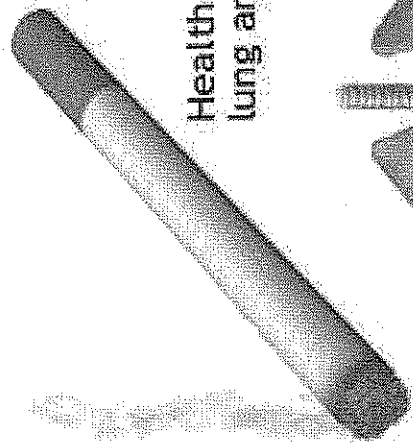


Understanding Financial Statements

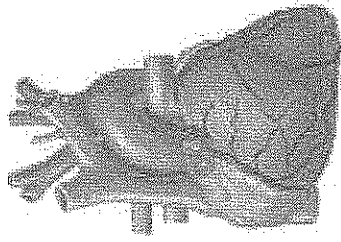
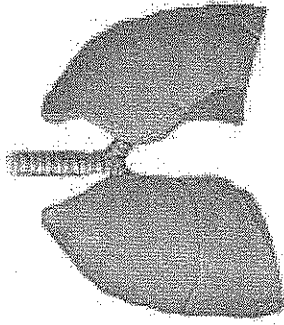
By: Tracy Porter

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Safety Moment



Health risks of tobacco include lung and heart disease



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Her Majesty's Revenue and Customs (HMRC)

- Department of the British government responsible for collection of taxes and payment of some forms of state support.
- FWEL is required to comply with the HMRC with regard to:-
 - Taxation
 - Transfer pricing

Transfer Pricing

- Transfer pricing rules in most sophisticated countries say that the transfer price must be at arm's length between the two affiliate companies
- Arm's length means the terms of business between the affiliate company must be the same as if it were with a third party business.

Companies House

- Companies House is the UK Registrar of Companies. All UK registered limited companies, including subsidiary, small and inactive companies, must file annual financial statements with Companies House.
- FWEL and other FW UK OU companies are registered with Companies House.

Companies House (Search for Foster Wheeler)

00163609		FOSTER WHEELER LIMITED	
01361134		FOSTER WHEELER ENERGY LIMITED	
01657494		FOSTER WHEELER ENVIRONMENTAL (UK) LIMITED	
04127813		FOSTER WHEELER EUROPE	
00745470		FOSTER WHEELER(G.B.)LIMITED	
02247293		FOSTER WHEELER (INDONESIA) LIMITED	
00887857		FOSTER WHEELER (LONDON) LIMITED	
BR001400	C	FOSTER WHEELER (MALAYSIA) SDN. BHD.	Company Removed
FC017495	C	FOSTER WHEELER (MALAYSIA) SDN. BHD.	Company Removed
05344191		FOSTER WHEELER NORTH-WEST SHELF LIMITED	
01808047		FOSTER WHEELER (PACIFIC) LIMITED	
01184825		FOSTER WHEELER PETROLEUM DEVELOPMENT LIMITED	
01184855		FOSTER WHEELER (PROCESS PLANTS) LIMITED	
01439353		FOSTER WHEELER WORLD SERVICES LIMITED	

US Securities and Exchange Commission (SEC)

- A US agency that holds primary responsibility for enforcing federal securities laws and regulating the securities industry, the nation's stock and options exchanges, and other electronic securities markets.
- The SEC was established by the US congress in 1934 during the Great Depression that followed the Stock Market Crash of 1929.
- Because Foster Wheeler is listed on an American Stock Exchange (NASDAQ) it is required to submit quarterly, annual, and other reports to the SEC.

US SEC (Search for Foster Wheeler)

CIK	Company	State/Country
0001130385	FOSTER WHEELER AG SIC: 1600 - HEAVY CONSTRUCTION OTHER THAN BUILDING CONST - CONTRACTORS formerly: FOSTER WHEELER LTD (filings through 2008-01-27)	VB
0001271958	FOSTER WHEELER ASIA LTD	
0001271959	FOSTER WHEELER CAPITAL & FINANCE CORP	
0001271960	FOSTER WHEELER CONSTRUCTORS INC	
0000038321	FOSTER WHEELER CORP SIC: 1600 - HEAVY CONSTRUCTION OTHER THAN BUILDING CONST - CONTRACTORS	NJ
0001271961	FOSTER WHEELER DEVELOPMENT CORP	
0001271968	FOSTER WHEELER ENERGY CORP	
0001271970	FOSTER WHEELER ENERGY MANUFACTURING INC	
0001271971	FOSTER WHEELER ENERGY SERVICES INC	
0001271973	FOSTER WHEELER ENVIRONMENTAL CORP	
0001271974	FOSTER WHEELER EUROPE LTD	NJ
0001261559	FOSTER WHEELER EUROPE LTD	
0001271975	FOSTER WHEELER FACILITIES MANAGEMENT INC	
0001237688	FOSTER WHEELER HOLDINGS LTD	
0001244234	FOSTER WHEELER INC	NJ
0001286579	FOSTER WHEELER INTERCONTINENTAL CORP	
0001271978	FOSTER WHEELER INTERNATIONAL CORP	
0001261556	FOSTER WHEELER INTERNATIONAL HOLDINGS INC	
0001271957	FOSTER WHEELER LLC SIC: 1600 - HEAVY CONSTRUCTION OTHER THAN BUILDING CONST - CONTRACTORS	NJ
0001286580	FOSTER WHEELER MIDDLE EAST CORP	
0001286572	FOSTER WHEELER NORTH AMERICA CORP	
0001271979	FOSTER WHEELER POWER GROUP INC	
0000333464	FOSTER WHEELER POWER SYSTEMS INC(NJ)	NJ
0001271980	FOSTER WHEELER PYROPOWER INC	
0001271981	FOSTER WHEELER REAL ESTATE DEVELOPMENT CORP	
0001271983	FOSTER WHEELER REALTY SERVICES INC	
0001271984	FOSTER WHEELER USA CORP	
0001271985	FOSTER WHEELER VIRGIN ISLANDS INC	
0001271986	FOSTER WHEELER ZACK INC	

Recent Accounting Scandals

- 2001 - Enron 's non-transparent financial statements led to the largest bankruptcy in American history and was attributed to the biggest audit failure. Many executives at Enron were indicted on various charges and later sent to prison, and the top 5 accounting firm, Arthur Anderson, was dissolved.
- 2002 – Worldcom filed for Chapter 11 bankruptcy protection, the largest such filing in US history (at the time). The Worldcom audit team uncovered a \$3.8 billion fraud, which was accomplished by underreporting expenses and inflating revenues.

Recent Accounting Scandals

- 2002 - Adelphia was the 5th largest cable company in the US before filing for bankruptcy. The founders used complicated cash management systems to spread money around to various entities as a cover for stealing \$100 million for themselves.
- 2004 – a federal grand jury issued an indictment charging 8 executives of Peregrine Systems with conspiracy to commit a multi-billion dollar securities fraud. The case resulted from an investigation by the FBI and the SEC pursued a parallel civil enforcement action. In 2005 Peregrine Systems was acquired by Hewlett-Packard.

Sarbanes-Oxley Act (SOX)

- Sarbanes-Oxley Act is a US federal law enacted in July 2002 as a reaction to a number of accounting scandals that cost investors billions of dollars when the share prices of the affected companies collapsed and shook public confidence in the nation's securities markets.
- Sarbanes-Oxley established new standards of corporate governance, accounting, and disclosure for companies listed on US stock exchanges. The Act requires CEOs and CFOs to be accountable for the accuracy of quarterly and annual reports.
- Because Foster Wheeler is listed on an American Stock Exchange (NASDAQ) it is required to comply with Sarbanes-Oxley.

Annual Report

- The annual report is a comprehensive report on a company's activities throughout the year. They are intended to give shareholders and other interested parties information about the company's activities and financial performance. Most jurisdictions require companies to prepare and disclose annual reports and companies listed on stock exchanges are usually required to report at more frequent intervals.

Annual Report

- The annual report that Foster Wheeler submits contains the following financial statements:-
 - Auditor’s Report
 - Consolidated Statement of Operations
 - Consolidated Balance Sheet
 - Consolidated Statement of Cash Flows

Auditor's Report

- The auditor's report is a formal opinion, or disclaimer, issued by an auditor as to the result of an audit of the company.

Auditor's Report

- There are four types of auditor's reports:-
 - Unqualified opinion – the financial statements are free from material misstatements and in accordance with GAAP.
 - Qualified opinion – there are one of two situations of non-compliance with GAAP but otherwise the financial statements are fairly represented.
 - Adverse opinion – the financial statements are materially misstated and do not conform with GAAP.
 - Disclaimer of opinion – the auditor was unable to form an opinion of the financial statements.

Foster Wheeler's Auditor's Report (2009)

- The wording of Foster Wheeler's auditor's report for 2009 stated:-

“In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects.....”

Consolidated Statement of Operations (Income Statement)

- The income statement is a company's financial statement that indicates how the revenue is transformed into the net income.
- The purpose of the income statement is to show managers and investors whether the company made or lost money during the reporting period.
- The income statement summarises a company's financial transactions over an interval of time.

Consolidated Statement of Operations (Income Statement)

FOSTER WHEELER AG AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

(In thousands of dollars, except per share amounts)

	Fiscal Years Ended		
	December 31, 2009	December 26, 2008	December 28, 2007
Operating revenues	\$5,056,354	\$6,854,290	\$5,107,243
Cost of operating revenues	4,297,687	5,958,644	4,362,922
Contract profit	758,647	895,646	744,321
Selling, general and administrative expenses	294,907	283,883	246,237
Other income, net	(52,263)	(53,001)	(61,410)
Other deductions, net	30,931	54,382	45,540
Interest income	(10,535)	(44,743)	(35,627)
Interest expense	14,122	17,621	19,855
Net asbestos-related provision/(gain)	26,365	6,697	(6,145)
Income before income taxes	455,120	630,897	535,871
Provision for income taxes	93,762	97,028	136,420
Net income	361,358	533,869	399,451
Less: Net income attributable to noncontrolling interests	11,202	7,249	5,577
Net income attributable to Foster Wheeler AG	\$ 350,156	\$ 526,620	\$ 393,874
Earnings per share (see Note 1):			
Basic	\$ 2.77	\$ 3.75	\$ 2.78
Diluted	\$ 2.75	\$ 3.68	\$ 2.72

Consolidated Statement of Operations (Income Statement)

- From 2008 to 2009:-
 - Operating revenue decreased
 - Contract profit decreased
 - Expenses increased when profit decreased
 - Interest income decreased
 - Net income decreased
 - Share prices decreased

Consolidated Balance Sheet

- A balance sheet is a summary of the financial balances of a sole proprietorship, a business partnership or a company.
- A balance sheet is often described as a 'snapshot' of the company's financial position and applies to a single point in time of a business' calendar year.

Consolidated Balance Sheet

- A balance sheet has three parts:-
 - Assets
 - Liabilities
 - Equity (Capital)
- Balance sheets are usually presented with Assets in one section and Liabilities and Equity in the second section, and the two sections must balance out, hence the name balance sheet.

Accounting Equation

- The accounting equation is the mathematical structure of the balance sheet and is stated as:-

$$\text{Assets} = \text{Liabilities} + \text{Capital (Equity)}$$

Assets

- Assets are economic resources that are capable of being owned or controlled to produce value and are held to have positive economic value:-
 - Assets can be current or non-current (fixed).
 - Assets can also be tangible or intangible.

Current and Non-Current Assets

- Current assets include:-
 - Cash and cash equivalents
 - Short term investments
 - Receivables
 - Inventories
 - Prepaid expenses
- Non-current (fixed) assets include:-
 - Plant, property and equipment
 - Investments
 - Intangible assets
 - Some financial assets

Tangible and Intangible Assets

- Tangible assets include:-
 - Current assets
 - Non-current (fixed) assets.
- Intangible assets are nonphysical resources and rights that have a value to the firm because they give an advantage in the marketplace. Intangible assets include:-
 - Goodwill
 - Copyrights
 - Trademarks
 - Patents
 - Computer programs
 - Some financial assets (receivables, bonds and stocks)

Assets

	December 31, 2009	December 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 997,158	\$ 773,163
Short-term investments	—	2,448
Accounts and notes receivable, net	526,525	608,994
Trade	117,718	95,633
Other	408,807	613,361
Contracts in process	319,774	341,135
Prepaid, deferred and refundable income taxes	46,478	51,667
Other current assets	33,902	37,146
Total current assets	<u>1,931,555</u>	<u>1,790,186</u>
Land, buildings and equipment, net	398,132	383,209
Restricted cash	34,905	22,737
Notes and accounts receivable — long-term	1,571	1,788
Investments in and advances to unconsolidated affiliates	228,080	210,776
Goodwill	88,702	62,165
Other intangible assets, net	73,029	59,874
Asbestos-related insurance recovery receivable	244,263	281,540
Other assets	87,781	82,223
Deferred tax assets	89,768	116,756
TOTAL ASSETS	<u><u>\$3,187,378</u></u>	<u><u>\$3,011,254</u></u>

Liabilities

- The International Accounting Standards Board (IASB) defines a liability as a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Liabilities

- Examples of liabilities are:-
 - Money owing on a loan
 - Money owing on a mortgage
 - An IOU
- Liabilities are usually classified as current or non-current.

Liabilities

- Current liabilities are expected to be paid within a year and include:-
 - Wages, accounts, taxes, accounts payable
 - Unearned revenue when adjusting entries
 - Portions of long-term bonds to be paid year
 - Short term obligations
- Non-current liabilities are not expected to be liquidated within a year and include:-
 - Issued long term bonds, notes payables, long term leases
 - Pension obligations and long term product warranties.

(Shareholders) Equity

- Shareholders' is part of the company's liabilities: they are funds "owing" to shareholders after payment of all other liabilities.
- Shareholders equity comprises:-
 - Issued capital and reserves attributable to equity holders of the parent company (controlling interest)
 - Non-controlling interest in equity

Liabilities & (Shareholders) Equity

LIABILITIES, TEMPORARY EQUITY AND EQUITY	
Current Liabilities:	
Current installments on long-term debt	\$ 24,375
Accounts payable	365,347
Accrued expenses	303,813
Billings in excess of costs and estimated earnings on uncompleted contracts	750,233
Income taxes payable	44,846
Total current liabilities	<u>1,488,614</u>
Long-term debt	192,989
Deferred tax liabilities	66,114
Pension, postretirement and other employee benefits	320,939
Absence-related liability	355,779
Other long-term liabilities	157,933
Commitments and contingencies	
TOTAL LIABILITIES	<u>2,582,388</u>
Temporary Equity:	
Non-vested share-based compensation awards subject to redemption	7,586
TOTAL TEMPORARY EQUITY	<u>7,586</u>
Equity:	
Preferred shares:	
\$0.01 par value; authorized: December 31, 2009 — 0 shares and December 26, 2008 — 901,135 shares; issued and outstanding: December 31, 2009 — 0 shares and December 26, 2008 — 1,079 shares	—
Common shares:	
\$0.01 par value; authorized: December 31, 2009 — 0 shares and December 26, 2008 — 296,007,818 shares; issued and outstanding: December 31, 2009 — 0 shares and December 26, 2008 — 126,177,611 shares	1,262
Registered shares:	
CHF 3.00 par value; authorized: December 31, 2009 — 190,649,900 shares, conditionally authorized: December 31, 2009 — 62,181,928 shares; issued and outstanding: December 31, 2009 — 127,441,843 shares	339,402
Paid-in capital	617,938
Retained earnings/(accumulated deficit)	322,181
Accumulated other comprehensive loss	(438,004)
TOTAL FOSTER WHEELER AG SHAREHOLDERS' EQUITY	<u>831,517</u>
Noncontrolling interests	38,970
TOTAL EQUITY	<u>870,487</u>
TOTAL LIABILITIES, TEMPORARY EQUITY AND EQUITY	<u>\$3,187,738</u>

Liabilities & (Shareholders) Equity

- From 2008 to 2009:-
 - Income tax increased
 - Other long term liabilities increased
 - Total equity more than doubled

Accounting Equation (2009)

- According to Foster Wheeler's 2009 Annual Report, the accounting equation is calculated as:-

Assets = Liabilities + Capital (Equity)

\$3188 million = \$2316 million + \$872 million

Accrual Basis Accounting

- The income statement and balance sheet reflect the accrual basis accounting used by firms to match revenues with the expenses associated with generating those revenues.

Consolidated Cash Flow Statement

- The cash flow statement shows how changes in balance sheet accounts and income affect cash and cash equivalents.
- As an analytical tool, the cash flow statement is useful in determining the short-term viability of a company, particularly its ability to pay its bills.
- The cash flow statement reports on three types of activities:-
 - Operating activities
 - Investing activities
 - Financing activities

Consolidated Cash Flow Statement

	Extracted from Foster Wheeler AG's 2009 Annual Report	
	2009	2008
	\$	\$
	'000	'000
Net cash provided by operating activities	290,615	428,926
Net cash used in investing activities	-87,265	-128,584
Net cash provided by/used in financing activities	1,456	-466,104
Cash and equivalents at beginning of year	773,163	1,048,544
Cash and equivalents at end of year	997,158	773,163
Increase/decrease in cash and equivalents	223,995	-275,381
Interest paid during the year	14,856	13,436
Income tax paid in the year	86,685	130,147

Case Study

Enron Trial Hears Skilling Lose It in Wall Street Conference Call

The *Houston Chronicle* reports that Enron's head of investor relations Mark Koenig drew blood in his testimony yesterday in the Enron trial:

Koenig said that in an April 2001 phone call with analysts and investors, Skilling didn't disclose \$230 million in first-quarter retail division losses, and that in July 2001 Skilling didn't disclose the then-\$726 million debt for the half year. Instead, Skilling told investors the division was doing "great."

You don't need a CPA to understand that losing \$230 million in three months does not make for a "great" quarter.

The court also heard a tape of the infamous April 2001 conference call in which Skilling lost his composure:

"You know, you are the only financial institution that can't produce a balance sheet or a cash flow statement with their earnings," [stock analyst Richard] Grubman said. Skilling, laughing, shot back, "Thank you very much, we appreciate it ... asshole."

Skilling used to be dismissive of those who didn't "get it" but Enron's failure to provide a balance sheet and cash flow statement made it more difficult for investors to uncover the techniques the company used to hide losses and make its numbers to keep Wall Street happy. Holding off on publishing complete financial statements gave Enron extra time to cover its tracks and maintain the fiction that the company was making money, when the actual cash flow from operations told a very different story.

Case Study (continued)

Taken from The Austin Chronicle: The Hubris at Enron

..... Enron failed because its leadership failed in paying attention to the most basic elements of business management. And in the case of Enron, that meant carefully managing its cash flow. It may sound mundane, but businesses go bankrupt because they run out of cash. That's exactly what happened at Enron. And the failure to manage the company's cash is directly attributable to Lay and Skilling. Lay was a Ph.D. economist who couldn't read a cash-flow statement. Skilling was a Harvard M.B.A. who once told another Enron employee that cash "didn't matter."