

# Finding Information from the McDonald's Annual Report

## Screen 001

This illustration deals with finding financial information in a company's annual report. The company that we will use is McDonald's Corporation, the leading global foodservice retailer. There are many resources available for such financial information. I will introduce you to a popular database, EdgarScan, that is available from a free website of PricewaterhouseCoopers, the world's leading professional services firm. You should visit this website after completion of the illustration and bookmark it for future reference. Learning about this database will provide you with a valuable tool that you can use in studying many accounting topics.

## McDonald's Corp – Income Statement

IN MILLIONS, EXCEPT PER SHARE DATA REVENUES	December 31, 2006	2005
Sales by Company-operated restaurants	Amount	Amount
Revenues from franchised and affiliated restaurants	\$16,082.7	\$14,726
<b>Total Revenues</b>	<b>5,503.7</b>	<b>5,105.9</b>
<b>OPERATING COSTS AND EXPENSES</b>	<b>21,586.4</b>	<b>19,832.5</b>
Company-operated restaurant expenses		
- Food & paper		
- Payroll & employee benefits	5,349.7	5,004.9
- Occupancy & other operating expenses	4,185.4	3,860.4
Franchised restaurants-occupancy expenses	4,006.6	3,709.2
Selling, general & administrative expenses	1,060.4	1,021.5
Impairment and other charges (credits) .net	2,337.9	2,167.1
Other operating expense. net	134.2	(28.4)
<b>Total operating costs and expenses</b>	<b>67.1</b>	<b>105.3</b>
Operating income	17,141.3	15,840.0
Interest expense-net of capitalized interest of \$5.4, \$4.9 and \$4.1	4,445.1	3,992.5
Nonoperating income, net	402.0	356.1
Income from continuing operations before provision for income taxes	(123.3)	(38.0)
Provision for income taxes	4,166.4	3,674.4
Income from continuing operations	1293.4	1,088.0
Income from discontinued operations (net of taxes of \$96.8, \$11.4 and \$0.7)	2,873.0	2,586.4
<b>Net income</b>	<b>671.2</b>	<b>15.8</b>
Per common share-basic:	\$3,544.2	\$2,602.2
Continuing operations	\$2.33	\$2.05
Discontinued operations	0.54	0.01
Net income	\$2.87	\$2.06
Per common share-diluted:		
Continuing operations		
Discontinued operations	\$2.30	\$2.03
Net income	0.53	0.01
Dividends per common share	\$2.83	\$2.04
<b>Weighted-average shares outstanding-basic</b>	<b>\$1.00</b>	<b>\$0.67</b>
<b>Weighted-average shares outstanding-diluted</b>	<b>1,234.0</b>	<b>1,260.4</b>
	1,251.7	1,274.2

Screen 002

This is the McDonald's comparative income statement for the years 2006 and 2005. We will use it later to answer some questions.

## McDonald's Corp – Consolidated Balance Sheet

Consolidated Balance Sheet

<i>IN MILLIONS, EXCEPT PER SHARE DATA</i>	December 31, 2006	2005
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and equivalents	\$ 2,136.4	\$4,260.6
Accounts and notes receivable	904.2	793.9
Inventories, at cost, not in excess of market	149.0	144.3
Prepaid expenses and other current assets	435.7	640.2
Discontinued operations		380.0
<b>Total current assets</b>	<b>3,625.3</b>	<b>6,219.0</b>
<b>Other assets</b>		
Investment in and advances to affiliates	1,036.2	1,035.4
Goodwill, net	2,209.2	1,924.4
Miscellaneous	1,307.4	1,236.7
<b>Total other assets</b>	<b>4,552.8</b>	<b>4,196.5</b>
<b>Property and equipment</b>		
Property and equipment, at cost	31,810.2	29,482.5
Accumulated depreciation and amortization	(10,964.5)	(9,909.2)
<b>Net property and equipment</b>	<b>20,845.7</b>	<b>19,573.3</b>
<b>Total assets</b>	<b>\$29,023.8</b>	<b>\$29,988.8</b>

This is the asset side of the McDonald's comparative year-end balance sheet for the years 2006 and 2005. We will use it later to answer some questions.

Screen 004

## McDonald's Corp – Liabilities &amp; Equity

*IN MILLIONS, EXCEPT PER SHARE DATA*

	December 31,	2006	2005
<b>Current Liabilities</b>		\$0.0	\$544.0
Notes payable		834.1	678.0
Accounts payable		250.9	569.6
Income taxes		251.4	233.1
Other taxes		135.1	158.5
Accrued interest		1,518.9	1,158.1
Accrued payroll and other liabilities		17.7	658.5
Current maturities of long-term debt			107.9
<b>Total current liabilities</b>		<b>3,008.1</b>	<b>4,107.7</b>
<b>Long-term Debt</b>		<b>8,416.5</b>	<b>8,934.3</b>
<b>Other long-term liabilities</b>		<b>1,074.9</b>	<b>851.5</b>
<b>Deferred income taxes</b>		<b>1,066.0</b>	<b>949.2</b>
<b>Shareholder's equity</b>			
Preferred stock, no par value; authorized - 165.0 million shares; issued - none			
Common stock, \$.01 par value; authorized - 3.5 billion shares; issued - 1,660.6 million shares		16.6	16.6
Additional paid-in capital		3,445.0	2,720.2
Retained earnings		25,845.6	23,516.0
Accumulated other comprehensive income (loss)		(296.7)	(733.1)
Common stock in treasury, at cost; 456.9 and 397.4 million shares		(13,552.2)	(10,373.6)
<b>Total shareholders' equity</b>		<b>15,458.3</b>	<b>15,146.1</b>
<b>Total liabilities and shareholder's equity</b>		<b>\$29,023.8</b>	<b>\$29,988.8</b>

This is the liabilities and equity side of the McDonald's comparative year-end balance sheet for the years 2006 and 2005. We will use it later to answer some questions.

## McDonald's Corp – Comparative Statements

<b>Consolidated statement of cash flows</b>		
<i>IN MILLIONS</i>	Years ended December 31, 2006	2005
<b>Operating activities</b>		
Net income	<b>\$3,544.2</b>	<b>\$2,602.2</b>
Adjustments to reconcile to cash provided by operations		
Charges and credits:		
Depreciation and amortization	<b>1,249.9</b>	<b>1,249.5</b>
Deferred income taxes	<b>28.7</b>	<b>(34.6)</b>
Income taxes audit benefit		<b>(178.8)</b>
Impairment and other charges (credits), net	<b>134.2</b>	<b>(28.4)</b>
Gains on Chipotle disposition, net of tax	<b>653.0</b>	
Share-based compensation	<b>122.5</b>	<b>152.0</b>
Other	<b>78.2</b>	<b>162.8</b>
Changes in working capital items:		
Accounts receivable	<b>(90.8)</b>	<b>(56.5)</b>
Inventories, prepaid expenses and other current assets	<b>(1.6)</b>	<b>(29.4)</b>
Accounts payable	<b>82.8</b>	<b>35.8</b>
Income taxes	<b>(350.3)</b>	<b>442.9</b>
Other accrued liabilities	<b>196.7</b>	<b>19.5</b>
<b>Cash provided by operations</b>	<b>4,341.5</b>	<b>4,337.0</b>

This is the operating section of the McDonald's comparative statements of cash flows for the years 2006 and 2005. We will use this later to answer some questions.

## McDonald's Corp – Comparative Statements

This is the remainder of the McDonald's comparative statements of cash flows for the years 2006 and 2005. We will use this later to answer some questions.

<b>Investing activities</b>		
Property and equipment expenditures	(1,741.9)	(1,606.8)
Purchases of restaurant businesses	(238.6)	(343.5)
Sales of restaurant businesses and property	315.7	259.1
Chipotle disposition	281.7	
Other	109.7	(126.6)
<b>Cash used for investing activities</b>	<b>(1,273.4)</b>	<b>(1,817.8)</b>
<b>Financing activities</b>		
Net short-term borrowings (repayments)	34.5	22.7
Long-term financing issuances	1.9	3,107.9
Long-term financing repayments	(2,301.1)	(1,518.3)
Treasury stock purchases	(2,959.4)	(1,202.0)
Common stock dividends	(1,216.5)	(842.0)
Proceeds from stock option exercises	975.7	768.1
Excess tax benefit on share-based compensation	87.1	70.1
Other	185.5	(44.9)
<b>Cash provided by (used for) financing activities</b>	<b>(5,192.3)</b>	<b>361.6</b>
<b>Cash and equivalents increase/(decrease)</b>	<b>(2,124.2)</b>	<b>2,880.8</b>
Cash and equivalents at beginning of year	4,260.6	1,379.8
<b>Cash and equivalents at end of year</b>	<b>\$2,136.4</b>	<b>\$4,260.6</b>
<b>Supplemental cash flow disclosures</b>		
Interest paid	\$430.3	\$390.3
Income taxes paid	1,528.5	795.1

## Some questions about McDonald's financial statements:

1. What amounts did McDonald's report for the following items during 2006?
  - a. Total revenues
  - b. Total operating costs and expenses
  - c. Net income
  - d. Amount paid in income taxes
  - e. Cash provided by operations
  
2. What amounts did McDonald's report for the following items as of December 31, 2006?
  - a. Total assets
  - b. Total current liabilities
  - c. Total shareholder's equity
  - d. Number of common stock shares issued
  
3. What was the percentage change for the following items by McDonald's during 2006?
  - a. Sales revenue
  - b. Operating income

Screen 007

Having found the McDonald's financial statements, they can provide answers to many questions of interest to decision makers. We will look at a small sampling of those questions here. Let's look at the questions before we discuss them.

1. What amounts did McDonald's report for the following items during 2006?
  - a. Total revenues
  - b. Total costs and operating expenses
  - c. Net income
  - d. Amount paid in income taxes
  - e. Cash provided by operations
  
2. What amounts did McDonald's report for the following items as of December 31, 2006?
  - a. Total assets
  - b. Total current liabilities
  - c. Total shareholders' equity
  - d. Number of common stock shares issued
  
3. What was the percentage change for the following items by McDonalds during 2006?
  - a. Sales revenue
  - b. Operating income

## McDonald's Consolidated Statement of Income

DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA

REVENUES	Years ended December 31,	
	2006	2005
Sales by Company-operated restaurants	\$16,082.7	\$14,726.6
Revenues from franchised and affiliated restaurants	5,503.7	5,105.9
<b>Total revenues</b>	<b>21,586.4</b>	<b>19,832.5</b>
<b>OPERATING COSTS AND EXPENSES</b>		
Company-operated restaurant expenses		
Food & paper	5,349.7	5,004.9
Payroll & employee benefits	4,185.4	3,860.4
Occupancy & other operating expenses	4,006.6	3,709.2
Franchised restaurants-occupancy expenses	1,060.4	1,021.5
Selling, general & administrative expenses	2,337.9	2,167.1
Impairment and other charges (credits), net	134.2	(28.4)
Other operating expense, net	67.1	105.3
<b>Total operating costs and expenses</b>	<b>17,141.3</b>	<b>15,840.0</b>
Operating income	4,445.1	3,992.5
Interest expense-net of capitalized interest of \$5.4, \$4.9 and \$4.1	402.0	356.1
Nonoperating income, net	(123.3)	(38.0)
Income from continuing operations before provision for income taxes	4,166.4	3,674.4
Provision for income taxes	1,293.4	1,088.0
Income from continuing operations	2,873.0	2,586.4
Income from discontinued operations (net of taxes of \$96.8, \$11.4 and \$0.7)	671.2	15.8
<b>Net income</b>	<b>\$3,544.2</b>	<b>\$2,602.2</b>
<b>Per common share-basic:</b>		
Continuing operations	\$2.33	\$2.05
Discontinued operations	0.54	0.01
Net income	\$2.87	\$2.06
<b>Per common share-diluted:</b>		
Continuing operations	\$2.30	\$2.03
Discontinued operations	0.53	0.01
Net income	\$2.83	\$2.04
<b>Dividends per common share</b>	<b>\$1.00</b>	<b>\$0.67</b>
<b>Weighted-average shares outstanding-basic</b>	<b>1,234.0</b>	<b>1,260.4</b>
<b>Weighted-average shares outstanding-diluted</b>	<b>1,251.7</b>	<b>1,274.2</b>

Screen 008

Now let's look at the McDonalds financial statements for the answers to these questions.

The following items are found in the McDonalds income statement for 2006:

Total revenues;  
Total costs and operating expenses; and  
Net income.

Screen 009

## McDonald's Corp – Comparative Statements

<b>Consolidated statement of cash flows</b>		
<i>IN MILLIONS</i>	Years ended December 31, 2006	2005
<b>Operating activities</b>		
Net income	\$3,544.2	\$2,602.2
Adjustments to reconcile to cash provided by operations		
Charges and credits:		
Depreciation and amortization	1,249.9	1,249.5
Deferred income taxes	28.7	(34.6)
Income taxes audit benefit		(178.8)
Impairment and other charges (credits), net	134.2	(28.4)
Gains on Chipotle disposition, net of tax	653.0	
Share-based compensation	122.5	152.0
Other	78.2	162.8
Changes in working capital items:		
Accounts receivable	(90.8)	(56.5)
Inventories, prepaid expenses and other current assets	(1.6)	(29.4)
Accounts payable	82.8	35.8
Income taxes	(350.3)	442.9
Other accrued liabilities	196.7	19.5
<b>Cash provided by operations</b>	<b>4,341.5</b>	<b>4,337.0</b>

The 2006 amount of cash provided by operations for McDonald's, over \$4.34 billion, is found in its statement of cash flows.

## McDonald's Corp – Comparative Statements

<b>Investing activities</b>		
Property and equipment expenditures	(1,741.9)	(1,606.8)
Purchases of restaurant businesses	(238.6)	(343.5)
Sales of restaurant businesses and property	315.7	259.1
Chipotle disposition	281.7	
Other	109.7	(126.6)
<b>Cash used for investing activities</b>	<b>(1,273.4)</b>	<b>(1,817.8)</b>
<b>Financing activities</b>		
Net short-term borrowings (repayments)	34.5	22.7
Long-term financing issuances	1.9	3,107.9
Long-term financing repayments	(2,301.1)	(1,518.3)
Treasury stock purchases	(2,959.4)	(1,202.0)
Common stock dividends	(1,216.5)	(842.0)
Proceeds from stock option exercises	975.7	768.1
Excess tax benefit on share-based compensation	87.1	70.1
Other	185.5	(44.9)
<b>Cash provided by (used for) financing activities</b>	<b>(5,192.3)</b>	<b>361.6</b>
<b>Cash and equivalents increase/(decrease)</b>	<b>(2,124.2)</b>	<b>2,880.8</b>
Cash and equivalents at beginning of year	4,260.6	1,379.8
<b>Cash and equivalents at end of year</b>	<b>\$2,136.4</b>	<b>\$4,260.6</b>
<b>Supplemental cash flow disclosures</b>		
Interest paid	\$430.3	\$390.3
Income taxes paid	1,528.5	795.1

Also, the 2006 amount of income taxes paid by McDonald's, almost \$1.53 billion, is found in its statement of cash flows. This differs from the provision for income taxes, that is, the amount of tax expense, that was shown in the McDonald's income statement.

## McDonald's Corp – Consolidated Balance Sheet

The amount of total assets is found in the McDonald's balance sheet for December 31, 2006.

### Consolidated Balance Sheet

<i>IN MILLIONS, EXCEPT PER SHARE DATA</i>	December 31, 2006	2005
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and equivalents	\$ 2,136.4	\$4,260.6
Accounts and notes receivable	904.2	793.9
Inventories, at cost, not in excess of market	149.0	144.3
Prepaid expenses and other current assets	435.7	640.2
Discontinued operations		380.0
<b>Total current assets</b>	<b>3,625.3</b>	<b>6,219.0</b>
<b>Other assets</b>		
Investment in and advances to affiliates	1,036.2	1,035.4
Goodwill, net	2,209.2	1,924.4
Miscellaneous	1,307.4	1,236.7
<b>Total other assets</b>	<b>4,552.8</b>	<b>4,196.5</b>
<b>Property and equipment</b>		
Property and equipment, at cost	31,810.2	29,482.5
Accumulated depreciation and amortization	(10,964.5)	(9,909.2)
<b>Net property and equipment</b>	<b>20,845.7</b>	<b>19,573.3</b>
<b>Total assets</b>	<b>\$29,023.8</b>	<b>\$29,988.8</b>

## McDonald's Corp – Liabilities & Equity

<i>IN MILLIONS, EXCEPT PER SHARE DATA</i>	December 31,	2006	2005
<b>Current Liabilities</b>		\$0.0	\$544.0
Notes payable		834.1	678.0
Accounts payable		250.9	569.6
Income taxes		251.4	233.1
Other taxes		135.1	158.5
Accrued interest		1,518.9	1,158.1
Accrued payroll and other liabilities		17.7	658.5
Current maturities of long-term debt			107.9
<b>Total current liabilities</b>		<b>3,008.1</b>	4,107.7
<b>Long-term Debt</b>		8,416.5	8,934.3
<b>Other long-term liabilities</b>		1,074.9	851.5
<b>Deferred income taxes</b>		1,066.0	949.2
<b>Shareholder's equity</b>			
Preferred stock, no par value; authorized - 165.0 million shares; issued - none			
Common stock, \$.01 par value; authorized - 3.5 billion shares; issued - 1,660.6 million shares		16.6	16.6
Additional paid-in capital		3,445.0	2,720.2
Retained earnings		25,845.6	23,516.0
Accumulated other comprehensive income (loss)		(296.7)	(733.1)
Common stock in treasury, at cost; 456.9 and 397.4 million shares		(13,552.2)	(10,373.6)
<b>Total shareholders' equity</b>		<b>15,458.3</b>	15,146.1
<b>Total liabilities and shareholder's equity</b>		<b>\$29,023.8</b>	<b>\$29,988.8</b>

Screen 012

In addition, these items are found in the McDonald's balance sheet:

Total current liabilities;  
Total shareholders' equity; and  
The number of common stock shares issued.

## McDonald's Consolidated Statement of Income

DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA

REVENUES	Years ended December 31,	
	2006	2005
Sales by Company-operated restaurants	\$16,082.7	\$14,726.6
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Income from continuing operations before provision for income taxes	4,166.4	3,674.4
Provision for income taxes	1,293.4	1,088.0
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Income from discontinued operations (net of taxes of \$96.8, \$11.4 and \$0.7)	671.2	15.8
<b>Net income</b>	<b>\$3,544.2</b>	<b>\$2,602.2</b>
<b>Per common share-basic:</b>		
Continuing operations	\$2.33	\$2.05
Discontinued operations	0.54	0.01
Net income	\$2.87	\$2.06
<b>Per common share-diluted:</b>		
Continuing operations	\$2.30	\$2.03
Discontinued operations	0.53	0.01
Net income	\$2.83	\$2.04
<b>Dividends per common share</b>	<b>\$1.00</b>	<b>\$0.67</b>
<b>Weighted-average shares outstanding-basic</b>	<b>1,234.0</b>	<b>1,260.4</b>
<b>Weighted-average shares outstanding-diluted</b>	<b>1,251.7</b>	<b>1,274.2</b>

Screen 013

One of the benefits of comparative financial statements is the possibility of using them to detect changes or trends.

For example, in the McDonald's income statement, you can measure the percentage change in each line item by taking the difference between the 2006 and 2005 amounts, and dividing them by the 2005 amounts.

## McDonald's Corp – Income Statement

<i>DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA</i>	2004	Increase/ (decrease)	2003
	Amount		Amount
<b>REVENUES</b>			
Sales by company-operated restaurants	\$14,224	11%	\$12,795
Revenues from franchised and affiliated restaurants	4,841	11	4,345
<b>Total revenues</b>	<b>19,065</b>	<b>11</b>	<b>17,140</b>
<b>Operating costs and expenses</b>	<b>12,100</b>	<b>10</b>	<b>11,006</b>
Company-operated restaurant expenses	1,003	7	938
Franchised restaurants-occupancy expenses	1,980	8	1,833
Selling, general & administrative expenses	441	(17)	531
Other operating expenses, net			
<b>Total operating costs and expenses</b>	<b>15,524</b>	<b>8</b>	<b>14,308</b>
<b>Operating income</b>	<b>3,541</b>	<b>25</b>	<b>2,832</b>
Interest expense	358	(8)	388
Nonoperating (income) expense, net	(20)	nm	98
<b>Income before provision for income taxes and Cumulative effect of accounting changes</b>	<b>3,203</b>	<b>36</b>	<b>2,346</b>
Provision for income taxes	924	10	838
<b>Income before cumulative effect of accounting changes</b>	<b>2,279</b>	<b>51</b>	<b>1,508</b>
Cumulative effect of accounting changes, net of tax *		nm	
<b>Net income</b>	<b>\$2,279</b>	<b>55%</b>	<b>\$1,471</b>
<b>Per common share-diluted:</b>			
<b>Income before cumulative effect of accounting changes</b>	<b>\$ 1.79</b>	<b>52%</b>	<b>\$ 1.18</b>
Cumulative effect of accounting changes*	-	nm	(.03)
<b>Net income</b>	<b>&amp; 1.79</b>	<b>56%</b>	<b>\$ 1.15</b>
<b>Weighted average common shares outstanding-diluted</b>	<b>1,273.70</b>		<b>1,276.50</b>

\* See cumulative effect of accounting changes for further discussion nm= not meaningful

Screen 014

When you compute those percentage changes for each income statement item, you derive this from the statement.

Notice, we can answer the questions dealing with changes in total sales revenue and operating income, which were 8.84% and 11.34%, respectively.

## Notes to Consolidated Financial Statements

### 1. Summary of significant accounting policies

Screen 015

Finally, we return to the footnotes to McDonald's Financial Statements. It is important to recognize that the footnotes are an integral part of a company's financial statements. In fact, they often provide the important details that financial statement users need to know to understand how well the company is doing. Typically, the first financial statement footnote summarizes a company's significant accounting policies.

This footnote methods used by the company to account for things like inventory, depreciation and the like. This allows the user to determine how that company's methods accounting methods compare to peer competitors and, therefore, the extent to which the resulting accounting numbers are comparable.

## Notes to Consolidated Financial Statements

### 1. Summary of significant accounting policies

#### **CONSOLIDATION**

The consolidated financial statements include the accounts of the Company and its subsidiaries. Substantially all investments in affiliates owned 50% or less (primarily McDonald's Japan) are accounted for by the equity method.

#### **Revenue recognition**

The Company's revenues consist of sales by Company-operated restaurants and fees from restaurants operated by franchises and affiliates. Sales by Company-operated restaurants are recognized on a cash basis. Fees from franchises and affiliated restaurants include continuing rent and service fees, initial fees and royalties received from foreign affiliates and developmental licensees. Continuing fees and royalties are recognized in the period earned. Initial fees are recognized upon the opening of a restaurant, which is when the Company has performed substantially all initial services required by the franchise arrangement.

#### **Property and equipment**

Property and equipment are stated at cost, with depreciation and amortization provided using the straight-line method over the following estimated useful lives: buildings – up to 40 years; leasehold improvements – the lesser of useful lives of assets or lease terms which generally include option periods; and equipment – three to 12 years.

Here is an excerpt for Footnote 1 in the McDonald's 2006 annual report. This excerpt describes the basis for consolidation of the McDonald's financial statements, as well as its accounting policies for revenue recognition and for property and equipment.