
- Shares in Treasury

- Blue Sky Value
- Excess Earnings
- Enterprise Value
- Intangible Assets
- Commercial Value
- Purchased Goodwill
- Consolidation Surplus
- Business Reputation Value
- Business Valuation Residual





# Balance Sheet

## QUESTIONS TO ASK



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Balance Sheet (Specific Date)			
Assets		Liabilities	
Current Assets ( $<1$ Year)	Cash & Cash Equivalents	Current Liabilities ( $<1$ Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt
	Accounts Receivable		Other Current Liabilities
	Inventory	Long-Term Liabilities ( $>1$ Year)	Long-Term Debt
	Other Current Assets		Other Long-Term Liabilities
Long-Term Assets ( $>1$ Year)	Long-Term Investments	Shareholder Equity	Preferred Stock
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill		Retained Earnings
	Other Long-Term Assets		Treasury Stock

- How much cash does the company have?
- Are there accounts receivables? How much?
- Is there any inventory? How much?
- Is there any goodwill? How much?
- What are the company's biggest assets?
- Does the company have debt? How much?
- Does the company have deferred revenue?
- What are the company's biggest liabilities?
- How has the company been funded?
- Is there any preferred stock?
- Are retained earnings positive and growing?
- Is there any treasury stock?



# How To Analyze A BALANCE SHEET



By Brian Feroldi



## WHAT IS A BALANCE SHEET?

- A balance sheet shows you what a company OWNS and OWES
- It's like a company's "Net Worth" statement

$$\text{Assets} = \text{Liabilities} + \text{Shareholders Equity}$$



## BALANCE SHEET = SNAPSHOT

- Balance Sheet is a SNAPSHOT at a certain POINT IN TIME

ASSETS	LIABILITIES
<ul style="list-style-type: none"> <li>• Shows everything the company OWNS.</li> <li>• Two categories of assets: <b>Current Assets</b> and <b>Long-Term Assets</b>.</li> </ul>	<ul style="list-style-type: none"> <li>• Shows everything the company OWES.</li> <li>• Two categories of liabilities: <b>Current Liabilities</b> and <b>Long-Term Liabilities</b>.</li> </ul>
<p><b>Current Assets:</b> Assets that are expected to be used thin 1 year.</p> <p><b>Long-Term Assets:</b> Assets that expected to last longer than 1 year:</p> <div style="display: flex; align-items: center;"> <div style="text-align: center; margin-right: 10px;"> <p style="background-color: #4CAF50; color: white; padding: 2px;">Most Liquid</p> <p style="background-color: #4CAF50; color: white; padding: 2px;">Least Liquid</p> </div> <ul style="list-style-type: none"> <li>• Cash &amp; cash equivalents</li> <li>• Marketable securities</li> <li>• Financial assets</li> <li>• Accounts receivable</li> <li>• Inventory</li> <li>• Plant, property &amp; equipment</li> <li>• Intangible assets</li> <li>• Goodwill</li> </ul> </div>	<p><b>Current Liabilities:</b> An obligation due in <u>less than 1 year</u>.</p> <p><b>Long-Term Liabilities:</b> An obligation due in <u>greater than 1 year</u>.</p>
<h3>SHAREHOLDER'S EQUITY</h3>	
<ul style="list-style-type: none"> <li>• A company's <u>net worth</u>.</li> <li>• The dollar amount that would be returned to the owners if the company was liquidated.</li> <li>• Shareholder's Equity = Assets – Liabilities</li> </ul>	

## HOW TO ANALYZE A BALANCE SHEET

### ? Questions ?

- 1: How much CASH does the company have?
- 2: Are there any ACCOUNTS RECEIVABLE?
- 3: Is there any GOODWILL? How much?
- 4: What are the biggest liabilities?
- 5: Does the company have any DEBT? What kind?
- 6: Is there any PREFERRED STOCK?
- 7: Are RETAINED EARNINGS positive? Is it growing?
- 8: Is there any TREASURY STOCK?

### Yellow Flags

- 1: CASH & CASH EQUIVALENTS → Less Than Total Debt
- 2: ACCOUNTS RECEIVABLE → Rising Faster Than Revenue
- 3: INVENTORY → Rising Faster Than Profits
- 4: GOODWILL → More Than 50% of Total Assets
- 5: INTANGIBLE ASSETS → More Than 50% of Total Assets
- 6: SHORT-TERM & LONG-TERM DEBT → More Than Cash
- 7: PREFERRED STOCK → There Shouldn't Be Any
- 8: RETAINED EARNINGS → A Negative Number



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# WARREN BUFFETT'S

## BALANCE SHEET RULES OF THUMB



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Metric:	Equation:	Rule:
Cash & Debt	$Cash > Total\ Debt$	More Cash Than Debt
Adjusted Debt to Equity	$\frac{Total\ Liabilities}{Shareholder\ Equity + (Treasury\ Stock)}$	Below 0.80
Preferred Stock	Preferred Stock	None
Retained Earnings	$\frac{Year\ 2\ Retained\ Earnings}{Year\ 1\ Retained\ Earnings}$	Recession - Proof Growth
Treasury Stock	$Treasury\ Stock > 1$	Exists



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# 4 BALANCE SHEET RATIOS



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**Ratio:**

**Question:**

**Equation:**

**Where:**

**Guide:**

**Quick Ratio**

"Can the company pay its bills?"

$$\frac{\text{Cash} + \text{Cash Equivalents} + \text{Accounts Receivables}}{\text{Current Liabilities}}$$

Assets		Liabilities	
Cash & Cash Equivalents	Current Liabilities	Accounts Payable	
Marketable Securities	Long-Term Liabilities	Accrued Expense	
Accounts Receivable		Short-Term Debt	
Inventory		Long-Term Debt	
Prepaid Expenses		Other Long-Term Liabilities	
Long Term Investments		Preferred Stock	
Fixed Assets	Shareholder Equity	Common Stock	
Goodwill		Additional Paid-In Capital	
Intangible Assets		Retained Earnings	
Other Long-Term Assets		Treasury Stock	

Fragile = <1.0  
Robust = 1 to 1.5  
Antifragile = >1.5

**Current Ratio**

"How well does the company manage its assets?"

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Assets		Liabilities	
Cash & Cash Equivalents	Current Liabilities	Accounts Payable	
Marketable Securities	Long-Term Liabilities	Accrued Expense	
Accounts Receivable		Short-Term Debt	
Inventory		Long-Term Debt	
Prepaid Expenses		Other Long-Term Liabilities	
Long Term Investments		Preferred Stock	
Fixed Assets	Shareholder Equity	Common Stock	
Goodwill		Additional Paid-In Capital	
Intangible Assets		Retained Earnings	
Other Long-Term Assets		Treasury Stock	

Fragile = <0.7  
Robust = 1 - 2  
Antifragile = >2.0

**Debt-to-Equity Ratio**

"How much leverage is the company using?"

$$\frac{\text{Total Liabilities}}{\text{Shareholder Equity}}$$

Assets		Liabilities	
Cash & Cash Equivalents	Current Liabilities	Accounts Payable	
Marketable Securities	Long-Term Liabilities	Accrued Expense	
Accounts Receivable		Short-Term Debt	
Inventory		Long-Term Debt	
Prepaid Expenses		Other Long-Term Liabilities	
Long Term Investments		Preferred Stock	
Fixed Assets	Shareholder Equity	Common Stock	
Goodwill		Additional Paid-In Capital	
Intangible Assets		Retained Earnings	
Other Long-Term Assets		Treasury Stock	

Fragile = >2.0  
Robust = 0.7 - 2.0  
Antifragile = <0.7

**Goodwill-to-Assets Ratio**

"Is the company growing organically?"

$$\frac{\text{Goodwill}}{\text{Total Assets}}$$

Assets		Liabilities	
Cash & Cash Equivalents	Current Liabilities	Accounts Payable	
Marketable Securities	Long-Term Liabilities	Accrued Expense	
Accounts Receivable		Short-Term Debt	
Inventory		Long-Term Debt	
Prepaid Expenses		Other Long-Term Liabilities	
Long Term Investments		Preferred Stock	
Fixed Assets	Shareholder Equity	Common Stock	
Goodwill		Additional Paid-In Capital	
Intangible Assets		Retained Earnings	
Other Long-Term Assets		Treasury Stock	

Fragile = >50%  
Robust = 10%-50%  
Antifragile = <10%



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# BALANCE SHEET



# INCOME STATEMENT



**BRIAN FEROLDI**

Balance Sheet (Specific Date)			
Assets		Liabilities	
Current Assets (<1 Year)	Cash & Cash Equivalents	Current Liabilities (<1 Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt
	Accounts Receivable		Other Current Liabilities
	Inventory	Long-Term Liabilities (>1 Year)	Long-Term Debt
	Other Current Assets		Other Long-Term Liabilities
Long-Term Assets (>1 Year)	Long-Term Investments	Shareholder Equity	Preferred Stock
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill		Retained Earnings
	Other Long-Term Assets		Treasury Stock

Income Statement (Period)	
	Revenue
-	Cost of Goods Sold
	Gross Profit
-	Operating Expenses
	Operating Income
-	Non-Operating Income/Expense
	Pre-Tax Income
-	Income Tax
	Net Income
/	Shares Outstanding
	Earnings Per Share

## PURPOSE

Track What it Owns & Owes



## SIMILAR TO

Your Net Worth



## TIME

Point in Time Snapshot



## ACCOUNTING

Accrual Accounting



## ADDITIONAL DETAILS



- Assets must always exactly equal Liabilities + Shareholder's Equity.
- Cash Balance comes from the ending balance on the Cash Flow Statement.
- Retained Earnings balance comes from last period's Balance Sheet plus this month's Net Income on your Income Statement minus any Dividends Paid.

## PURPOSE

Track Income & Expenses



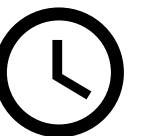
## SIMILAR TO

Your Budget



## TIME

Period of Time



## ACCOUNTING

Accrual Accounting



## ADDITIONAL DETAILS



- Also called a "Profit & Loss" statement or "P&L".
- Has a start and end date.
- Net Income is added to Retained Earnings on the Balance Sheet minus any Dividend Payments.



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# BALANCE SHEET



# CASH FLOW STATEMENT



**BRIAN FEROLDI**

Balance Sheet (Specific Date)			
Assets		Liabilities	
Current Assets (<1 Year)	Cash & Cash Equivalents	Current Liabilities (<1 Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt
	Accounts Receivable		Other Current Liabilities
	Inventory	Long-Term Liabilities (>1 Year)	Long-Term Debt
	Other Current Assets		Other Long-Term Liabilities
Long-Term Assets (>1 Year)	Long-Term Investments	Shareholder Equity	Preferred Stock
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill		Retained Earnings
	Other Long-Term Assets		Treasury Stock

Cash Flow Statement (Period)	
Operating Activities	Net Income
	+ Non-Cash Charges
	+/- Changes In Working Capital
Operating Cash Flow	
Investing Activities	- Capital Expenditure for Property, Plant, & Equipment
	- Acquisitions
	+ Proceeds From Sale of Investments
Net Cash From Investing Activities	
Financing Activities	+/- Borrow / Repay debt
	+/- Issue / Repurchase Stock
	- Pay Dividends
Net Cash From Financing Activities	
+/- Changes in Cash During Period	
Cash Start of Period	
Cash End of Period	

**PURPOSE**  
Track What it Owns & Owes

**PURPOSE**  
Track Cash Movements

**TIME**  
Point in Time Snapshot

**TIME**  
Period of Time

**ACCOUNTING**  
Accrual Accounting

**ACCOUNTING**  
Cash Accounting

**ADDITIONAL DETAILS**

- Assets must always exactly equal Liabilities + Shareholder's Equity.
- Cash Balance comes from ending balance on the Cash Flow Statement.
- Retained Earnings balance comes from last period's Balance Sheet + this month's Net Income on your Income Statement.

**ADDITIONAL DETAILS**

- Ending cash balance becomes Cash on the Balance Sheet
- Begins with Net Income from the Income Statement
- Cash Flow From Operation minus Capital Expenditures equals Free Cash Flow



# 8 BALANCE SHEET YELLOW FLAGS



**BRIAN FEROLDI**

**1: Less Than Total Debt**

**2: Rising Faster Than Revenue**

**3: Rising Faster Than Profits**

**4: More Than Cash**

Balance Sheet (Specific Date)			
Assets		Liabilities	
Current Assets (<1 Year)	Cash & Cash Equivalents ●	Current Liabilities (<1 Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt ●
	Accounts Receivable ●		Other Current Liabilities
	Inventory ●	Long-Term Liabilities (>1 Year)	Long-Term Debt ●
	Other Current Assets		Other Long-Term Liabilities
Long-Term Assets (>1 Year)	Long-Term Investments	Shareholder Equity	Preferred Stock ●
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill ●		Retained Earnings ●
	Other Long-Term Assets ●		Treasury Stock

**6: Intangibles > 50% of Total Assets**

**8: A Negative Number**

**5: More Than 50% of Total Assets**

**7: There Shouldn't Be Any**



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# 10 BALANCE SHEET GREEN FLAGS



**BRIAN FEROLDI**

**2: No Accounts Receivables**

**4: Current Liabilities Less Than Cash**

**5: No Short-Term or Long Term Debt**

**1: More Cash Than Debt**

**3: No Inventory**

## Balance Sheet (Specific Date)

Assets		Liabilities	
Current Assets (<1 Year)	Cash & Cash Equivalents	Current Liabilities (<1 Year)	Payables & Accrued Expenses
	Marketable Securities		Short-Term Debt
	Accounts Receivable		Other Current Liabilities
	Inventory	Long-Term Liabilities (>1 Year)	Long-Term Debt
	Other Current Assets	Other Long-Term Liabilities	
Long-Term Assets (>1 Year)	Long-Term Investments	Shareholder Equity	Preferred Stock
	Fixed Assets		Common Stock & Additional Paid-In Capital
	Goodwill		Retained Earnings
	Other Long-Term Assets		Treasury Stock

**6: Goodwill Less Than 10% of Total Assets**

**8: Retained Earnings Positive & Growing**

**10: Deferred Revenue**

**7: No Preferred Stock**

**9: Treasury Stock**



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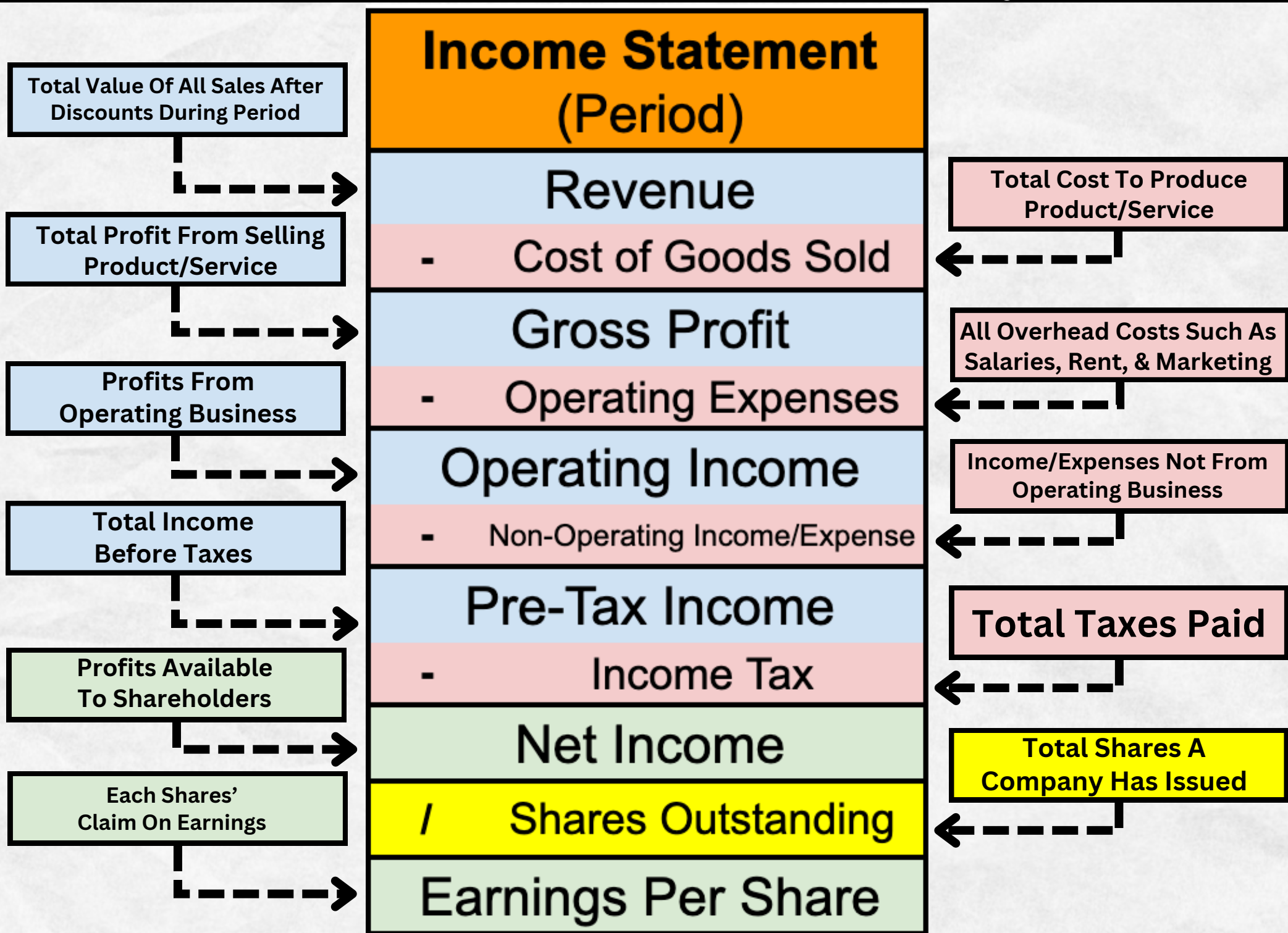
**INCOME  
STATEMENT**



# INCOME STATEMENT EXPLAINED SIMPLY



By Brian Feroldi



## PURPOSE:

Track Income & Expenses



## TIME:

Period of Time



## SIMILAR TO:

Your Monthly Budget



## ACCOUNTING:

Accrual Accounting



## + ADDITIONAL DETAILS

- Also called a "Profit & Loss" statement or "P&L".
- Net Income is added to Retained Earnings on the Balance Sheet.
- Has a start and end date.



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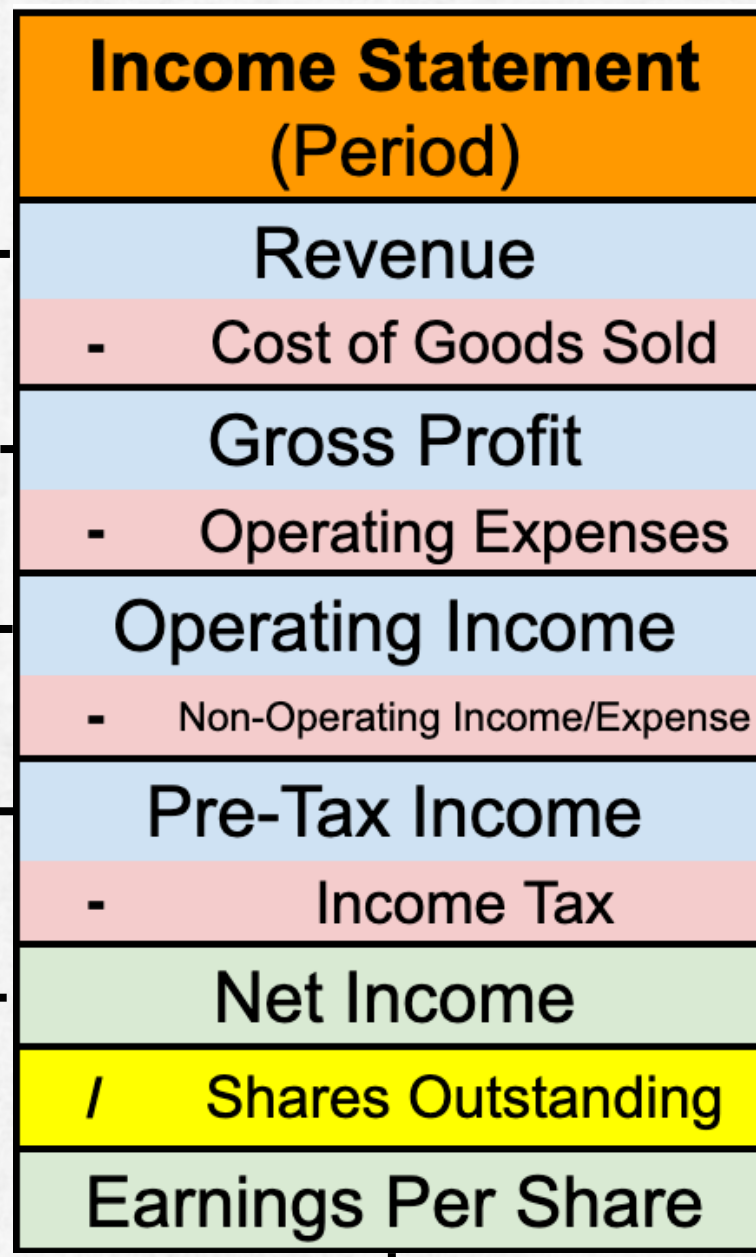
# INCOME STATEMENT SYNONYMS



BY BRIAN FEROLDI

- Earnings Statement
- Operating Statement
- Statement of Operations
- Statement of Earnings
- Profit and Loss Statement (P&L)
- Revenue Statement

- Sales
- Income
- Turnover
- Gross Income
- Gross Sales
- Top Line
- Receipts



- Cost of Sales
- Cost of Revenue
- Goods Costs
- Cost of Products Sold

- Gross Income
- Gross Margin
- Sales Profit
- Gross Earnings

- Overhead
- Operating Costs
- Selling, General, and Administrative Expenses (SG&A)
- Sales & Marketing (S&M)
- Research & Development (R&D)
- General & Administrative (G&A)
- Operating Outgo
- Operational Expenses
- Business Expenses

- Operating Profit
- Operating Earnings
- Operating Margin
- Earnings Before Interest and Taxes (EBIT)
- Operating Cash Flow
- Business Income

- Other Income / Expense
- Interest Income / Expense
- Secondary Income / Expense
- Incidental Income / Expense
- Extraordinary Items

- Earnings Before Tax (EBT)
- Income Before Tax
- Profit Before Tax (PBT)
- Operating Profit Before Tax
- Earnings Before Income & Taxes (EBIT)
- Pretax Earnings
- Pretax Profit

- Tax on Income
- Revenue Tax
- Earnings Tax
- Fiscal Charge on Income
- Corporate Income Tax
- Direct Tax

- Earnings
- Net Earnings
- Net Profit
- Bottom Line
- Profits
- Income
- Net Income After Taxes
- Profit After Tax (PAT)
- Earnings After Tax (EAT)
- Net Income Before Extraordinary Items

- EPS
- Net Income Per Share
- Profit Per Share

- Issued Shares
- Basic Shares Outstanding
- Diluted shares Outstanding
- Fully Diluted Shares Outstanding
- Outstanding Stock
- Outstanding Equity
- Outstanding Shares of Stock





# Income Statement



## QUESTIONS TO ASK



**BRIAN FEROLDI**

### Income Statement (Period)

Revenue

- Cost of Goods Sold

Gross Profit

- Operating Expenses

Operating Income

- Non-Operating Income/Expense

Pre-Tax Income

- Income Tax

Net Income

/ Shares Outstanding

Earnings Per Share

- Does revenue consistently grow?
- What is the gross margin?
- Is the gross margin stable? Expanding? Contracting? Why?
- Are there research + development expenses?
- Are there selling + marketing expenses?
- What are the company's biggest operating expenses?
- What is the company operating margin?
- Does the company have any non-operating expenses?
- What is the company net profit margin?
- Is the company profitable on a Non-GAAP basis?
- Is the company profitable on a GAAP basis?



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# WARREN BUFFETT'S



## INCOME STATEMENT RULES OF THUMB

BY BRIAN FEROLDI

METRIC:	EQUATION:	RULE OF THUMB:
Gross Margin	$\frac{\text{Gross Profit}}{\text{Revenue}}$	>40%
SG&A Margin	$\frac{\text{SG\&A}}{\text{Gross Profit}}$	<30%
R&D Margin	$\frac{\text{R\&D}}{\text{Gross Profit}}$	<30%
Depreciation Margin	$\frac{\text{Depreciation}}{\text{Gross Profit}}$	<10%
Interest Margin	$\frac{\text{Interest}}{\text{Operating Income}}$	<15%
Tax Margin	$\frac{\text{Taxes}}{\text{Pre-Tax Income}}$	Corporate Tax Rate
Net Income Margin	$\frac{\text{Net Income}}{\text{Revenue}}$	>20%
EPS Growth	$\frac{\text{Year 2 EPS}}{\text{Year 1 EPS}}$	Positive & Growing



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# INCOME STATEMENT

## 5 KEY METRICS








BY BRIAN FEROLDI

### METRIC:

### FORMULA:

### WHAT:

<p><b>SALES GROWTH</b></p> 	$\frac{\text{YEAR 2 SALES}}{\text{YEAR 1 SALES}}$	<p>Companies are either growing or dying – there isn't a third direction. Great companies consistently grow their revenues by at least 5% per year.</p>
<p><b>GROSS MARGINS</b></p> 	$\frac{(\text{REVENUE} - \text{COST OF GOODS SOLD})}{\text{REVENUE}}$	<p>A stable or rising Gross Margin is a sign that a company has negotiating power with suppliers and pricing power with customers.</p>
<p><b>OPERATING LEVERAGE</b></p> 	<p>REVENUE GROWTH RATE VS PROFIT GROWTH RATE</p>	<p>"Operating Leverage" means profits can grow FASTER than revenues. A \$1 increase in revenue leads to more than a \$1 increase in profits. This happens when revenue grows faster than expenses.</p>
<p><b>DEBT COVERAGE</b></p> 	$\frac{\text{INTEREST EXPENSE}}{\text{OPERATING INCOME}}$	<p>Good companies can easily cover their interest expense. A rule of thumb is this ratio should be under 25%.</p>
<p><b>DILUTION</b></p> 	$\frac{\text{YEAR 2 DILUTED SHARES OUTSTANDING}}{\text{YEAR 1 DILUTED SHARES OUTSTANDING}}$	<p>Companies that pay a lot of Stock-Based Compensation dilute shareholders by rapidly increasing their share count. This growth should be under 3% for fast-growing companies and under 1% for slow growing companies.</p>

## 4 CAVEATS TO KEEP IN MIND

- 1 Not all revenue growth is good for investors
- 2 There can be good reasons for Gross Margin to decline
- 3 Operating Leverage will diminish over time
- 4 Stock buybacks can mask the true dilution rate



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# INCOME STATEMENT

# VS

# CASH FLOW STATEMENT



**BRIAN FEROLDI**

Income Statement (Period)	
	Revenue
-	Cost of Goods Sold
	Gross Profit
-	Operating Expenses
	Operating Income
-	Non-Operating Income/Expense
	Pre-Tax Income
-	Income Tax
	Net Income
/	Shares Outstanding
	Earnings Per Share

Cash Flow Statement (Period)	
	Net Income
+	Non-Cash Charges
±	Changes In Working Capital
	Operating Cash Flow
-	Capital Expenditure for Property, Plant, & Equipment
-	Acquisitions
+	Proceeds From Sale of Investments
	Net Cash From Investing Activities
±	Borrow / Repay debt
±	Issue / Repurchase Stock
-	Pay Dividends
	Net Cash From Financing Activities
+	Changes in Cash During Period
	Cash Start of Period
	Cash End of Period

**PURPOSE**  
Track Income & Expenses

**PURPOSE**  
Track Cash Movements

**TIME**  
Period of Time

**TIME**  
Period of Time

**ACCOUNTING**  
Accrual Accounting

**ACCOUNTING**  
Cash Accounting

**ADDITIONAL DETAILS**

- Also called a "Profit & Loss" statement or "P&L"
- Has a start and end date, usually a quarter or year
- Net Income is added to Retained Earnings on the Balance Sheet.

**ADDITIONAL DETAILS**

- Has a start and end date
- Begins with Net Income from the Income Statement
- Cash Flow From Operation minus Capital Expenditures equals Free Cash Flow



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HOW THE

# INCOME STATEMENT

&

# BALANCE SHEET LINK



BY BRIAN FEROLDI

## INCOME STATEMENT

	ITEM	EXPLANATION
Start With	Revenues	Accountant's estimate of the sales generated by any transactions made the business during the period.
Net Out	Operating Expenses	Include all expenses associated with operation this year, with no benefits spilling over into future years.
To Get	Operating Profit	Operating profitability of business.
Net Out	Financial Income & Expenses	Subtract non-operating expenses (interest payments on debt). Add non-operating income (interest income, equity investments).
To get	Taxable Income	Income to equity investors before taxes.
Net Out	Taxes	Taxes, based upon taxable income.
To get	Net Income	Income to equity investors, after taxes.

OPERATING EXPENSES

WRITTEN OFF AS DEPRECIATION OR AMORTIZATION OVER LIFE OF ASSET

ADD / SUBTRACT NON-OPERATING INCOME / EXPENSES

NON-OPERATING EXPENSES

FINANCING EXPENSES

BORROWINGS ON BALANCE SHEET

## BALANCE SHEET

ASSETS		LIABILITIES	
SHORT LIVED ASSETS	Current Assets	Current Liabilities	SHORT TERM OBLIGATIONS
LONG LIVED PHYSICAL ASSETS	Fixed Assets	Debt	LONG TERM DEBT
INVESTEMENTS IN SECURITIES & OTHER BUSINESS	Financial Assets	Other Liabilities	OTHER LONG TERM OBLIGATIONS
ASSETS WHICH ARE NOT PHYSICAL	Intangible Assets	Equity	SHAREHOLDERS' EQUITY

NET INCOME



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# 6 INCOME STATEMENT YELLOW FLAGS



BRIAN FEROLDI

1: Growth Rate Suddenly Plunges

## Income Statement (Period)

Revenue

- Cost of Goods Sold

Gross Profit

- Operating Expenses

Operating Income

- Non-Operating Income/Expense

Pre-Tax Income

- Income Tax

Net Income

/ Shares Outstanding

Earnings Per Share

2: Gross Margin Declining

3: Marketing Expense Rise Faster Than Revenue

4: Goodwill Writedown

5: Dilution Excessively High

6: Tax Rate Consistently Lower Than Home Country Corporate Rate



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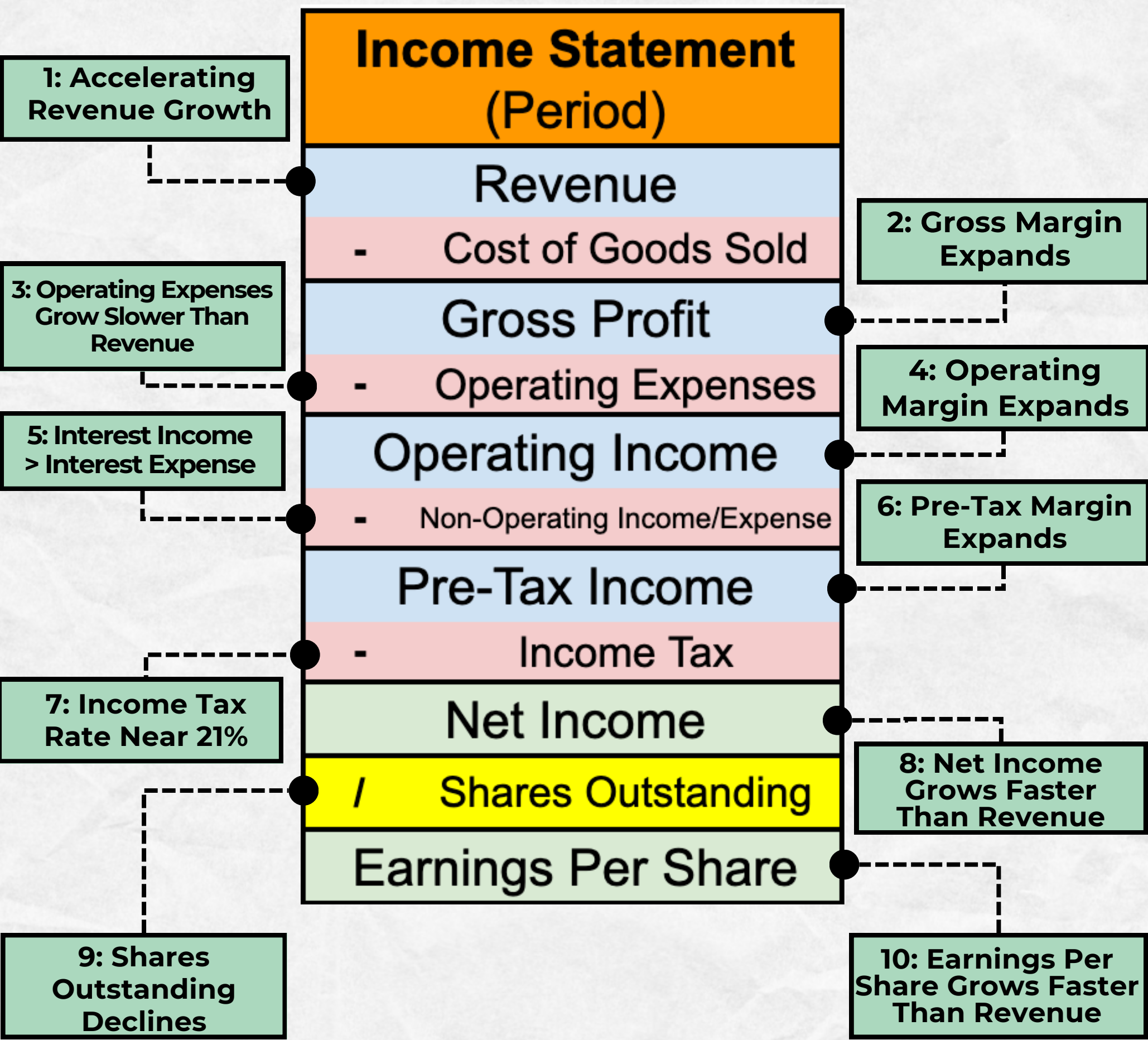


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# 10 INCOME STATEMENT GREEN FLAGS



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