

Contents at a Glance

Introduction	1
Part I: Getting Down to Financial Reporting Basics.....	7
Chapter 1: Discovering What Reports Reveal.....	9
Chapter 2: Recognising Different Business Types.....	19
Chapter 3: Discovering How Company Structure Affects the Books	27
Chapter 4: Digging into Accounting Basics	43
Part II: Understanding Published Information: Annual Reports.....	59
Chapter 5: Exploring the Anatomy of an Annual Report.....	61
Chapter 6: Balancing Assets Against Liabilities and Equity	77
Chapter 7: Using the Income Statement	95
Chapter 8: The Statement of Cash Flows.....	111
Chapter 9: Scouring the Notes to the Financial Statements	125
Chapter 10: Considering Consolidated Financial Statements.....	147
Part III: Analysing the Numbers	157
Chapter 11: Testing the Profits and Market Value.....	159
Chapter 12: Looking at Liquidity	179
Chapter 13: Making Sure the Company Has Cash to Carry On.....	189
Part IV: Understanding How Companies Optimise Operations.....	203
Chapter 14: Using Basic Budgeting	205
Chapter 15: Turning Up Clues in Turnover and Assets	215
Chapter 16: Examining Cash Inflow and Outflow	227
Chapter 17: How Companies Keep the Cash Flowing.....	239
Part V: The Many Ways Companies Answer to Stakeholders	247
Chapter 18: Finding Out How Companies Find Errors: The Auditing Process	249
Chapter 19: Checking Out the Analyst–Company Connection	259
Chapter 20: How Companies Soothe the Shareholders.....	271
Chapter 21: Keeping Score When Companies Play Games with Numbers.....	283

<i>Part VI: The Part of Tens</i>	307
Chapter 22: Ten Financial Crises That Rocked the World.....	309
Chapter 23: Ten Signs That a Company's in Trouble	319
Chapter 24: Ten Top-Notch Online Resources.....	325
<i>Part VII: Appendixes</i>	331
Appendix A: Financial Statements.....	333
Appendix B: Glossary	349
<i>Index</i>	359

<http://www.pbookshop.com>

Table of Contents

<i>Introduction</i>	1
About This Book.....	2
Conventions Used in This Book	2
What You're Not to Read.....	3
Foolish Assumptions	3
How This Book Is Organised.....	4
Part I: Getting Down to Financial Reporting Basics	4
Part II: Understanding Published Information: Annual Reports.....	4
Part III: Analysing the Numbers	4
Part IV: Understanding How Companies Optimise Operations.....	5
Part V: The Many Ways Companies Answer to Stakeholders.....	5
Part VI: The Part of Tens	5
Part VII: Appendixes.....	5
Icons Used in This Book.....	6
Where to Go from Here.....	6
<i>Part 1: Getting Down to Financial Reporting Basics</i>	7
Chapter 1: Discovering What Reports Reveal	9
Finding Out What Financial Reporting Is For	9
Looking at Different Types of Reporting	11
Keeping everyone informed.....	12
Staying within the walls of the company: Internal reporting	13
Preparing the reports	14
Dissecting the Annual Report for Shareholders.....	15
Understanding How the Number Crunchers Are Kept in Line.....	16
Chapter 2: Recognising Different Business Types	19
Flying Solo: Sole Traders	19
Keeping taxes personal	20
Reviewing requirements for reporting	20
Joining Forces: Partnerships	21
Partnering up on taxes	21
Meeting reporting requirements	21
Shielding Your Assets: Public and Private Limited Companies	22
Paying taxes the corporate way.....	23
Getting familiar with reporting requirements.....	23

Seeking Protection with Limited Liability Partnerships	24
Taking stock of taxes.....	24
Reviewing reporting requirements	25
Chapter 3: Discovering How Company Structure Affects the Books	27
Investigating Private Companies.....	27
Checking out the benefits.....	28
Defining disadvantages.....	29
Figuring out reporting.....	30
Understanding Public (Listed) Companies.....	33
Meeting filing requirements	34
Examining the perks.....	35
Looking at the negative side	36
Filing and more filing: Government and shareholder reports	37
A Whole New World: How a Company Goes from Private to Public.....	39
Teaming up with an investment banker	40
Timetable for listing.....	41
Chapter 4: Digging into Accounting Basics	43
Making Sense of the Accounting Method.....	43
Cash-basis accounting	43
Accrual accounting	44
Why method matters	45
Understanding Debits and Credits.....	46
Double-entry bookkeeping.....	46
Profit and loss statements.....	47
The effect of debits and credits on sales	47
Digging into Depreciation and Amortisation	48
Checking Out the Chart of Accounts	50
Asset accounts.....	51
Liability accounts	53
Equity accounts	54
Revenue accounts	55
Expense accounts.....	56
Differentiating Profit Types.....	57
 Part II: Understanding Published Information: Annual Reports	 59
Chapter 5: Exploring the Anatomy of an Annual Report	61
Meeting the Basic Parts of an Annual Report.....	61
Everything but the Numbers	63
Debunking the statements to shareholders.....	63
Making sense of the corporate message	64

Meeting the people in charge	64
Getting the real gen from management	64
Bringing the auditor's answers to light	69
Studying the standard auditor's report	69
Mulling over the modified auditor's report	70
Presenting the Financial Picture	73
Summarising the Financial Data.....	74
Finding the highlights	74
Reading the notes.....	75

Chapter 6: Balancing Assets against Liabilities and Equity 77

Understanding the Balance Equation	77
Introducing the Balance Sheet	78
Digging into dates.....	78
Nailing down the numbers	79
Comparing formats	80
Assessing Assets	82
Non-current assets	82
Current assets	85
Looking at Liabilities.....	88
Current liabilities	88
Net current assets	89
Non-current liabilities	90
Navigating the Equity Maze.....	91
Share capital.....	91
Other reserves.....	93
Retained earnings.....	93
Capital	93
Drawing.....	94

Chapter 7: Using the Income Statement 95

Introducing the Income Statement	96
Digging into dates.....	97
Comparing formats	97
Delving into the Tricky Business of Revenues	99
Defining revenue.....	100
Adjusting sales.....	101
Considering cost of sales	103
Gauging gross profit	104
Acknowledging Expenses	105
Sorting Out the Profit and Loss Types	107
EBITDA.....	107
Non-operating income or expense	108
Net profit or loss.....	109
Calculating Earnings Per Share	110

Chapter 8: The Statement of Cash Flows	111
Digging into the Statement of Cash Flows.....	111
The parts	112
The sections of the cash flow statement using UK standards.....	113
The formats.....	113
Checking Out Operating Activities	116
Depreciation.....	116
Inventory	117
Accounts receivable.....	117
Accounts payable.....	117
The cash flow from activities section	118
Investigating Investing Activities	119
Understanding Financing Activities	120
Issuing shares	120
Buying back shares	121
Paying dividends	121
Incurring new debt	122
Paying off debt.....	122
Recognising Special Line Items	122
Discontinued operations	123
Foreign currency exchange	123
Adding It All Up	123
Chapter 9: Scouring the Notes to the Financial Statements	125
Deciphering the Small Print	126
Accounting Policies Note: Laying Out the Rules of the Road.....	127
Depreciation.....	128
Revenue	128
Expenses.....	129
Working Out Financial Borrowings and Other Liabilities	130
Short-term borrowings	131
Long-term borrowings	131
Lease obligations.....	134
Accounting for Share-Based Payment: Something New in the Accountants' World.....	136
Mergers and Acquisitions: Noteworthy Information.....	137
Pondering Pension and Retirement Benefits	138
Breaking Down Business Breakdowns.....	140
Reviewing Significant Events	142
Finding the Red Flags.....	143
Finding out about valuing assets and liabilities	144
Considering changes in accounting policies	144
Decoding obligations to pensioners and future pensioners.....	145

Chapter 10: Considering Consolidated Financial Statements147

Getting a Grip on Consolidation.....	147
Looking at Methods of Buying Up Companies	150
Reading Consolidated Financial Statements	151
Looking to the Notes.....	153
Mergers and acquisitions	154
Goodwill.....	154
Liquidations or discontinued operations.....	155

Part III: Analysing the Numbers..... 157**Chapter 11: Testing the Profits and Market Value159**

The Price/Earnings Ratio	160
Working out earnings per share	160
Calculating the P/E ratio.....	161
Practising the P/E ratio calculation	161
Using the P/E ratio to judge company market value (share price).....	163
Understanding variation among ratios.....	164
Dividend Yield and Cover	166
Determining dividend yield.....	166
Digging into dividend cover	167
Return on Sales.....	169
Figuring out ROS.....	170
Reaching the truth about profits with ROS.....	171
Return on Assets.....	172
Doing some dividing to get ROA.....	172
Ranking companies with the help of ROA.....	172
Return on Equity	173
Calculating ROE.....	173
Reacting to companies by understanding the ROE	174
The Big Three: Margins	175
Dissecting gross margin.....	175
Investigating operating margin.....	176
Catching the leftover money: Calculating the net profit margin.....	177

Chapter 12: Looking at Liquidity179

Finding the Current Ratio.....	180
Calculating the current ratio.....	180
What do the numbers mean?.....	181

Determining the Quick Ratio	181
Calculating the quick ratio	182
What do the numbers mean?	182
Investigating Income Gearing	183
Calculating historic income gearing	183
What do the numbers mean?	184
Comparing Debt to Shareholders' Equity	184
Calculating debt to shareholders' equity	185
What do the numbers mean?	186
Determining Debt-to-Capital Ratio	186
Calculating the ratio	186
What do the numbers mean?	188

Chapter 13: Making Sure the Company Has Cash to Carry On 189

Measuring Income Success	189
Calculating free cash flow	190
What do the numbers mean?	192
Figuring out cash return on sales ratio	192
What do the numbers mean?	193
Checking Out Debt	193
Determining current cash-debt coverage ratio	194
What do the numbers mean?	195
Computing cash-debt coverage ratio	196
What do the numbers mean?	198
Calculating Cash-Flow Coverage	198
Finding out the cash-flow coverage ratio	198
What do the numbers mean?	201

Part IV: Understanding How Companies Optimise Operations 203

Chapter 14: Using Basic Budgeting 205

Peering Into the Budgeting Process	205
Working out who does what	206
Setting goals	207
Building Budgets	209
Providing Monthly Budget Reports	211
Using Internal Reports	213

Chapter 15: Turning Up Clues in Turnover and Assets 215

Exploring Inventory Valuation Methods	215
Applying Inventory Valuation Methods	219
FIFO	219
Average costing	220
Comparing inventory methods and financial statements	220

Determining Inventory Turnover	221
Calculating inventory turnover	221
What do the numbers mean?	223
Investigating Tangible Fixed Assets Turnover	224
Calculating fixed assets turnover	224
What do the numbers mean?	225
Tracking Total Asset Turnover	225
Calculating total asset turnover	225
What do the numbers mean?	226
Chapter 16: Examining Cash Inflow and Outflow	227
Assessing Trade-Receivable Turnover and Average Collection Period	227
Calculating trade-receivable turnover	228
What do the numbers mean?	230
Taking a Close Look at Customer Accounts	231
Finding the Accounts-Payable Turnover Ratio	232
Calculating the ratio	232
What do the numbers mean?	233
Determining the Number of Days in Accounts-Payable Ratio	234
Calculating the ratio	234
What do the numbers mean?	235
Deciding Whether Discount Offers Make Good Financial Sense	235
For terms of 2/10 net 30	236
For terms of 3/10 net 60	236
What do the numbers mean?	237
Chapter 17: How Companies Keep the Cash Flowing	239
Slowing Down Bill Payments	239
Collecting Accounts Receivables Faster	240
Borrowing on Receivables	242
Reducing Inventory	243
Getting Cash More Quickly	244
Part V: The Many Ways Companies Answer to Stakeholders	247
Chapter 18: Finding Out How Companies Find Errors: The Auditing Process	249
Meeting Mr or Ms Auditor	249
Delving Into the Auditing Process	251
Gathering knowledge of the business	252
Planning	253
Performing fieldwork	254
Creating an audit report	255

Filling the GAAP	256
Accounting standards: Four important qualities	257
Changing principles: More work for the IASB.....	258
Chapter 19: Checking Out the Analyst–Company Connection	259
Typecasting the Analysts	259
Buy-side analysts	260
Sell-side analysts	261
Independent analysts.....	264
Bond analysts	265
Regarding Bond Rating Agencies	265
Delving Into Share Rating.....	268
Looking at How Companies Talk to Analysts	269
Analyst briefings.....	269
Press releases	269
Road shows	270
Chapter 20: How Companies Soothe the Shareholders	271
Knowing What to Expect from an Annual General Meeting.....	272
Culling Information from the Annual General Meeting	273
Listening between the lines	274
Looking towards the future.....	276
Checking Out How the Board Runs the Company	276
Speaking Out at Meetings: Proxy Votes.....	278
Moving away from battling it out	279
Sorting through reports and proxy votes	280
Catching Up on Corporate Actions.....	280
Staying Up-to-Date Using Company Web Sites	282
Chapter 21: Keeping Score When Companies Play Games with Numbers	283
Getting to the Bottom of Creative Accounting	284
Defining the scope of the problem.....	285
Following recipes for cooked books	285
Unearthing the Games Played with Earnings	287
Reading between the revenue lines	288
Detecting creative revenue accounting.....	292
Exploring Exploitations of Expenses	295
Advertising expenses.....	296
Research and development costs	296
Patents and licences	297
Asset impairment	297
Restructuring charges	299
Finding Funny Business in Assets and Liabilities	299
Recognising overstated assets	300
Looking for undervalued liabilities	302

Playing Detective with Cash Flow	304
Discontinued operations	304
Corporation tax paid.....	305

***Part VI: The Part of Tens*.....307**

Chapter 22: Ten Financial Crises That Rocked the World 309

Enron: Be Cautious of Explosive Growth	309
Adelphia and Hollinger: Be Wary of Lavish Lifestyles.....	310
WorldCom/MCI: If It Looks too Good to Be True	311
Parmalat: Keep It Simple	312
Independent Insurance: Unreliable Info, Higher Risk.....	313
Versailles: Don't Follow the Money-Go-Round	314
Barings Bank: Security, Accuracy, and Incompetence	314
Equitable Life: Spread Your Pension Bets	315
Robert Maxwell: Unfit to Lead.....	316
Northern Rock: Financial Problems Without Wrongdoing.....	316

Chapter 23: Ten Signs That a Company's in Trouble 319

Lower Liquidity	319
Low Cash Flow.....	320
Disappearing Profit Margins	320
Revenue Game-Playing	321
Too Much Debt	321
Unrealistic Values for Assets and Liabilities.....	322
A Change in Accounting Methods.....	322
Questionable Mergers and Acquisitions	323
Slow Inventory Turnover	324
Slow-Paying Customers	324

Chapter 24: Ten Top-Notch Online Resources 325

Companies House	325
IASB.....	326
Yahoo! Finance UK.....	326
Standard & Poor's	327
Biz/ed.....	327
Financial Times.....	327
Accounting Web: ICC	328
Find	328
Department of Business, Enterprise and Regulatory Reform	328
Reuters	329

<i>Part VII: Appendixes</i>	331
Appendix A: Financial Statements	333
Appendix B: Glossary	349
 <i>Index</i>	 359

<http://www.pbookshop.com>