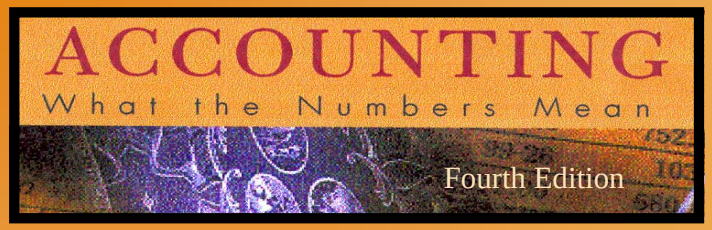

DAVID H. MARSHALL / WAYNE W. MCMANUS

Electronic Presentations by
Douglas Cloud, D.B.A, C.P.A.
Pepperdine University

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Accounting-- Present and Past

1

DAVID H. MARSHALL / WAYNE W. MCMANUS

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ A definition of accounting.
❷ Who the users of information are, and why they find accounting information useful.
❸ Several of the categories of accounting, and the kinds of work that professional accountants in each company perform.
❹ The development of accounting, from a broad historical perspective.
❺ That the Financial Accounting Standards Board (FASB) is the current standard setting body for generally accepted accounting principles.

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I JECTIVES

Click the mouse again; there's more.

After should understand:

❶ A de

❷ Who the users of information are, and they find accounting information useful.

❸ Several of the categories of acco kinds of work that professional accounta perform.

❹ The development of accounting, fr rical perspective.

❺ That the Financial Accountin (FASB) is the current standard setting bo ccepted accounting principles.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❻ That financial statements do not result from following a codified set of hard and fast rules; that there are, in fact, alternative methods of accounting for and reporting similar economic activities.

❼ The key elements of ethical behavior for a professional accountant.

❽ The reasons for the FASB's Conceptual Framework project.

❾ The objectives of financial reporting for business enterprises.

❿ The plan of the book.

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What is accounting?

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Accounting is the process of:

- **Identifying**
- **Measuring**
- **Communicating**

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Accounting is the process of:

- **Identifying**
- **Measuring**
- **Communicating**

} **Economic information about an entity**

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Accounting is the process of:

- **Identifying**
- **Measuring**
- **Communicating**

} **Economic information about an entity** > **For decisions and informed judgments**

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Users and Uses of Accounting Information

- MANAGEMENT
- INVESTORS
- CREDITORS
- EMPLOYEES
- GOVERNMENTAL AGENCIES

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CLASSIFICATIONS OF ACCOUNTING

- Financial Accounting
- Managerial Accounting/Cost Accounting
- Auditing--Public/Internal
- Governmental and Not-for-Profit Accounting
- Income Tax Accounting

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Professional Degrees

- **CERTIFIED PUBLIC ACCOUNTANT (CPA)**
- **CERTIFIED MANAGEMENT ACCOUNTANT (CMA)**
- **CERTIFIED INTERNAL AUDITOR (CIA)**

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FINANCIAL ACCOUNTING STANDARD SETTING

- ***Statements of Financial Accounting Standards***--Over 100 issued. Deal with specific accounting/reporting issues.
- ***Statements of Financial Accounting Concepts***--6 issued. An attempt to provide a common foundation to support financial accounting standards.

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Key Objectives of Financial Reporting (SFAC #1)

- **Relate to external financial reporting.**
- **Support business and economic decisions.**
- **Provide information about cash flows.**
- **Primary focus on earnings based on accrual accounting.**
- **Not to measure directly the value of a business enterprise.**
- **Information reported subject to evaluation by individual financial statement users.**
- **Accounting standards are still evolving.**

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International Accounting Standards

- (IASC) International Accounting Standards Committee
- Standards differ significantly among countries
- Individual country standards reflect local market needs and country regulation and taxation practices

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ETHICS AND THE ACCOUNTING PROFESSION

- AICPA Code of Professional Conduct
- IMA Standard of Ethical Conduct for Management Accountants

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ETHICS AND THE ACCOUNTING PROFESSION

- AICPA Code of Professional Conduct
- IMA Standard of Ethical Conduct for Management Accountants

- *OBJECTIVITY客觀*
- *INTEGRITY誠實*
- *INDEPENDENCE獨立*
- *COMPETENCE稱職*

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Chapter 1

The End

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Financial Statements and Accounting Concepts/Principles

2

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ The kind of information reported on each financial statement and the way financial statements are related to each other.

❷ What transactions are and the meaning and usefulness of the accounting equation.

❸ The meaning of each of the captions on the financial statements illustrated in this chapter.

❹ The broad, generally accepted concepts and principles that apply to the accounting profession.

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LEARNING O

There's more. Click the mouse again!

After studying this chapter

❶ The kind of information
statement and way fin
related to ea

❷ What tra and the meaning and
usefuli nting equation.

❸ The mea the captions on the
financial s strated in this chapter.

❹ The broad, cepted concepts and
principles th the accounting profession.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❺ Several limitations of financial statements.

❻ What a corporation's annual report is, and why it is issued.

❼ Business practices related to organizing a business, fiscal year, par value, and parent-subsidiary corporations.

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FROM TRANSACTIONS TO FINANCIAL STATEMENTS

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FROM TRANSACTIONS TO FINANCIAL STATEMENTS

Financial
Transaction

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FROM TRANSACTIONS TO FINANCIAL STATEMENTS

Financial
Transaction

An economic interchange between entities.

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FROM TRANSACTIONS TO FINANCIAL STATEMENTS

Financial
Transaction

Procedures for sorting, classifying and presenting (bookkeeping)

Selection of alternative methods of reflecting the effect of transactions (accounting)

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FROM TRANSACTIONS TO FINANCIAL STATEMENTS

Financial Transaction → Procedures for sorting, classifying and presenting (bookkeeping)

Selection of alternative methods of reflecting the effect of transactions (accounting)

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FROM TRANSACTIONS TO FINANCIAL STATEMENTS

Financial Transaction → Procedures for sorting, classifying and presenting (bookkeeping)

Selection of alternative methods of reflecting the effect of transactions (accounting) → Financial Statements

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FINANCIAL STATEMENTS

- **Balance Sheet**--Financial position at a point in time.
- **Income Statement**--Earnings for a period of time.
- **Statement of Cash Flows**--Summary of cash flows for a period of time.
- **Statement of Changes in Owners' Equity**--Investments by owners, earnings of the firm, and distributions to owners.

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MAIN STREET STORE, INC.
Balance Sheet
August 31, 1999

Assets		Liabilities and Owners' Equity	
Current assets:		Current liabilities:	
Cash	$ 34,000	Short-term debt	$ 20,000
Accounts receivable	80,000	Accounts payable	35,000
Merchandise inv.	170,000	Other acc. liabilities	12,000
Total current assets	$284,000	Total current liabilities	$ 67,000
Plant and equipment:		Long-term debt	50,000
Equipment	40,000	Total liabilities	$117,000
Less: Accum. depr.	4,000	Owners' equity	203,000
Total assets	$320,000	Total liabilities and owners' equity	$320,000

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MAIN STREET STORE, INC.
Balance Sheet
August 31, 1999

Assets		Liabilities and Owners' Equity	
Current assets:		Current liabilities:	
Cash			
Accounts r			
Merchand			
Total asset			
Plant and equipment:		Long-term debt	
Equipment		Total liabilities	$
Less: Accum. depr.		Owners' equity	2 0
		Total liabilities and owners' equity	
Total assets	$320,000		$320,000

Assets = Liabilities + Owners' Equity

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MAIN STREET STORE, INC.
Balance Sheet
August 31, 1999

Assets		Liabilit	Equity
Current assets:		Current	
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Accounts receivable	80,000	Account	5,000
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Equipment	40,000	l liabilities	$117,000
Less: Accum. depr.	4,000	quity	203,000
		liabilities and owners' equity	
Total assets	$320,000		$320,000

Current assets!

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MAIN STREET STORE, INC.
Balance Sheet
August 31, 1999

Current liabilities!

		Liabilities and Owners' Equity	
Cu		Current liabilities:	
C	$ 34,000	Short-term debt	$ 20,000
Accounts receivable	80,000	Accounts payable	35,000
Merchandise inv.	170,000	Other acc. liabilities	12,000
Total current assets	,000	Total current liabilities	$ 67,000
Plant and equipment:		Long-term debt	50,000
Equipment	0	Total liabilities	$117,000
Less: Accum. depr.	0	Owners' equity	203,000
		Total liabilities and owners' equity	
Total assets	$320,000		$320,000

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MAIN STREET STORE, INC.
Income Statement
For the Year Ended August 31, 1999

Net sales	$1,200,000
Cost of goods sold	850,000
Gross profit	$ 350,000
Selling, general, and administrative exp.	311,000
Income from operations	$ 39,000
Interest expense	9,000
Income before taxes	$ 30,000
Income taxes	12,000
Net income	$ 18,000
Net income per share of common stock outstanding	$ 1.80

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2-17

MAIN STREET STORE, INC.
Income Statement
For the Year Ended August 31, 1999

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Net income	$ 18,000
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Revenue

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MAIN STREET STORE, INC.
Income Statement
For the Year Ended August 31, 1999

Net sales.....	$1,200,000
Cost of goods sold.....	850,000
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Interest expense	9,000
Income before taxes	$ 30,000
Income taxes	12,000
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Net income per share of common stock outstanding	$ 1.80

Less Expenses

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MAIN STREET STORE, INC.
Income Statement
For the Year Ended August 31, 1999

Net sales.....	$1,200,000
Cost of goods sold.....	850,000
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Net income	$ 18,000
Net income per share of common stock outstanding	$ 1.80

Equals Net Income

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2-20

MAIN STREET STORE, INC.
Statement of Changes in Owners' Equity
For the Year Ended August 31, 1999

Paid in capital:	
Beginning balances.....	$ - 0 -
Common stock, par value, $10, 50,000 shares authorized, 10,000 shares issued and outstanding.....	100,000
Additional paid-in capital.....	90,000
Balance, August 31, 1999.....	$190,000
Retained earnings:	
Beginning balance.....	$ -0-
Net income for the year.....	18,000
Less: Cash dividends of $.50 per share.....	(5,000)
Balance, August 31, 1999.....	$ 13,000
Total owners' equity.....	$203,000

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MAIN STRE
Statement of Cha
For the Year

The two principal components of this statement are paid-in capital changes and retained earnings changes.

Paid in capital:

Beginning balances.....	
Common stock, par value,	
shares authorized, 10,000 sha issued	
and outstanding.....	100,000
Additional paid-in cap.....	90,000
Balance, August 31.....	$190,000
Retained earnings:	
Beginning balanc.....	$ -0-
Net income for the	18,000
Less: Cash dividen share.....	(5,000)
Balance, August	$ 13,000
Total owners' equit.....	$203,000

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KEY RELATIONSHIP

Retained Earnings beginning balance
+ Net income for the period
- Dividends paid to stockholders
= Retained Earnings ending balance

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MAIN STREET STORE, INC.
Statement of Cash Flows
For the Year Ended August 31, 1999

Cash flows from operating activities:	
Net income.....	$ 18,000
Add (deduct) items not affecting cash:	
Depreciation expense.....	4,000
Increase in accounts receivable.....	(80,000)
Increase in merchandise inventory.....	(170,000)
Increase in current liabilities.....	67,000
Net cash used by operating activities.....	$(161,000)
Cash flows from investing activities:	
Cash paid for equipment.....	$ (40,000)

(continued on next slide)

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MAIN STREET STORE, INC.
Statement of Cash Flows
For the Year Ended August 31, 1999

Cash paid for equipment.....	$ (40,000)
Cash flows from financing activities:	
Cash received from issue of long-term debt.....	$ 50,000
Cash received from sale of common stock.....	190,000
Payment of cash dividend on common stock.....	(5,000)
Net cash provided by financing activities.....	$235,000
Net increase in cash for the year.....	$ 34,000

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KEY TERMINOLOGY

> Cash flows from operating activities

> Cash flows from financing activities

> Cash flows from investing activities

> Change in cash for the year

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FINANCIAL STATEMENT RELATIONSHIPS

Statement of Cash Flows
8/31/99

Balance Sheet, 8/31/98

The *Cash* balance on the August 31, 1998 balance sheet plus (or minus) the net change in cash on the cash flow statement should equal *Cash* shown on the August 31, 1999 balance sheet.

Balance Sheet, 8/31/99

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FINANCIAL STATEMENT RELATIONSHIPS

Statement of Cash Flows
8/31/99

Balance Sheet, 8/31/98

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Balance Sheet, 8/31/99

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FINANCIAL STATEMENT RELATIONSHIPS

Statement of Cash Flows
8/31/99

Balance Sheet, 8/31/98

The *Cash* balance on the August 31, 1998 balance sheet plus (or minus) the net change in cash on the cash flow statement should equal *Cash* shown on the August 31, 1999 balance sheet.

Balance Sheet, 8/31/99

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FINANCIAL STATEMENT RELATIONSHIPS

Paid-in capital from the August 31, 1998 balance sheet, plus (minus) changes in *Paid-in capital* on the statement of changes in owners' equity, provide the *Paid-in capital* balance for the August 31, 1999 balance sheet.

Balance Sheet, 8/31/98

Statement of Changes in Owners' Equity

Balance Sheet, 8/31/99

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FINANCIAL STATEMENT RELATIONSHIPS

Paid-in capital from the August 31, 1998 balance sheet, plus (minus) changes in *Paid-in capital* on the statement of changes in owners' equity, provide the *Paid-in capital* balance for the August 31, 1999 balance sheet.

Balance Sheet, 8/31/98

Statement of Changes in Owners' Equity

Balance Sheet, 8/31/99

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FINANCIAL STATEMENT RELATIONSHIPS

Paid-in capital from the August 31, 1998 balance sheet, plus (minus) changes in *Paid-in capital* on the statement of changes in owners' equity, provide the *Paid-in capital* balance for the August 31, 1999 balance sheet.

Balance Sheet, 8/31/98 → Statement of Changes in Owners' Equity

Balance Sheet, 8/31/99

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FINANCIAL STATEMENT RELATIONSHIPS

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Balance Sheet, 8/31/98 → Statement of Changes in Owners' Equity

Balance Sheet, 8/31/99

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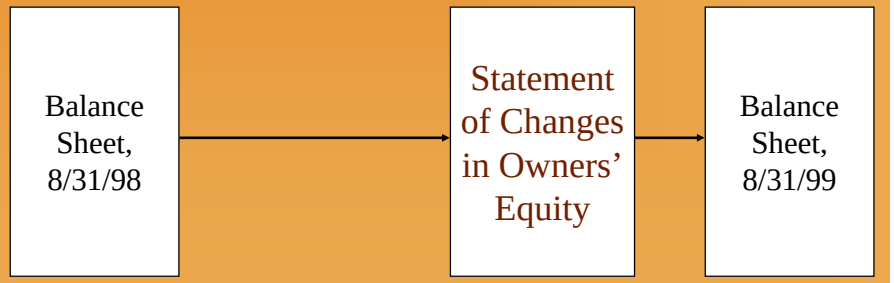
FINANCIAL STATEMENT RELATIONSHIPS

Paid-in capital from the August 31, 1998 balance sheet, plus (minus) changes in *Paid-in capital* on the statement of changes in owners' equity, provide the *Paid-in capital* balance for the August 31, 1999 balance sheet.



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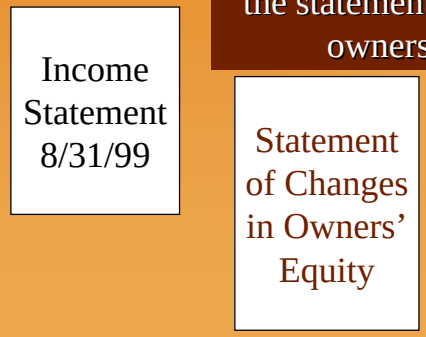
FINANCIAL STATEMENT RELATIONSHIPS

Net income from the income statement is used to determine ending *Retained Earnings* on the statement of changes in owners' equity.



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FINANCIAL STATEMENT RELATIONSHIPS

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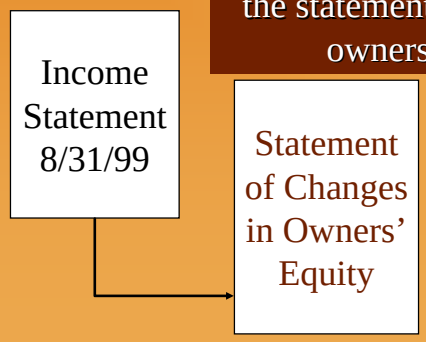

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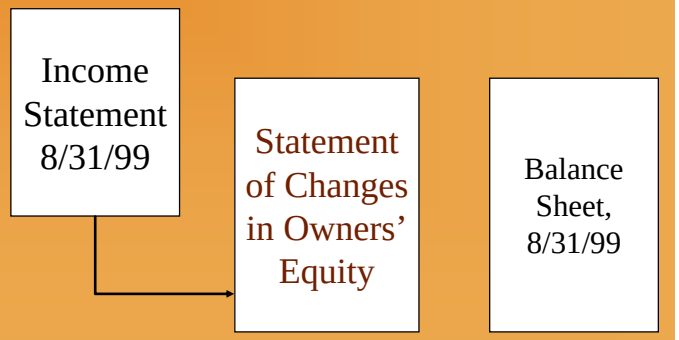
FINANCIAL STATEMENT RELATIONSHIPS

The ending *Retained Earnings* balance on the statement of changes in owners' equity is carried forward to the August 31, 1999 balance sheet.



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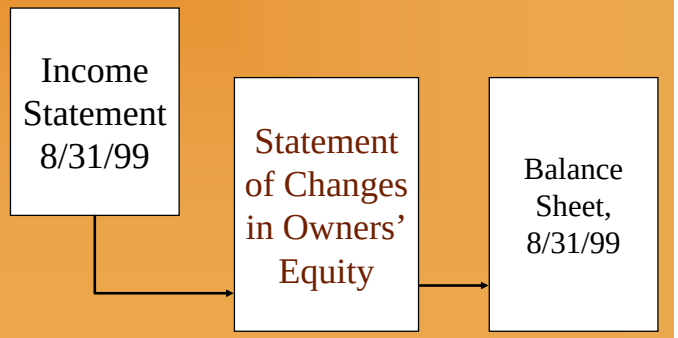
FINANCIAL STATEMENT RELATIONSHIPS

The ending *Retained Earnings* balance on the statement of changes in owners' equity is carried forward to the August 31, 1999 balance sheet.



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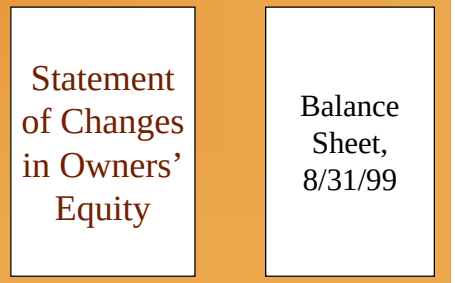
FINANCIAL STATEMENT RELATIONSHIPS

The amount shown as total owners' equity on the August 31, 1999 balance sheet should match total owners' equity on the statement of changes in owners' equity



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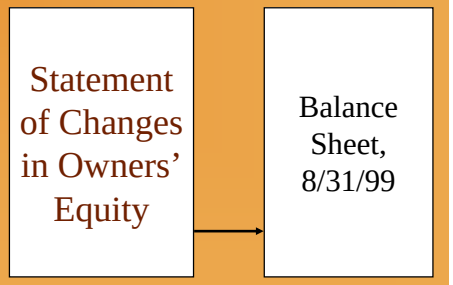
FINANCIAL STATEMENT RELATIONSHIPS

The amount shown as total owners' equity on the August 31, 1999 balance sheet should match total owners' equity on the statement of changes in owners' equity



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FINANCIAL STATEMENT RELATIONSHIPS

KEY IDEAS

- Transactions affecting the income statement also affect the balance sheet.
- For the balance sheet to balance, income statement transactions must be reflected in the Retained Earnings part of owners' equity.
- The statement of cash flows explains why the cash amount changed during the period.

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Relationship Between the Balance Sheet and Income Statement

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity ←	Net Income = Revenues - Expenses

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Relationship Between the Balance Sheet and Income Statement

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity ←	Net Income = Revenues - Expenses

Using the August 31, 1999, data from the balance sheet (slide 12)....

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Relationship Between the Balance Sheet and Income Statement

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity ←	Net Income = Revenues - Expenses
$320,000 = $117,000 + ?	

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Relationship Between the Balance Sheet and Income Statement

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity ←	Net Income = Revenues - Expenses
$320,000 = $117,000 + $216,000	

The balance sheet must be in balance (A = L + OE) after every transaction.

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Accounting Concepts and Principles

Accounting entity

Assets = Liabilities + Owners' Equity

Going Concern (continuity)

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Accounting Concepts and Principles

Accounting entity

Assets = Liabilities + Owners' Equity

Going Concern (continuity)

Procedures for sorting, classifying, and presenting (bookkeeping)

Selection of alternative methods of reflecting the effect of certain transactions (accounting)

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Accounting Concepts and Principles

Accounting entity

Assets = Liabilities + Owners' Equity

Going Concern (continuity)

Procedures for sorting, classifying, and presenting (bookkeeping)

Selection of alternative methods of reflecting the effect of certain transactions (accounting)

Transaction

- Unit of measurement
- Cost principle
- Objectivity

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Accounting Concepts and Principles

Accounting entity

Assets = Liabilities + Owners' Equity

Going Concern (continuity)

Procedures for sorting, classifying, and presenting (bookkeeping)

Selection of alternative methods of reflecting the effect of certain transactions (accounting)

Transaction

- Unit of measurement
- Cost principle
- Objectivity

- Accounting period
- Matching
- Revenue recognized at time of sale
- Accrual concept

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Accounting Concepts and Principles

Accounting entity

Assets = Liabilities + Owners' Equity

Going Concern (continuity)

Procedures for sorting, classifying, and presenting (bookkeeping)

Selection of alternative methods of reflecting the effect of certain transactions (accounting)

Transaction

- Unit of measurement
- Cost principle
- Objectivity

- Accounting period
- Matching
- Revenue recognized at time of sale
- Accrual concept

Financial Statements

- Consistency
- Full disclosure
- Materiality物質性
- Conservatism保守

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KEY CLARIFICATION

Matching of revenue and expense means that all expenses incurred in generating revenue for the period are subtracted from those revenues to determine net income. Matching does not mean that revenues equal expenses.

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Chapter 2

The End

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Fundamental Interpretations Made from Financial Statement Data

3

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ Why financial statement ratios are important.

❷ The significance and calculation of return on investment.

❸ The DuPont model, an expansion of the basic return on investment calculation, and the terms *margin* and *turnover*.

❹ The significance and calculation of return on equity.

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LEARNING OBJECTIVES

There's more. Click the mouse again!

After studying this chap

❶ Why financial state

❷ The significance and ca investment.

❸ The DuPon , a xpansion of the basic return lculation, and the terms *mar* .

❹ The s and calculation of return on equity.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❺ The meaning of liquidity, and why it is important.

❻ The significance and calculation of three measures of liquidity: working capital, the current ratio, and the acid-test ratio.

❼ How ratio trends can be used most effectively.

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Measurements and Trend Analysis

Pat's GPA is 2.8 on a 4.0 scale.

Pat's GPA for the last four semesters--
1.9, 2.3, 2.6, 2.8

JUDGMENT: Pat's performance has been improving.

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Measurements and Trend Analysis

GPA for all students for the last four semesters--
2.85, 2.76, 2.70, 2.65

JUDGMENT: Pat's performance has improved while performance of all students has declined.

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KEY POINTS

- The trend of data is frequently more significant than the data itself.
- Comparison of individual and group trends is important when making judgments.

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RETURN ON INVESTMENT (ROI)

$$\text{RATE OF RETURN} = \frac{\text{AMOUNT OF RETURN}}{\text{AMOUNT INVESTED}}$$

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RETURN ON INVESTMENT (ROI)

$$\text{RATE OF RETURN} = \frac{\$75}{\$1{,}000}$$

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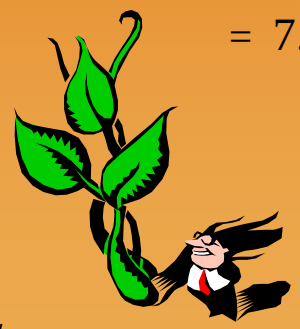
RETURN ON INVESTMENT (ROI)

$$\text{RATE OF RETURN} = \frac{\$75}{\$1{,}000} = 7.5\%$$



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KEY POINTS

- ✶ Rate of return is an annual percentage rate unless otherwise specified, therefore...
- ✶ The amount of return is the amount received during the year and...
- ✶ The amount invested is the average amount invested during the year.
- ✶ ROI is a significant measure of economic performance because it describes the results obtained by management's use of the assets made available during the year.

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The DuPont Model for Calculating Return on Investment

$$\text{Return on Investment} = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Average total assets}}$$

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The DuPont Model for Calculating Return on Investment

$$\text{Return on Investment} = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Average total assets}}$$

MARGIN TURNOVER

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The DuPont Model for Calculating Return on Investment

$$\text{Return on Investment} = \frac{\$34{,}910}{\text{Sales}} \times \frac{\text{Sales}}{\text{Average total assets}}$$

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The DuPont Model for Calculating Return on Investment

$$\text{Return on Investment} = \frac{\$34{,}910}{\$611{,}873} \times \frac{\$611{,}873}{\text{Average total assets}}$$

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The DuPont Model for Calculating Return on Investment

$$\text{Return on Investment} = \frac{\$34{,}910}{\$611{,}873} \times \frac{\$611{,}873}{\text{Average total assets}}$$

$$\frac{\$364{,}720 + \$402{,}654}{2}$$

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The DuPont Model for Calculating Return on Investment

$$\text{Return on Investment} = \frac{\$34{,}910}{\$611{,}873} \times \frac{\$611{,}873}{\$383{,}687}$$

$$\frac{\$364{,}720 + \$402{,}654}{2}$$

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The DuPont Model for Calculating Return on Investment

$$\text{Return on Investment} = \frac{\$34{,}910}{\$611{,}873} \times \frac{\$611{,}873}{\$383{,}687}$$

$$\text{Return on Investment} = 9.1\%$$

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KEY IDEAS

- ✓ Margin describes the profitability from sales.
- ✓ Turnover describes the efficiency with which assets have been used to generate sales.
- ✓ Overall profitability - return on investment is a function of both profitability of sales and the efficient use of assets.

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KEY POINTS

- Net income and sales are <u>for the year</u>. For consistency, total assets is the average of total assets from the balance sheet at the beginning and end of the year.
- Operating income may be used in the margin calculation instead of net income, and average operating assets may be used in the turnover calculation. As long as the data used are consistently calculated, the <u>trend</u> of ROI will be useful for judgments.

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RETURN ON EQUITY (ROE)

$$\text{Return on Equity} = \frac{\text{Net income}}{\text{Average owners' equity}}$$

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RETURN ON EQUITY (ROE)

$$\text{Return on Equity} = \frac{\$34{,}910}{(\$230{,}320 + \$265{,}230)/2}$$

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RETURN ON EQUITY (ROE)

$$\text{Return on Equity} = \frac{\$34{,}910}{(\$230{,}320 + \$265{,}230)/2}$$

$$\text{Return on Equity} = 14.1\%$$

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KEY POINT

As in ROI, net income is <u>for the year</u>, therefore it is related to the average of the owners' equity at the beginning and end of the year.

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KEY IDEAS

- ✓ ROI relates net income to average total assets, and expresses a rate of return on the assets used by the firm.
- ✓ ROE relates net income to average owners' equity, and expresses a rate of return on that portion of the assets provided by the owners of the firm.

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WORKING CAPITAL

Working capital = Current assets - Current liabilities

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WORKING CAPITAL

Working capital = $118,319 - $57,424

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WORKING CAPITAL

Working capital = $60,895

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WORKING CAPITAL

KEY DEFINITIONS

- **Current assets**: Cash and assets likely to be converted to cash within a year.
- **Current liabilities**: Obligations that must be paid within a year.

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WORKING CAPITAL

KEY IDEA

A measure of the firm's ability to pay its current obligations.

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CURRENT RATIO

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

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CURRENT RATIO

$$\text{Current ratio} = \frac{\$118{,}319}{\$57{,}424}$$

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CURRENT RATIO

$$\text{Current ratio} = \frac{\$118{,}319}{\$57{,}424}$$

$$\text{Current ratio} = 2.1$$

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CURRENT RATIO

KEY IDEA

The current ratio is usually a more useful measurement than the amount of working capital because it is a ratio measurement.

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ACID-TEST RATIO

$$\text{Acid-test ratio} = \frac{\text{Cash (including temporary cash investments)+ Accounts receivable}}{\text{Current liabilities}}$$

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ACID-TEST RATIO

$$\text{Acid-test ratio} = \frac{\$22{,}286 + \$42{,}317}{\$57{,}424}$$

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ACID-TEST RATIO

$$\text{Acid-test ratio} = \frac{\$22{,}286 + \$42{,}317}{\$57{,}424}$$

$$\text{Acid-test ratio} = 1.1$$

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ACID-TEST RATIO

KEY IDEA

Focusing on cash and accounts receivable provides a more short-term measure of liquidity than the current ratio.

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VERTICAL GRAPH SCALES

Arithmetic計算Scale

KEY FEATURE

Vertical scale distances are equal.

KEY IDEA

A constant rate of growth plots as an increasingly steep line over time.

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VERTICAL GRAPH SCALES

Logarithmic對數的Scale

KEY FEATURE

Vertical scale distances are increasingly narrow and compressed.

KEY IDEA

A constant rate of growth plots as a straight line.

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VERTICAL GRAPH SCALES

KEY OBSERVATIONS

- ✓ The horizontal scale will almost always be an arithmetic scale, with equal distance between the dates of data observations.
- ✓ Semi-logarithmic format means that only the vertical scale is logarithmic; the horizontal scale is arithmetic.

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Chapter 3

The End

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The Bookkeeping Process and Transaction Analysis

4

DAVID H. MARSHALL / WAYNE W. MCMANUS

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ The expansion of the basic accounting equation to include revenues and expenses.

❷ How the expanded accounting equation stays in balance after every transaction.

❸ How the income statement is linked to the balance sheet through owners' equity.

❹ The meaning of the bookkeeping terms *journal, ledger, T-account, account balance, debit, credit* and *closing the books.*

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LEARNING OBJECTIVES

There's more. Click the mouse again!

After studying this chap

❶ The expansion of th
equation to include

❷ How the expanded acc nting equation stays
in balance after y transaction.

❸ How t tement is linked to the
balanc ugh owners' equity.

❹ The m bookkeeping terms
journa ccount, account balance,
debit, c closing the books.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❺ That the bookkeeping system is a mechanical adaptation of the expanded accounting equation.

❻ How to analyze a transaction, prepare a journal entry, and determine the effect of a transaction on working capital.

❼ The five questions of transaction analysis.

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TRANSACTIONS AND THE FINANCIAL STATEMENTS

- ☞Transactions affect the balance sheet and/or the income statement.
- ☞The balance sheet must be in balance after every transaction.
- ☞The *Retained Earnings* account on the balance sheet includes net income from the income statement.
- ☞Balance sheet accounts may have amount balances at the end of a fiscal period, and before transactions of the subsequent period are recorded.

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KEY TERMINOLOGY

Each individual asset, liability, owners' equity, revenue, or expense "account" may additionally be described with its category title.

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KEY TERMINOLOGY

Each individual asset, liability, owners' equity, revenue, or expense "account" may additionally be described with it's category title.

- **"Cash Asset Account"**
- **"Accounts Payable Liability Account"**
- **"Common Stock Owners' Equity Account"**
- **"Sales Revenue Account"**
- **"Wages Expense Account"**

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KEY RELATIONSHIP

> Transactions during a fiscal period cause the balance of the affected account(s) to increase or decrease.

> *Bookkeeping* is the process of keeping track of these changes.

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BOOKKEEPING JARGON

> **Journal**--a chronological依時間前後排列 record of each transaction.

> **Ledger**--a book of all of the accounts; accounts are usually arranged in the sequence found on the balance sheet and income statement, respectively.

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Accounts are frequently in the shape of a T.

Account Name

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The left-hand side is the *debit* side.

Account Name

Debit

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The right-hand side is the *credit* side.

Account Name

Debit | **Credit**

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4-13

An increase in an asset or an expense account is recorded as a debit.

Account Name

Debit	

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4-14

A decrease in either an asset or an expense is recorded as a credit.

Account Name

Debit	Credit

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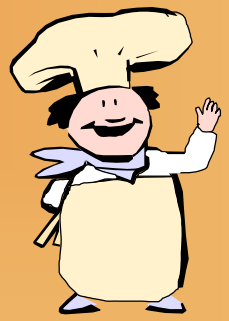
4-15

An increase in a liability, owners' equity or revenue account is recorded as a credit.

Account Name

Debit	Credit



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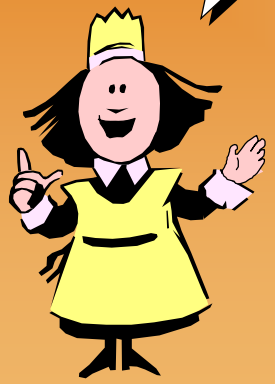
4-16

A decrease in either a liability, owners' equity, or revenue account is recorded as a debit.

Account Name

Debit	Credit



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ADJUSTING ENTRIES

Two categories of adjusting entries.

- **Accruals積累--**Transactions for which cash has not been received or paid, but the effect of which must be recorded in the accounts to accomplish matching.
- **Reclassification分類法--**The bookkeeping for the original transaction was appropriate when it was recorded, but the passage of time requires a reclassification of the original bookkeeping to reflect correct account balances as of the date of the financial statements.

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KEY IDEAS

- ✓ Accrual accounting means that revenues are recognized when earned (not when cash is received) and that expenses are reflected in the period in which they are incurred (not when cash is paid).
- ✓ Adjusting entries result in matching revenues and expenses, which is the objective of accrual accounting.

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TRANSACTION ANALYSIS

To understand either the bookkeeping procedure for a transaction, or the effect of a transaction on the financial statements, the following questions must be answered.

❶ What's going on?

❷ What accounts are affected?

❸ How is each account affected?

❹ Does the balance sheet balance?

❺ Does my analysis make sense?

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The firm borrowed $2,500 by issuing a 12% note payable.

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity	Net income = Revenues - Expenses

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The firm borrowed $2,500 by issuing a 12% note payable.

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity	Net income = Revenues - Expenses

Cash	Note Payable
+2,500	+2,500

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The firm borrowed $2,500 by issuing a 12% note payable.

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity	Net income = Revenues - Expenses

Cash	Note Payable
+2,500	+2,500

The journal entry would be:

Dr. Cash	2,500	
Cr. Notes Payable		2,500

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Accrued interest of $25 is recorded at the end of each month for ten months.

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity	Net income = Revenues - Expenses

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Accrued interest of $25 is recorded at the end of each month for ten months.

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity	Net income = Revenues - Expenses

Interest Payable	Interest Expense
+25	+25

$2,500 x .12 x 1/12 = $25

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Accrued interest of $25 is recorded at the end of each month for ten months.

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity	Net income = Revenues - Expenses
Interest Payable +25	Interest Expense +25

The journal entry would be:

Dr. Interest Expense	25	
Cr. Interest Payable		25

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At the end of ten months, the loan and accrued interest are paid.

Balance Sheet	Income Statement
Assets = Liabilities + Owners' equity	Net income = Revenues - Expenses

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At the end of ten months, the loan and accrued interest are paid.

Balance Sheet		Income Statement
Assets = Liabilities + Owners' equity		Net income = Revenues - Expenses
Cash	Note Payable	
-2,750	-2,500	
	Interest Payable	
	-250	

$2,500 x .12 x 10/12 = $250

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At the end of ten months, the loan and accrued interest are paid.

Balance Sheet		Income Statement
Assets = Liabilities + Owners' equity		Net income = Revenues - Expenses
Cash	Note Payable	
-2,750	-2,500	
	Interest Payable	
	-250	

The journal entry would be:

Dr. Note Payable	2,500	
Dr. Interest Payable	250	
Cr. Cash		2,570

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Chapter 4

The End

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Accounting for and Presentation of Current Assets

5

DAVID H. MARSHALL / WAYNE W. MCMANUS

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ What is included in the *Cash* account reported on the balance sheet.

❷ The bank reconciliation procedure.

❸ The features of a system of internal control, and why internal controls are important.

❹ How short-term marketable securities are reported on the balance sheet.

❺ How accounts receivable are reported on the balance sheet.

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LEARNING OBJECTIVES

After studying this chap

❶ What is included in
on the balance shee

❷ The bank rec liation procedure.

❸ The feature stem of internal control,
and why inte s are important.

❹ How short- etable securities are
reported on e b e sheet.

❺ How accounts receiva e are reported on the
balance sheet.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❻ How notes receivable and related accrued interest are reported on the balance sheet.

❼ How inventories are reported on the balance sheet.

❽ The alternative inventory cost-flow assumptions, and their respective effects on the statements when price levels are changing.

❾ The impact of inventory errors on the balance sheet and income statement.

❿ What prepaid expenses are, and how they are reported on the balance sheet.

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CURRENT ASSETS

Current assets are cash and those assets expected to be converted to cash or used up in the operating activities of the entity within one year.

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CURRENT ASSETS

Current assets are cash and those assets expected to be converted to cash or used up in the operating activities of the entity within one year.

ACCOUNTS THAT COMPRISE CURRENT ASSETS

- Cash
- Marketable (or Short-Term) Securities
- Accounts and Notes Receivable
- Inventories
- Prepaid Expenses

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KEY IDEA

Every entity has an operating cycle in which products and services are purchased, services are performed on account (usually), payment is made to employees and suppliers, and finally cash is received from customers. If the entity is a manufacturer, the product is made and held as inventory before it is sold. Current assets reflect the investment required to support this cycle.

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Internal Control Structures

KEY IDEA

1) Operating effectiveness and efficiency

2) Financial reporting reliability

3) Compliance with applicable laws and regulaions

ACCOUNTING CONTROLS

Assure accuracy of bookkeeping records and financial statements.

Protect assets from unauthorized use or loss.

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Internal Control Structures

ADMINISTRATIVE CONTROLS

Encourage adherence to management's policies.

Provide for efficient operations.

KEY OBSERVATION

Internal controls are positive; they support achievement of organizational objectives.

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CASH

- ✓ The cash amount on the balance sheet is the amount of cash owned by the entity on the balance sheet date.
- ✓ Thus the ledger account balance of cash must be reconciled with the bank statement's ending balance, and the ledger account balance must be adjusted as necessary.
- ✓ The adjustment will reflect bank timing differences and book errors.

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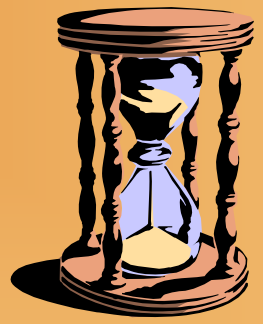
BANK RECONCILIATION和解

Timing Differences

- Deposits in transit
- Outstanding checks
- Bank service charges
- NSF (not sufficient funds) checks
- Errors



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MARKETABLE SECURITIES

- ➔ Short-term marketable securities that will be held until maturity are shown on the balance sheet at cost, which is usually about the same as market value.
- ➔ Securities expected to be held for several months after the balance sheet date are shown at their market value.
- ➔ Interest income from marketable securities that has not been received must be accrued.

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ACCOUNTS RECEIVABLE

KEY ISSUES

☑ Accounts receivable are reported on the balance sheet at their "net realizable value," which is the amount of cash expected to be collected from the accounts receivable.

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ACCOUNTS RECEIVABLE

KEY ISSUES

☑ When sales are made on account, there is a very high probability that some accounts receivable will not be collected.

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ACCOUNTS RECEIVABLE

KEY ISSUES

☑ The matching of revenues and expenses concept requires that the "cost" of uncollectible accounts receivable be reported in the same period as the revenue that was recognized when the account receivable was created.

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ACCOUNTS RECEIVABLE

KEY POINTS

☑ The "cost" of uncollectible accounts (*Bad Debts Expense*) must be estimated. This leads to valuation adjustments.

☑ The amount of accounts receivable not expected to be collected is recorded and reported in an *Allowance for Bad Debts* account.

☑ The *Allowance for Bad Debts* account is a "contra asset" reported on the balance sheet as a subtraction from *Accounts Receivable*.

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ACCOUNTS RECEIVABLE

Accounts receivable	$10,000
Less: Allowance for bad debts	(500)
Net accounts receivable	$ 9,500

or

Accounts receivable, less allowance for bad debts of $500	$ 9,500

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INVENTORIES

The inventory asset account contains the cost of items that are being held for sale. When an item of inventory is sold, it's cost is transferred from the inventory asset account (in the balance sheet) to the cost of goods sold expense account (in the income statement).

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INVENTORIES

Inventory (asset)	Cost of Goods Sold
Purchases of merchandise for resale increase inventory (credit *Accounts Payable* or *Cash*)	

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INVENTORIES

Inventory (asset)		Cost of Goods Sold
Purchases of merchandise for resale increase inventory (credit *Accounts Payable* or *Cash*)	**When merchandise is sold, the cost flows from the *Inventory* asset account to**	

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INVENTORIES

Inventory (asset)		Cost of Goods Sold
Purchases of merchandise for resale increase inventory (credit *Accounts Payable* or *Cash)*	When merchandise is sold, the cost flows from the *Inventory* asset account to →	the *Cost of Goods Sold* account

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INVENTORIES

This is a transaction separate from the sale transaction, which results in an increase in an asset account in the balance sheet (either *Accounts Receivable* or *Cash*), and an increase in *Sales*, a revenue account in the income statement.

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INVENTORIES

This is a transaction separate from the sale transaction, which results in an increase in an asset account in the balance sheet (either *Accounts Receivable* or *Cash*), and an increase in *Sales*, a revenue account in the income statement.

KEY ISSUE

When the inventory includes the cost of several units of the item sold, how is the cost of the item sold determined?

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INVENTORY COST FLOW ASSUMPTIONS

- Specific identification
- Weighted average
- First-in, first-out (FIFO)
- Last-in, first-out (LIFO)

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WEIGHED-AVERAGE

9/1/98	Beginning inventory	5	@ $1,500	$ 7,500
11/7/98	Purchase	8	@ $1,600	12,800
3/13/99	Purchase	12	@ $1,650	19,800
5/22/99	Purchase	10	@ $1,680	16,800
7/28/99	Purchase	6	@ $1,700	10,200
8/30/99	Purchase	4	@ $1,720	6,880
Total boats available for sale		45		$73,980
Number of boats sold		37		
Number of boats in 8/31/99 inventory		8		

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WEIGHED-AVERAGE

$$\frac{\text{Total cost of boats available for sale}}{\text{Number of boats available for sale}}$$

9/1/98				
11/7/9				
3/13/9				
5/22/9				
7/28/99	Purchase	6	@ $1,700	10,200
8/30/99	Purchase	4	@ $1,720	6,880
Total boats available for sale		45		$73,980
Number of boats sold		37		
Number of boats in 8/31/99 inventory		8		

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WEIGHED-AVERAGE

$$\frac{\$73{,}980}{45} = \$1{,}644 \text{ per boat}$$

9/1/98				
11/7/9				
3/13/9				
5/22/9				
7/28/99	Purchase	6	@ $1,700	10,200
8/30/99	Purchase	4	@ $1,720	6,880
Total boats available for sale		45		$73,980
Number of boats sold		37		
Number of boats in 8/31/99 inventory		8		

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WEIGHED-AVERAGE

Cost of Goods Sold
$1,644 per boat x 37 = $60,828

9/1/98				
11/7/9				
3/13/9				
5/22/9				
7/28/99	Purchase	6	@ $1,700	10,200
8/30/99	Purchase	4	@ $1,720	6,880
Total boats available for sale		45		$73,980
Number of boats sold		37	@ $1,644	(60,828)
Number of boats in 8/31/99 inventory		8	@ $1,644	$13,152

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WEIGHED-AVERAGE

Ending Inventory
$1,644 per boat x 8 = $13,152

9/1/98				
11/7/9				
3/13/9				
5/22/9				
7/28/99	Purchase	6	@ $1,700	10,200
8/30/99	Purchase	4	@ $1,720	6,880
Total boats available for sale		45		$73,980
Number of boats sold		37	@ $1,644	(60,828)
Number of boats in 8/31/99 inventory		8	@ $1,644	$13,152

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FIRST-IN, FIRST-OUT

9/1/98	Beginning inventory	5	@ $1,500	$ 7,500
11/7/98	Purchase	8	@ $1,600	12,800
3/13/99	Purchase	12	@ $1,650	19,800
5/22/99	Purchase	10	@ $1,680	16,800
7/28/99	Purchase	6	@ $1,700	10,200
8/30/99	Purchase	4	@ $1,720	6,880

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FIRST-IN, FIRST-OUT

SOLD				
SOLD				
SOLD				
SOLD				
7/28/99	Purchase	6	@ $1,700	10,200
8/30/99	Purchase	4	@ $1,720	6,880

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FIRST-IN, FIRST-OUT

SOLD				
SOLD				
SOLD				
SOLD				
7/28/99	Pur	SOLD 2	6 @ $1,700	10,200
8/30/99	Purchase		4 @ $1,720	6,880

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FIRST-IN, FIRST-OUT

SOLD
SOLD
SOLD
SOLD

7/28/99	Pur	6 @ $1,700	10,200
8/30/99	Purchase	4 @ $1,720	6,880

SOLD 2

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FIRST-IN, FIRST-OUT

SOLD
SOLD
SOLD
SOLD

7/28/99	Purchase	4 @ $1,700	6,800
8/30/99	Purchase	4 @ $1,720	6,880
Boats in ending inventory		8	$13,680

.

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FIRST-IN, FIRST-OUT

SOLD
SOLD
SOLD
SOLD

7/28/99	Purchase	4 @ $1,700	6,800
8/30/99	Purchase	4 @ $1,720	6,880
Ending inventory		8	$13,680

.

Cost of goods sold: $73,980 - $13,680 = $60,300

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LAST-IN, FIRST-OUT

9/1/98	Beginning inventory	5 @ $1,500	$ 7,500
11/7/98	Purchase	8 @ $1,600	12,800
3/13/99	Purchase	12 @ $1,650	19,800
5/22/99	Purchase	10 @ $1,680	16,800
7/28/99	Purchase	6 @ $1,700	10,200
8/30/99	Purchase	4 @ $1,720	6,880

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LAST-IN, FIRST-OUT

9/1/98	Beginning inventory	5	@ $1,500	$ 7,500
11/7/98	Purchase	8	@ $1,600	12,800
3/13/99	Purchase	SOLD	@ $1,650	19,800
5/22/99	Purchase	SOLD	@ $1,680	16,800
7/28/99	Purchase	SOLD	@ $1,700	10,200
8/30/99	Purchase	SOLD	@ $1,720	6,880

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LAST-IN, FIRST-OUT

9/1/98	Beginning inventory	5	@ $1,500	$ 7,500
11/7/98	Purch SOLD 5	8	@ $1,600	12,800
	SOLD			
	SOLD			
	SOLD			
	SOLD			

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LAST-IN, FIRST-OUT

9/1/98	Beginning inventory	5	@ $1,500	$ 7,500
11/7/98	Purch SOLD 5	8	@ $1,600	12,800
	SOLD			
	SOLD			
	SOLD			
	SOLD			

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LAST-IN, FIRST-OUT

9/1/98	Beginning inventory	5	@ $1,500	$ 7,500
11/7/98	Purchase	3	@ $1,600	4,800
	SOLD			
	SOLD			
	SOLD			
	SOLD			
Ending inventory		**8**		**$12,300**

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LAST-IN, FIRST-OUT

9/1/98	Beginning inventory	5 @ $1,500	$ 7,500
11/7/98	Purchase	3 @ $1,600	4,800
SOLD			
SOLD			
SOLD			
SOLD			
Ending inventory		**8**	**$12,300**

Cost of goods sold: $73,980 - $12,300 = $61,680

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KEY ISSUES

> How do changes in the cost of inventory items over time affect cost of goods sold under each of the cost flow assumptions?

> How do changes in the quantity of inventory items affect cost of goods sold under each of the cost flow assumptions?

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KEY POINT

ROI, ROE, and measures of liquidity will be affected by the inventory cost flow assumption used when the cost of inventory items changes over time.

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PREPAID EXPENSES

WHAT'S GOING ON?

__Prepaid expenses result from the application of accrual accounting. Some expenditures made in one period are not properly recognized as expenses until a subsequent period.

In these situations, expense recognition is deferred until the period in which the expense applies.

PREPAID EXPENSES FREQUENTLY INCLUDE:

Insurance premiums
Rent

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Chapter 5

The End

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Accounting for and Presentation of Property, Plant and Equipment, and Other Noncurrent Assets

6

DAVID H. MARSHALL / WAYNE W. MCMANUS

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ How the cost of land, buildings, and equipment is reported on the balance sheet.

❷ How the terms *capitalize* and *expense* are used with respect to property, plant, and equipment.

❸ Alternative methods of calculating depreciation for financial accounting purposes, and the relative effect of each on the income statement (*Depreciation Expense*) and the balance sheet (*Accumulated Depreciation*).

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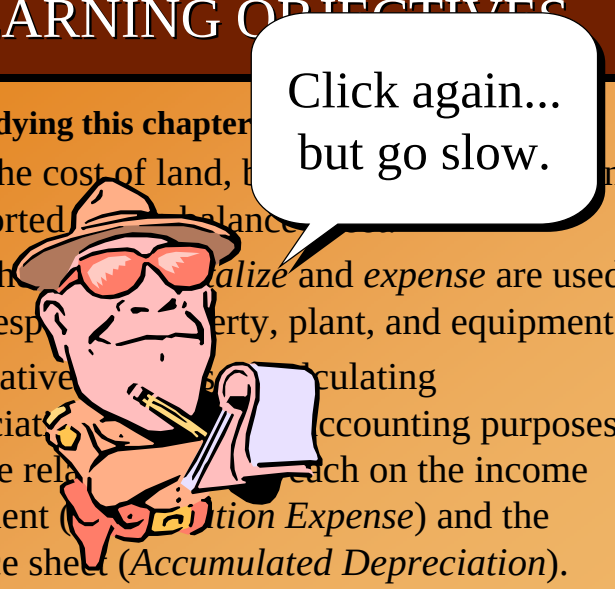
LEARNING OBJECTIVES



After studying this chapter

❶ How the cost of land, b nt is reported balance

❷ How th alize and *expense* are used with resp erty, plant, and equipment.

❸ Alternative culating depreciat ccounting purposes, and the rel ach on the income statement (ition Expense) and the balance shee (*Accumulated Depreciation*).

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❹ Why depreciation for income tax purposes is an important concern of taxpayers, and how tax depreciation differs from financial accounting depreciation.

❺ The accounting treatment of maintenance and repair expenditures.

❻ The effect on the financial statements of the disposition of noncurrent assets, either by abandonment, sale, or trade-in.

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LEARNING OBJECTIVES

Click one more time.

After studying this chapter

❹ Why depreciation for in
important c of taxpa
deprecia om financial accounting
depreciati

❺ The accou ent of maintenance and
repair exper

❻ The effect atements of the
disposition assets, either by
abandonmen sale, or trade-in.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❼ The similarities in the financial statements effects of buying an asset and using a capital lease.

❽ The role of present value concepts in financial reporting and their usefulness in decision making.

❾ The meaning of various intangible assets, how their values are measured, and how their cost is reflected in the income statement.

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LONG-LIVED ASSETS

KEY TERMINOLOGY

Depreciation Expense refers to that portion of the cost of a long-lived asset recorded as an expense in an accounting period. Depreciation in accounting is the spreading of the cost of a long-lived asset over its estimated useful life to the entity. This is an application of the matching concept.

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LONG-LIVED ASSETS

KEY TERMINOLOGY

Accumulated Depreciation is a contra asset account. The balance in this account is the accumulated total of all of the depreciation expense recognized to date on the related asset(s).

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LONG-LIVED ASSETS

KEY TERMINOLOGY

- To capitalize an expenditure means to record the expenditure as an asset. A long-lived asset that has been capitalized will be depreciated.
- To expense an expenditure means to record the expenditure as an expense.
- The difference between an asset's cost and its accumulated depreciation is its net book value.

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DEPRECIATION OF LONG-LIVED ASSETS

KEY POINT

The recognition of ***Depreciation Expense*** does not affect cash.

DEPRECIATION EXPENSE CALCULATION ELEMENTS

Asset cost

Estimated salvage value

Estimated useful life to entity

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DEPRECIATION OF LONG-LIVED ASSETS

- Straight-line
  - Based on years of life
  - Based on units of production
- Accelerated
  - Sum-of-the-years'-digits
  - Declining-balance

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Straight-line depreciation:

$$\frac{\text{Cost - Estimated salvage value}}{\text{Estimated useful life}} = \text{Annual Depreciation}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Straight-line depreciation:

$$\frac{\$22{,}000 - \$2{,}000}{5} = \$4{,}000$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Units-of-production depreciation:

$$\frac{\text{Cost - Estimated salvage value}}{\text{Estimated total units to be made}} = \text{Unit Depreciation}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Units-of-production depreciation:

$$\frac{\$22{,}000 - \$2{,}000}{200 \text{ hulls}} = \$100 \text{ per hull}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Sum-of-the-years'-digits depreciation:

$$\text{(Cost - Estimated salvage value)} \times \frac{\text{Remaining life in years}}{\text{Sum-of-the-years'-digits}}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Sum-of-the-years'-digits depreciation:

$$\text{Annual depreciation} = (\$22{,}000 - \$2{,}000) \times \frac{5 \text{ years}}{15 \text{ years}}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls wi

5 + 4 + 3 + 2 + 1

Sum-of-the-years'-digits depreciation:

$$\text{Annual depreciation} = (\$22{,}000 - \$2{,}000) \times \frac{5 \text{ years}}{15 \text{ years}}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Sum-of-the-years'-digits depreciation:

$$\$6{,}667 = (\$22{,}000 - \$2{,}000) \times \frac{5 \text{ years}}{15 \text{ years}}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Declining-balance depreciation:

Annual depreciation = Double the straight-line depreciation rate x Asset's net book value at beginning of year

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Declining-balance depreciation:

$$\text{Straight-line depreciation rate} = \frac{1}{\text{Life in years}}$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Declining-balance depreciation:

$$\text{Straight-line depreciation rate} = \frac{1}{5} = 20\%$$

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Declining-balance depreciation:

$8,800 = (20% x 2) x $22,000 **YEAR 1**

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Cruisers, Inc. purchased a molding machine at the beginning of 1998 at a cost of $22,000. The machine is estimated to have a useful life of five years, and an estimated salvage value of $2,000. Management estimates that 200 boat hulls will be produced.

Declining-balance depreciation:

$5,280 = (20% x 2) x $13,200 **YEAR 2**

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DEPRECIATION METHODS

KEY POINTS

> Accelerated depreciation results in greater depreciation expense during the early years of the asset's life than straight-line depreciation. Most firms use straight-line depreciation for financial reporting purposes.

> Depreciation expense does not affect cash, but because depreciation is deductible for income tax purposes, most firms use an accelerated method for calculating income tax deprecation.

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DEPRECIATION METHODS

KEY POINTS

> The depreciation method selected for financial reporting purposes will have an effect on ROI and ROE. To make valid comparisons between companies, it is necessary to know whether or not comparable depreciation calculation methods have been used.

> If an expenditure has been inappropriately capitalized or expensed, both assets and net income will be affected, in the current year and in future years of the asset's life.

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Present Value Analysis

KEY IDEAS

> Money has value over time.

> An amount to be received or paid in the future has a value today (present value) that is less than future value.

> Why? Because the interest that can be earned between the present and the future.

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Present Value Analysis

KEY RELATIONSHIPS

A time line approach creates a visual image that makes the time value of money concept easy to work with.

What is the present value of $4,000 to be received or paid in four year, at an interest rate of 8%?

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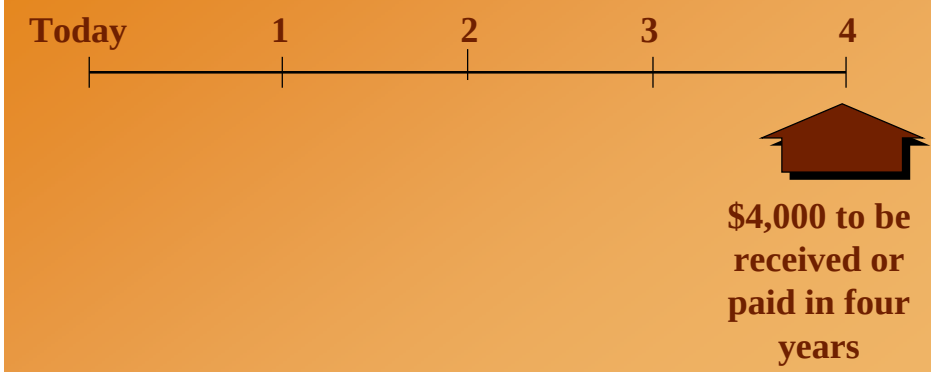
Present Value Analysis



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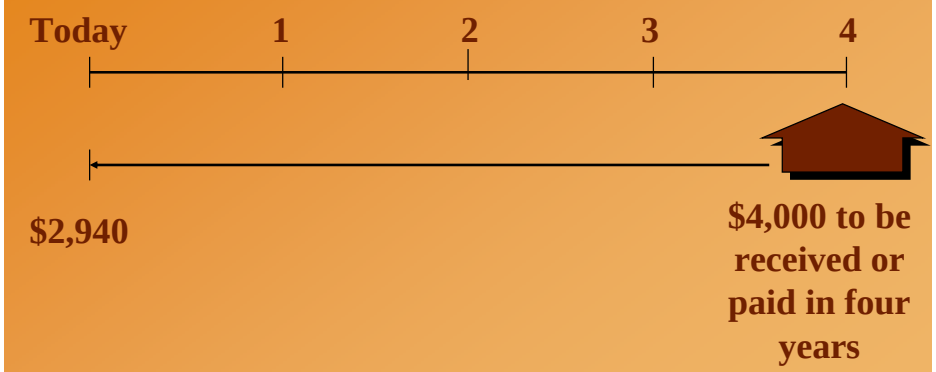
Present Value Analysis



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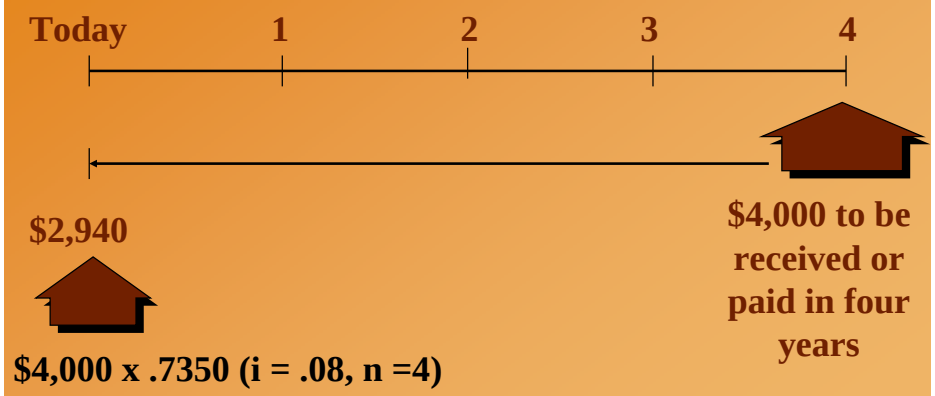
Present Value Analysis



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Assets Acquired by Capital Lease

KEY IDEAS

- A long-term lease is frequently a way of financing the acquisition of a long-lived asset.
- The effect of the accounting for a leased asset should not be different from the accounting for a purchased asset.

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Assets Acquired by Capital Lease

ACCOUNTING FOR A LEASED ASSET

- The "cost" of a leased asset is the present value of the lease obligations.
- Depreciation expense is recorded based on this "cost."
- As annual lease payments are made, interest expense is recognized and the lease obligation is reduced.

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INTANGIBLE ASSETS AND NATURAL RESOURCES

KEY POINT

Although the terminology is different from that used for depreciable assets, the accounting is essentially the same; the expenditure is capitalized, and the expense is recognized periodically over the useful life of the asset to the entity.

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INTANGIBLE ASSETS AND NATURAL RESOURCES

TERMINOLOGY

INTANGIBLE ASSETS:
- Amortization分期償還Expense
  - Usually an accumulated amortization account is not used.

NATURAL RESOURCES:
- Depletion消耗Expense
- Accumulated Depletion

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Chapter 6

The End

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Accounting for and Presentation of Liabilities

7

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ The financial statement presentation of short-term debt, current maturities of long-term debt, and unearned revenues.

❷ The difference between interest calculated on a straight basis and on a discount basis.

❸ The accounting for an employer's liability for payroll and payroll taxes.

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LEARNING OBJECTIVES

After studyin

❶ The finan
term debt
and unearne

❷ The difference between interest calculated on a straigh
and on a discount basis.

❸ The a for an employer's liability for payro
ll taxes.

There are nine objectives, so keep clicking the mouse until you've seen all of them.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❹ The importance of making estimates for certain accrued liabilities, and how these items are presented in the balance sheet.

❺ What leverage is, and how it is provided by long-term debt.

❻ The different characteristics of a bond, which is the formal document representing most long-term debt.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❼ Why bond discount or premium arises, and how it is accounted for.

❽ What deferred income taxes are, and why they arise.

❾ What minority interest is, why it arises, and what it means in the balance sheet.

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CURRENT LIABILITIES

DEFINITION

Current liabilities are those that must be paid within one year of the balance sheet date.

Accounts that comprise current liabilities:

> Short-term debt

> Accounts payable

> Various accrued liabilities

> Current maturities of long-term debt

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CURRENT LIABILITIES

KEY IDEAS

☑ A principal concern about liabilities is that they are not understated. If liabilities are too low, expenses are probably understated also, which means that net income is overstated.

☑ The amount of current liabilities is related to the amount of current assets to measure the firm's ***liquidity***, its ability to pay its bills when they come due.

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INTEREST CALCULATION METHODS

Assume that $1,000 is borrowed for one year at an interest rate of 12%.

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INTEREST CALCULATION METHODS

Assume that $1,000 is borrowed for one year at an interest rate of 12%.

Basic Model for Calculating Interest

Interest = Principal x Rate x Time (in years)

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INTEREST CALCULATION METHODS

STRAIGHT INTEREST

- ✧ Principal used in the interest calculation is equal to the cash received by the borrower.
- ✧ Interest is paid to the lender periodically during the term of the loan, or at the maturity date.

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INTEREST CALCULATION METHODS

STRAIGHT INTEREST

Interest = Principal x Rate x Time (in years)

Interest = $1,000 x 0.12 x 1

Interest = $120

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INTEREST CALCULATION METHODS

DISCOUNT

- ♦ Principal used in the interest calculation is the "amount borrowed," but then interest is subtracted from that principal to get the amount of cash made available to the borrower. This results in an effective interest rate (APR) greater than the rate used in the interest calculation.
- ♦ Because interest was paid in advance, only the principal amount is repaid at the loan maturity date.

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INTEREST CALCULATION METHODS

Assume that $1,000 is borrowed for one year at an interest rate of 12%.

Loan	$1,000
Less discount	120
Proceeds	$ 880

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INTEREST CALCULATION METHODS

Assume that $1,000 is borrowed for one year at an interest rate of 12%.

$$\text{APR} = \frac{\text{Interest paid}}{\text{Money available for use x Time (in years)}}$$

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INTEREST CALCULATION METHODS

Assume that $1,000 is borrowed for one year at an interest rate of 12%.

$$\text{APR} = \frac{\$120}{\$880 \text{ x } 1}$$

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INTEREST CALCULATION METHODS

Assume that $1,000 is borrowed for one year at an interest rate of 12%.

APR = 13.6%

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INTEREST CALCULATION METHODS

Assume that $1,000 is borrowed for one year at an interest rate of 12%.

APR = 13.6%

Only the principal amount ($1,000) is repaid at the loan maturity date.

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LONG-TERM DEBT

KEY IDEA

Firms issue long-term debt (bonds payable) to get some of the funds needed to invest in assets. The owners do not usually provide all of the necessary funds because it is usually desirable to have some financial leverage.

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LONG-TERM DEBT

KEY IDEA

Firms issue long-term debt (bonds payable) to get some of the funds needed to invest in assets. The owners do not usually provide all of the necessary funds because it is usually desirable to have some financial leverage.

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FINANCIAL LEVERAGE

- When money is borrowed at a fixed interest rate, the difference between ROI earned on that money and the interest rate paid affects the wealth of the borrower. This is called *financial leverage*.
- Financial leverage is positive when the ROI earned on borrowed money is greater than the interest rate paid on the borrowed money. Financial leverage is negative when the opposite occurs.

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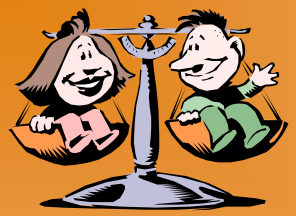

FINANCIAL LEVERAGE 槓桿

- Financial leverage increases the risk that a firm's ROI will fluctuate, because ROI changes as business conditions and the firm's operating results change, but the interest rate on borrowed funds is usually fixed.

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LONG-TERM DEBT

BOND CHARACTERISTICS

- A fixed interest rate (usually) is called the stated rate or coupon rate.
- Interest usually is payable quarterly or semi-annually.
- Individual bonds usually have a face amount (principal) of $1,000.
- Bond prices are stated as a percent of the face amount.
- Most bonds have a stated maturity date, but most bonds are also callable; they can be redeemed prior to maturity at the option of the issuer.
- Frequently some collateral is provided by the issuer.

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BOND MARKET VALUE

KEY POINT

- The market value of a bond is a function of the relationship between market interest rates and the bond's stated or coupon rate of interest.
- As market interest rates fall, the market value of a bond rises.
- As market interest rates rise, the market value of a bond falls.

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BOND MARKET VALUE

Cruisers, Inc. issues a 10%, $1,000 bond when market interest rates are 12%. The bond will mature in eight years. Interest is paid semiannually.

Interest: 10%/2 x $1,000 = $50	
$50 x 10.1059 (6%, 16 periods) =	$505.30
Principal:	
$1,000 x 0.936 (6%, 16 periods) =	393.60
PROCEEDS	**$898.90**

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BOND PREMIUM AND DISCOUNT

KEY IDEA

- When the market interest rate at the date a bond is issued is different from the stated or coupon rate of the bond, the bond will be issued at--
  - -a ***premium*** (market interest rate < stated or coupon rate)
  - -a ***discount*** (market interest rate > stated or coupon rate).

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BOND PREMIUM AND DISCOUNT

- When a bond is issued at a premium, the premium is amortized to *Interest Expense* over the term of the bond, resulting in lower annual interest expense than the interest paid on the bond.
- When a bond is issued at a discount, the discount is amortized to *Interest Expense* over the term of the bond resulting in higher annual interest expense than the interest paid on the bond.
- The amortization of premium or discount results in reporting an actual interest expense from the bonds is a function of the market interest rate when the bonds were issued.

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DEFERRED INCOME TAXES

WHAT'S GOING ON?

Differences between book and taxable income arise because financial accounting methods differ from accounting methods permitted for income tax purposes.

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DEFERRED INCOME TAXES

WHAT'S GOING ON?

Differences between book and taxable income arise because financial accounting methods differ from accounting methods permitted for income tax purposes.

EXAMPLE: Book depreciation is usually calculated on a straight-line basis, and tax depreciation is usually based on an accelerated method.

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DEFERRED INCOME TAXES

KEY ISSUE

When taxable income is different from book income, income tax expense should be a function of book income before taxes, not taxable income. This is an application of the matching concept.

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DEFERRED INCOME TAXES

KEY IDEA

Income tax expense based on book income is usually more than the income taxes currently payable. The difference is shown a liability called *Deferred Federal Income Taxes*. This liability will become current when taxable income exceeds book income.

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Chapter 7

The End

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Accounting for and Presentation of Owners' Equity

8

DAVID H. MARSHALL / WAYNE W. MCMANUS

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ The characteristics of common stock, and how common stock is presented in the balance sheet.

❷ What preferred stock is, what its advantage and disadvantage to the corporation are, and how it is presented in the balance sheet.

❸ The accounting for a cash dividend, and the dates involved in dividend transactions.

❹ What stock dividends and stock splits are, and why each is used.

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LEARNING OBJECTIVES

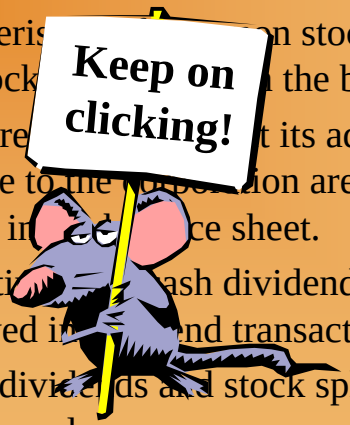
After studying this chapter you should understand:

❶ The characteris[illegible]n stock, and how common stock [illegible] the balance sheet.

❷ What preferre[illegible]t its advantage and disadvantage to the [illegible]ion are, and how it is presented in [illegible]ce sheet.

❸ The accounti[illegible]ash dividend, and the dates involved i[illegible]nd transactions.

❹ What stock divi[illegible]ds and stock splits are, and why each is used.



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LEARNING OBJECTIVES

After studying this chapter you should understand:

❺ What treasury stock is, why it is acquired, and how treasury stock transactions affect owners' equity.

❻ What the cumulative foreign currency transaction adjustment is, and why it appears in owners' equity.

❼ How owners' equity transactions for the year are reported in the financial statements.

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	August 31 1999	August 31 1998
Owners' equity:		
Paid-in capital:		
Preferred stock, 6%, $100 par value, cumulative, callable at $102, 5,000 shares authorized, issued, and outstanding	$ 500,000	$ 500,000
Common stock, $2 par value, 1,000,000 shares authorized, 244,800 shares issued at August 31, 1999, and 200,000 at August 31, 1998	489,600	400,000
Additional paid-in capital	3,322,400	2,820,000
Total paid-in capital	$4,312,000	$3,720,000
Retained earnings	2,828,000	2,600,000
Less: Common stock in treasury, at cost; 1,000 shares at August 31, 1999	(12,000)	--
Total owners' equity	$7,128,000	$6,320,000

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Owner's Equity: Paid -in Capital

ACCOUNTS INCLUDED IN PAID-IN CAPITAL

- *Common Stock* (sometimes called *Capital Stock*)
- *Preferred Stock* (if authorized by the corporation's charter)
- *Additional Paid-In Capital*

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Owner's Equity: Paid -in Capital

KEY TERMINOLOGY FOR STOCK VALUE

Par Value--An arbitrary獨斷amount assigned to each share at incorporation.

Stated Value--No-par stock that has been assigned an assigned amount.

No-Par Value--True no-par stock without an assigned stated value.

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During the year ended August 31, 1999, Racer, Inc. sold 40,000 additional shares of its $2 par value common stock at a price of $13 per share.

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Dr. Cash (40,000 shares x $13)	**520,000**	
Cr. Common Stock (40,000 x $2)		**80,000**
Cr. Additional Paid-In Capital (40,000 x $11)		**440,000**

During the year ended August 31, 1999, Racer, Inc. sold 40,000 additional shares of its $2 par value common stock at a price of $13 per share.

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Dr. Cash (40,000 shares x $13)	**520,000**	
Cr. Common Stock (40,000 x $2)		**80,000**
Cr. Additional Paid-In Capital (40,000 x $11)		**440,000**

Balance Sheet	Income Statement
Assets = Liabilities + Owner' equity	**Net income = Revenues - Expenses**

Cash
+ $20,000

Common Stock
+ $80,000

Additional Paid-In Capital
+ $440,000

During the year ended August 31, 1999, Racer, Inc. sold 40,000 additional shares of its $2 par value common stock at a price of $13 per share.

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Owner's Equity: Paid -in Capital

KEY TERMINOLOGY FOR NUMBER OF SHARES OF STOCK

Authorized--By the corporation's charter

Issued--Sold in the past to stockholders

Outstanding--Still held by stockholders

Treasury stock--Shares of its own stock purchased and held by the corporation

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Common Stock and Preferred Stock

KEY IDEAS

> **Common stock represents the basic ownership of a corporation.**

> **Preferred stock represents ownership, but has some preferences relative to common stock. These include--**
  > priority claim to dividends, and
  > priority claim to assets in liquidation.

However, preferred stockholders are not usually entitled to vote for directors.

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Common Stock and Preferred Stock

KEY POINTS ABOUT DIVIDENDS ON PREFERRED STOCK

- Dividends are usually "cumulative," which means that dividends not paid during one year (in arrears) must be paid in future years before dividends can be paid on common stock.
- Dividend amount is expressed as a certain amount per share ($3.50), or a percent of par value (7% of par value of $50).

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Preferred Stock Dividend Calculations

Case 1

6%, $100 par value cumulative preferred stock, 50,000 shares authorized, issued, and outstanding. Dividends payable semiannually, no dividends in arrears. Determine the semiannual preferred dividend amount.

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Preferred Stock Dividend Calculations

Case 1

6%, $100 par value cumulative preferred stock, 50,000 shares authorized, issued, and outstanding. Dividends payable semiannually, no dividends in arrears. Determine the semiannual preferred dividend amount.

6% x $100 x 50,000 shares outstanding x 1/2 year

= $150,000

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Preferred Stock Dividend Calculations

Case 2

$4.50, $75 par value cumulative preferred stock, 50,000 shares authorized and issued, 40,000 shares outstanding (there are 10,000 shares of treasury stock). Dividends payable quarterly, no dividends in arrears. Calculate the quarterly preferred dividend amount.

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Preferred Stock Dividend Calculations

Case 2

$4.50, $75 par value cumulative preferred stock, 50,000 shares authorized and issued, 40,000 shares outstanding (there are 10,000 shares of treasury stock). Dividends payable quarterly, no dividends in arrears. Calculate the quarterly preferred dividend amount.

$4.50 x 40,000 shares outstanding x 1/4 year =

$45,000

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Preferred Stock Dividend Calculations

Case 3

$4, $50 par value cumulative preferred stock, 100,000 shares authorized, 60,000 shares issued, 54,000 shares outstanding (there are 6,000 shares of treasury stock). Dividends payable annually . Dividends were not paid in prior two years. Calculate dividends required in current year to pay dividends in arrears and current year's preferred dividend.

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Preferred Stock Dividend Calculations

Case 3

$4, $50 par value cumulative preferred stock, 100,000 shares authorized, 60,000 shares issued, 54,000 shares outstanding (there are 6,000 shares of treasury stock). Dividends payable annually . Dividends were not paid in prior two years. Calculate dividends required in current year to pay dividends in arrears and current year's preferred dividend.

$4 x 54,000 shares outstanding x 3 years = $648,000

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Preferred Stock Dividend Calculations

Case 4

$2, $25 par value cumulative participating preferred stock, 30,000 shares authorized, 25,000 shares issued and outstanding. Dividends payable annually. Dividends are two years in arrears. The company has 100,000 shares of common stock outstanding (common stockholders receive a base dividend of $2 per share), and dividends for the year total $410,000.

	Preferred	*Common*	*Balance*
Total amount declared			$410,000
Preferred dividends in arrears	$100,000		310,000
Current year's preferred dividend	50,000		260,000
Common stock base dividend		$200,000	60,000
Allocated balance (1:4)	12,000	48,000	0
Total dividends paid	**$162,000**	**$248,000**	

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Paid-In Capital Amounts on the Balance Sheet

WHAT'S GOING ON?

- If the stock has a par value, the amounts opposite the stock captions are always par value multiplied by the number of shares issued.
- The difference between the par value and the amount received per share when the stock was issued is recorded as additional paid-in capital.
- If the stock is no-par value stock (without a stated value) the amount opposite the caption is the total amount received when the stock was issued.

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Retained Earnings and Dividends

KEY IDEAS

- *Retained Earnings* increases each period by the amount of net income for that period. (Net losses decrease *Retained Earnings.*)
- Dividends are distributions of *Retained Earnings* to the stockholders, and are a reduction in *Retained Earnings.*
- Cash dividends are declared by the board of directors as an amount per share.

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Retained Earnings and Dividends

KEY IDEAS

- *Retained Earni* by the amount of net i et losses decrease *Retain*
- Dividends are distributions of *Retained Earnings* to the stockholders, and are a reduction in *Retained Earnings.*
- Cash dividends are declared by the board of directors as an amount per share.

There are more key ideas, so click again!

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Retained Earnings and Dividends

KEY IDEAS

- Stock dividends are declared by the board of directors as a percentage of currently issued shares. Stock dividends affect only *Retained Earnings* and *Paid-In Capital*; assets and liabilities are not affected.
- Cash dividends <u>are not</u> paid on treasury stock. Stock dividends <u>are</u> usually issued on treasury stock.

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Cash Dividends

The board of directors declared a dividend.

Dr. Retained Earnings	xx	
Cr. Dividends Payable		xx

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Cash Dividends

The board of directors declared a dividend.

Dr. Retained Earnings	xx	
Cr. Dividends Payable		xx

On the payment of the dividend.

Dr. Dividends Payable	xx	
Cr. Cash		xx

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Cash Dividends

Balance Sheet	Income Statement
Assets = Liabilities + Owner' equity	**Net income = Revenues - Expenses**

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Cash Dividends

Balance Sheet	Income Statement
Assets = Liabilities + Owner' equity	**Net income = Revenues - Expenses**

Declaration Date

+ Dividends Payable - Retained Earnings

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Cash Dividends

Balance Sheet	Income Statement
Assets = Liabilities + Owner' equity	**Net income = Revenues - Expenses**

Declaration Date

+ Dividends Payable - Retained Earnings

Payment Date

- Cash - Dividends Payable

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Stock Splits

KEY IDEA

- A stock split involved issuing additional shares of stock in proportion to the number of shares currently owned by each stockholder. The relative ownership interest of each stockholder does not change.
- Because there are more shares of stock outstanding, the market price of each share will fall to reflect the split.

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Stock Dividends

Racer, Inc. issued a 2% stock dividend on its $2 par value common stock when the market price was $15 per share. There were 240,000 shares outstanding at the time of the stock dividend.

Dr. Retained Earnings	72,000	
Cr. Common Stock		9,600
Cr. Additional Paid-In Capital		62,400

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Stock Dividends

Racer, Inc. issued a 2% stock dividend on its $2 par value common stock when the market price was $15 per share. There were 240,000 shares outstanding at the time of the stock dividend.

Balance Sheet	Income Statement
Assets = Liabilities + Owner' equity	**Net income = Revenues - Expenses**
Retained Earnings - 72,000	
Common Stock + 9,600	
Additional Paid-In Capital + 62,400	

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Stock Dividends

Note that the stock dividend affects *only* the owners' equity of the firm.

Balance Sheet			Income Statement
Assets	**= Liabilities +**	**Owner' equity**	**Net income = Revenues - Expenses**
		Retained Earnings - 72,000	
		Common Stock + 9,600	
		Additional Paid-In Capital + 62,400	

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Treasury Stock

Racer, Inc. purchased 1,000 shares of its own common stock at a total cost of $12,000 during the year ended August 31, 1999.

Dr. Treasury Stock	12,000	
Cr. Cash		12,000

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Treasury Stock

Racer, Inc. purchased 1,000 shares of its own common stock at a total cost of $12,000 during the year ended August 31, 1999.

Balance Sheet			Income Statement
Assets	**= Liabilities +**	**Owner' equity**	**Net income = Revenues - Expenses**
Cash - 12,000		*Treasury Stock* - 12,000	

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Treasury Stock

Five hundred shares of this treasury stock were sold at a price of $15 per share in fiscal 2000.

Dr. Cash	7,500	
Cr. Treasury Stock		6,000
Cr. Additional Paid-In Capital		1,500

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Treasury Stock

Five hundred shares of this treasury stock were sold at a price of $15 per share in fiscal 2000.

Balance Sheet		Income Statement
Assets = Liabilities + Owner' equity		**Net income = Revenues - Expenses**
Cash	*Treasury Stock*	
+ 7,500	+ 6,000	
	Additional Paid-In Capital	
	+ 1,500	

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Statement of Changes in Retained Earnings

RACER, INC.
Statement of Changes in Retained Earnings
For the Year Ended August 31, 1999

Retained earnings balance, beginning of year		$2,600,000
Add:	Net income	390,000
Less:	Cash dividends	(30,000)
	Preferred stock	(60,000)
	2% stock dividend on common stock	(72,000)
Retained earnings balance, end of year		$2,828,000

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Chapter 8

The End

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The Income Statement and the Statement of Cash Flows

9

DAVID H. MARSHALL / WAYNE W. MCMANUS

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LEARNING OBJECTIVES

After studying this chapter you should understand:

1. What revenue is, and what the two criteria are that permits revenue recognition.
2. How cost of goods sold is determined under both perpetual and periodic inventory accounting systems.
3. The significance of gross profit (or gross margin), and how the gross profit (or gross margin) ratio is calculated and used.
4. The principal categories and components of "other operating expenses," and how these items are reported on the income statement.

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LEARNING

Click again! There are two more learning objectives slides!

After studying this chapte

1. What revenue is, and wh that permits rev ognition.
2. How cost of is determined under both perpetual and nventory accounting systems.
3. The sign rofit (or gross margin), and h r gross margin) ratio is cal d.
4. The principal cate ories and components of "other operating expenses," and how these items are reported on the income statement.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

5. What "income from operations" includes, and why this income statement subtotal is significant to managers and financial analysts.
6. The components of the earnings per share calculation, and the reason for some of the refinements made in that calculation.
7. The alternative income statement presentation models.
8. The unusual items that may appear on the income statement.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

9. The purpose and general format of the statement of cash flows.

10. The difference between the direct and indirect methods of presenting cash flows from operating activities.

11. Why the statement of cash flows is significant to financial analysts and investors who rely on the financial statements for much of their evaluative data.

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Cost of Goods Sold Section

	Cost of beginning inventory	$ 2,004
+	Net purchases	8,453
=	Cost of goods available for sale	$10,457
-	Cost of ending inventory	1,293
=	Cost of goods sold	$ 9,164

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Income Statement

KEY OBSERVATIONS ABOUT THE MULTIPLE-STEP MODEL

- There is a great deal of summarization.
- Captions reflect the revenue and expense categories that are most significant to understanding results of operations.
- Income from operations is sometimes more meaningful for trend comparisons than net income.

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Gross Profit Ratio

INTEL CORPORATION
Gross Profit Ratio--1996
(dollars in millions)

Net sales (or net revenues)	**$20,847**
Cost of goods sold (or cost of sales)	**9,164**
Gross profit (or gross margin)	**$11,683**

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Gross Profit Ratio

INTEL CORPORATION
Gross Profit Ratio--1996
(dollars in millions)

Net sales (or net revenues)	$20,847
Cost of goods sold (or cost of sales)	9,164
Gross profit (or gross margin)	$11,683

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Gross Profit Ratio

INTEL CORPORATION
Gross Profit Ratio--1996
(dollars in millions)

Net sales (or net revenues)	$20,847
Cost of goods sold (or cost of sales)	9,164
Gross profit (or gross margin)	$11,683

$$\frac{\$11{,}683}{\$20{,}847} = 56\%$$

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Linkage Between Balance Sheet and Income Statement Accounts

BALANCE SHEET	INCOME STATEMENT
Accounts Receivable-------->	Sales/Revenues
Notes Receivable and Short-Term Investments------->	Interest Income
Inventories---------->	Cost of Goods Sold
Prepaid Expenses and------->	Operating Expenses Accrued Liabilities

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Linkage Between Balance Sheet and Income Statement Accounts

BALANCE SHEET	INCOME STATEMENT
Accumulated Depreciation---------->	Depreciation Expense
Notes Payable and Bonds Payable---------->	Interest Expense
Income Taxes Payable and Deferred Tax Liability------>	Income Tax Expense

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Estimating Ending Inventory (Gross Profit Method)

Net sales		$100,000	100%
Cost of goods sold:			
Beginning inventory	$19,000		
Net purchases	63,000		
Cost of goods available for sale	$82,000		
Less: Ending inventory	?		
Cost of goods sold		?	
Gross profit		?	30%

All the known facts!

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Estimating Ending Inventory (Gross Profit Method)

Net sales		$100,000	100%
Cost of goods sold:			
Beginning inventory	$19,000		
Net purchases	63,000		
Cost of goods available for sale	$82,000		
Less: Ending inventory	?		
Cost of goods sold		?	
Gross profit		$ 30,000	30%

All the known facts!

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Estimating Ending Inventory (Gross Profit Method)

Net sales		$100,000	100%
Cost of goods sold:			
Beginning inventory	$19,000		
Net purchases	63,000		
Cost of goods available for sale	$82,000		
Less: Ending inventory	?		
Cost of goods sold		70,000	70%
Gross profit		$ 30,000	30%

All the known facts!

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Estimating Ending Inventory (Gross Profit Method)

Net sales		$100,000	100%
Cost of goods sold:			
Beginning inventory	$19,000		
Net purchases	63,000		
Cost of goods available for sale	$82,000		
Less: Ending inventory	12,000		
Cost of goods sold		70,000	70%
Gross profit		$ 30,000	30%

All the known facts!

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Estimating Ending Inventory (Gross Profit Method)

Net sales		$100,000	100%
Cost of goods sold:			
Beginning inventory	$19,000		
Net purchases	63,000		
Cost of goods available for sale	$82,000		
Less: Ending inventory	12,000		
Cost of goods sold			
Gross profit		$ 30,000	30%

Estimated Ending Inventory

All the known facts!

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Weighted-Average Shares

Periods	Number of Months	Number of Shares Outstanding	Months x Shares
9/1-1/3	4	200,000	800,000
1/3-6/25	6	240,000	1,440,000
6/25-8/31	2	225,000	450,000

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Weighted-Average Shares

Periods	Number of Months	Number of Shares Outstanding	Months x Shares
9/1-1/3	4	200,000	800,000
1/3-6/25	6	240,000	1,440,000
6/25-8/31	2	225,000	450,000
Totals	12		2,690,000

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Weighted-Average Shares

Periods	Number of Months	Number of Shares Outstanding	Months x Shares
9/1-1/3	4	200,000	800,000
1/3-6/25	6	240,000	1,440,000
6/25-8/31	2	225,000	450,000
Totals	12		2,690,000

2,690,000/12 = 224.167

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Earnings Per Share

$$\frac{\text{Net income available for common stock}}{\text{Weighted-average number of shares of common stock outstanding}}$$

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Earnings Per Share

$$\frac{\text{Net income available for common stock}}{\text{Weighted-average number of shares of common stock outstanding}}$$

$$\text{EPS} = \frac{\$1{,}247{,}000}{224{,}167} = \$5.56$$

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Single-Step Income Statement

CRUISERS, INC., AND SUBSIDIARIES
Consolidated Income Statement
For the Year Ended August 31, 1999, and 1998
(000 omitted)

	1999	*1998*
Net sales	$77,543	$62,531
Cost of goods sold	48,077	39,870
Selling expenses	13,957	10,590
General and administrative expenses	9,307	7,835
Interest expense	3,378	2,679
Other income (net)	385	193
Minority interest	432	356
Income before taxes	$ 2,777	$ 1,394
Provision for income taxes	1,250	630
Net income	$ 1,527	$ 764

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Multiple-Step Income Statement

CRUISERS, INC., AND SUBSIDIARIES
Consolidated Income Statement
For the Year Ended August 31, 1999, and 1998
(000 omitted)

	1999	*1998*
Net sales	$77,543	$62,531
Cost of goods sold	48,077	39,870
Gross profit	$29,466	$22,661
Selling, general, and administrative expenses	23,264	18,425
Income from operations	$ 6,202	$ 4,236
Other income (expense):		
Interest expense	(3,378)	(2,679)
Other income (net)	385	193
Minority interest	(432)	(356)
Income before taxes	$ 2,777	$ 1,394
Provision for income taxes	1,250	630
Net income	$ 1,527	$ 764

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Income Statement Presentation of Unusual Items

	1999	1998
Income from continuing operations before taxes	$2,777	$1,394
Provision for income taxes	1,250	630
Income from continuing operations	$1,527	$764
Discontinued operations, net of income taxes:		
Loss from operations	(162)	----
Loss on disposal	(79)	----
Loss from discontinued operations	$ (241)	----
Earnings before extraordinary items	$1,286	$ 764
Extraordinary item:		
Gain on termination of pension plan, net of income taxes	357	----
Net income	$1,643	$ 764

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Statement of Cash Flows

WHAT'S GOING ON?

- ☑ The income statement reports accrual basis net income. Financial statement users also want to know about the firm's cash flows.
- ☑ The reasons for the change in cash from the beginning of the period are summarized in three categories.
  - > Cash flows from **operating** activities
  - > Cash flows from **investing** activities
  - > Cash flows from **financing** activities

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Statement of Cash Flows

KEY QUESTIONS

- What happened to the cash balance during the year?
- What is the relationship between cash flows from operating, investing, and financing activities?

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Interpreting the Statement of Cash Flows

KEY RELATIONSHIPS TO OBSERVE

- ✓ Did cash flows from operating activities exceed cash used for investing activities?
- ✓ Did financing activities cause net increase or net decrease in cash?
- ✓ In operating activities, what were the effects of accounts receivable, inventory, and accounts payable changes?
- ✓ In investing activities, what was the relationship between the investment in new assets and the sale of old assets?
- ✓ In financing activities, what were the net effects of long-term debt and capital stock changes? What was the effect of cash dividends paid?

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Statement of Cash Flows
(Direct Method)

CRUISERS, INC., AND SUBSIDIARIES
Consolidated Statement of Cash Flows
For the Year Ended August 31, 1999, and 1998
(000 omitted)

	1999	*1998*
Cash flows from operating activities:		
Cash received from customers	$14,929	$13,021
Cash paid to suppliers	(6,784)	(8,218)
Payments for compensation of employees	(2,137)	(1,267)
Other operating expenses paid	(1,873)	(1,002)
Interest paid	(675)	(703)
Taxes paid	(1,037)	(532)
Net cash provided by operating activities	$ 2,423	$ 1,299

Top Part

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Statement of Cash Flows
(Direct Method)

	1999	*1998*
Cash flows from investing activities:		
Proceeds from sale of land	$ ----	$ 200
Investment in plant and equipment	(1,622)	(1,437)
Net cash used for investing activities	$(1,622)	$(1,237)
Cash flows from financing activities:		
Additional long-term borrowing	$ 350	$ 180
Payment of long-term debt	(268)	(53)
Purchase of treasury stock	(37)	(26)
Payment of dividends on capital stock	(363)	(310)
Net cash used for financing activities	$ (318)	$ (209)
Increase (Decrease) in cash	$ 483	$ (147)
Cash balance, August 31, 1998, and 1997	276	423
Cash balance, August 31, 1999, and 1998	$ 759	$ 276

Bottom Part

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Statement of Cash Flows
(Direct Method)

	1999	*1998*
Reconciliation of net income and net cash provided by operating activities:		
Net income	$ 1,390	$ 666
Add (Deduct) items not affecting cash:		
Depreciation expense	631	526
Minority interest	432	356
Gain on sale of land	---	(110)
Increase in accounts receivable	(30)	(44)
Increase in inventories	(21)	(168)
Increase in current liabilities	16	66
Other (net)	5	7
Net cash provided by operating activities	$ 2,423	$ 1,299

Reconciliation

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Statement of Cash Flows
(Indirect Method)

Top Part

CRUISERS, INC., AND SUBSIDIARIES
Consolidated Statement of Cash Flows
For the Year Ended August 31, 1999, and 1998
(000 omitted)

	1999	*1998*
Cash flows from operating activities:		
Net income	$1,390	$ 777
Add (Deduct) items not affecting cash:		
Depreciation expense	631	526
Minority interest	432	356
Gain on sale of land	---	(110)
Increase in accounts receivable	(30)	(44)
Increase in inventories	(21)	(168)
Increase in current liabilities	16	66
Other (net)	5	7
Net cash provided by operating activities	$2,423	$1,299

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Statement of Cash Flows
(Indirect Method)

	1999	1998
Cash flows from investing activities:		
Proceeds from sale of land	$ ----	$ 200
Investment in plant and equipment	(1,622)	(1,437)
Net cash used for investing activities	$(1,622)	$(1,237)
Cash flows from financing activities:		
Additional long-term borrowing	$ 350	$ 180
Payment of long-term debt	(268)	(53)
Purchase of treasury stock	(37)	(26)
Payment of dividends on capital stock	(363)	(310)
Net cash used for financing activities	$ (318)	$ (209)
Increase (Decrease) in cash	$ 483	$ (147)
Cash balance, August 31, 1998, and 1997	276	423
Cash balance, August 31, 1999, and 1998	$ 759	$ 276

Bottom Part

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Explanatory Notes and Other Financial Information

10

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ That the explanatory notes are an integral part of the financial statements; the notes provide detailed disclosure of information needed by users wishing to gain a full understanding of the financial statements.

❷ The kinds of significant accounting policies that are explained in the notes.

❸ The nature and content of disclosures relating to
- Accounting changes
- Business combinations
- Contingencies and commitments

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LEARNING OBJECTIVES

There' more learning objectives; including the rest of Objective 3.

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explained in the notes.

❸ The nature and content of d res relating to
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- Business combination
- Contingencies and commitments

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❸ Learning Objective 3 (continued)
- Contingencies and commitments
- Events subsequent to the balance sheet date
- Impact of inflation
- Segment information

❹ The role of the Securities and Exchange Commission, and some of its reporting requirements.

❺ Why a statement of management's responsibility is included with the notes.

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Financial Statement Sequence

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Explanatory Notes to Financial Statements

KEY POINTS

Financial statement readers must be able to learn about the following key issues that affect their ability to understand the statements.

- ✦ Depreciation methods
- ✦ Inventory cost flow assumptions
- ✦ Current and deferred income taxes
- ✦ Employee benefit information
- ✦ Earnings per share of common stock details (Stock option and stock purchase plan information)

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Explanatory Notes to Financial Statements

OTHER KEY DISCLOSURES

- Management's statement of responsibility
- Management's discussion and analysis

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Explanatory Notes to Financial Statements

OTHER KEY DISCLOSURES

- Management's statement of responsibility
- Management's discussion and analysis

KEY IDEA

- The explanatory notes to the financial statements must be reviewed to have a reasonably complete understanding of what the numbers mean.

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Significant Accounting Policies

Depreciation method???

- *straight-line*
- *units-of-production*
- *sum-of-the-years'-digits*
- *declining-balance*

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Significant Accounting Policies

Depreciation method???

- *straight-line*
- *units-of-production*
- *sum-of-the-years'-digits*
- *declining-balance*

Inventory valuation method???

- *weighted average*
- *FIFO*
- *LIFO*

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Significant Accounting Policies

Other Policies

- Basis of consolidation
- Income taxes
- Employee benefits
- Amortization of intangibles
- Earnings per share of common stock
- Stock option and stock purchase plan

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Other Disclosures

An **accounting change** is a change in an accounting principle that has a material effect on the comparability of financial statements.

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Other Disclosures

An **accounting change** is a change in an accounting principle that has a material effect on the comparability of financial statements.

The effects of a **business combination** describing the effects on the financial statements.

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Other Disclosures

An **accounting change** is a change in an accounting principle that has a

It is appropriate to disclose any material **contingencies and commitments** in which the firm is involved.

The effects of a **business combination** describing the effects on the financial statements.

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Other Disclosures

An **accounting change** is a change in an

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If, subsequent to the balance sheet date, a material **subsequent event** occurs that impacts the financial statement, it should be reported.

The effects of a **business combination** describing the effects on the financial statements.

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Other Disclosures

An **accounting change** is a change in an

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The effects of a

Certain **inflation-adjusted data** should be disclosed in the explanatory notes to the financial statements.

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Other Disclosures

An **accounting change** is a change in an

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If, subsequent t
the balance she
date, a materia
subsequent eve
occurs that impa
the financial
statement, it shoul
be reported.

Certain **inflation-adjusted data** should be disclosed in the

The effects of a

Firms that operate in several lines of businesses should report **segment information.**

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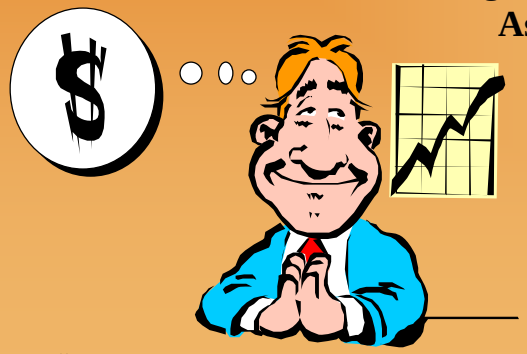
Return on investment (ROI)

$$\frac{\text{Operating Income}}{\text{Net Revenue}} \times \frac{\text{Net Revenue}}{\text{Average Identifiable Assets}}$$



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Five-Year (or Longer) Summary of Financial Data

KEY IDEAS

- ✧ Look at trend of data.
- ✧ Notice the effect of stock dividends and stock splits on per share data.
- ✧ Use the data reported for prior years to make ratio calculations for evaluative purposes.

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Independent Auditors' Report

KEY IDEA

Financial statements present fairly, in all material respects, the financial position and results of operations.

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Independent Auditors' Report

KEY IDEA

Financial statements present fairly, in all material respects, the financial position and results of operations.

KEY POINT

Auditors give no guarantee that financial statements are free for error or fraud.

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Financial Statement Analysis

11

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❶ How liquidity measures can be influenced by the inventory cost-flow assumption.

❷ How suppliers and creditors use a customer's payment practices to judge liquidity.

❸ The influence of alternative inventory cost-flow assumptions and depreciation methods on turnover ratios.

❹ How the number of day' sales in accounts receivable and inventory are used to evaluate the effectiveness of the management of receivables and inventory.

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LEARNING OBJECTIVES

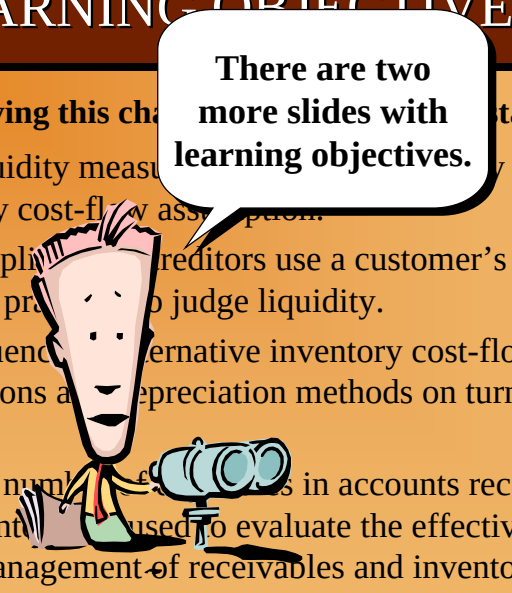
After studying this cha stand:

❶ How liquidity meas y the inventory cost-fl w ass pt

❷ How suppli reditors use a customer's payment pr o judge liquidity.

❸ The influenc ernative inventory cost-flow assumptions a epreciation methods on turnover ratios.

❹ How the nu s in accounts receivable and invent used to evaluate the effectiveness of the management of receivables and inventory.



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LEARNING OBJECTIVES

After studying this chapter you should understand:

❺ The significance of the price/earnings ratio in the evaluation of the market price of a company's common stock.

❻ How dividend yield and the dividend payout ratio are used by investors to evaluate a company's common stock.

❼ What financial leverage is, and why it is significant to management, creditors, and owners.

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LEARNING OBJECTIVES

After studying this chapter you should understand:

❽ What book value per share of common stock is, how it is calculated, and why it is not a very meaningful amount for most companies.

❾ How common-size financial statements can be used to evaluate a firm's financial position and results of operations over a number of years.

❿ How operating statistics using physical, or nonfinancial, data can be used to help management evaluate the results of the firm's activities.

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LIQUIDITY ANALYSIS

KEY QUESTION

> Is the firm likely to be able to pay its obligations when they come due?

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LIQUIDITY ANALYSIS

KEY QUESTION

> Is the firm likely to be able to pay its obligations when they come due?

LIQUIDITY MEASURES

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LIQUIDITY ANALYSIS

KEY QUESTION

> Is the firm likely to be able to pay its obligations when they come due?

LIQUIDITY MEASURES

> Working capital
> Current ratio
> Acid-test ratio

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LIQUIDITY ANALYSIS

KEY ISSUE

> The inventory cost flow assumption used by the firm (FIFO, LIFO, weighted average, or specific identification) will affect these measures.

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Activity Measures

KEY QUESTIONS

- How efficiently are the firm's assets being used?

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Activity Measures

KEY QUESTIONS

- How efficiently are the firm's assets being used?

ACTIVITY MEASURES

- ☑ Accounts receivable turnover (or number of day's sales in accounts receivable)
- ☑ Inventory turnover (or number of day's sales in inventory)
- ☑ Plant and equipment turnover
- ☑ Total asset turnover

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Activity Measures

GENERAL MODEL

$$\text{Turnover} = \frac{\text{Sales for Period}}{\text{Average Asset Balance for Period}}$$

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Activity Measures

GENERAL MODEL

$$\text{Turnover} = \frac{\text{Sales for Period}}{\text{Average Asset Balance for Period}}$$

KEY IDEAS

- Inventory activity calculations use cost of goods sold instead of sales.
- Number of day's sales calculations use the ending balance of the asset account divided by average daily sales or average daily cost of goods sold.

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Intel Corporation's Asset Turnover Calculations Illustrated

Accounts Receivable Turnover ($ millions)

Sales (net revenue) for 1996 ($ millions)	$20,847
Accounts receivable (net), 12/28/96	3,723
Accounts receivable (net), 12/30/95	3,116

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Intel Corporation's Asset Turnover Calculations Illustrated

Accounts Receivable Turnover ($ millions)

Sales (net revenue) for 1996 ($ millions)	$20,847
Accounts receivable (net), 12/28/96	3,723
Accounts receivable (net), 12/30/95	3,116

$$\text{Accounts receivable turnover} = \frac{\text{Sales}}{\text{Average accounts receivable}}$$

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Intel Corporation's Asset Turnover Calculations Illustrated

Accounts Receivable Turnover ($ millions)

Sales (net revenue) for 1996 ($ millions)	$20,847
Accounts receivable (net), 12/28/96	3,723
Accounts receivable (net), 12/30/95	3,116

$$\text{Accounts receivable turnover} = \frac{\$20{,}847}{(\$3{,}723 + \$3{,}116)/2}$$

= 6.1 times

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Intel Corporation's Asset Turnover Calculations Illustrated

Inventory Turnover ($ millions)

Cost of goods sold for 1996	$9,164
Inventories, 12/28/96	1,293
Inventories, 12/30/95	2,004

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Intel Corporation's Asset Turnover Calculations Illustrated

Inventory Turnover ($ millions)

Cost of goods sold for 1996	$9,164
Inventories, 12/28/96	1,293
Inventories, 12/30/95	2,004

$$\text{Inventory turnover} = \frac{\text{Cost of goods sold}}{\text{Average inventories}}$$

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Intel Corporation's Asset Turnover Calculations Illustrated

Inventory Turnover ($ millions)

Cost of goods sold for 1996	$9,164
Inventories, 12/28/96	1,293
Inventories, 12/30/95	2,004

$$\text{Inventory turnover} = \frac{\$9{,}164}{(\$1{,}293 + \$2{,}004)/2}$$

= 5.6 times

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Intel Corporation's Asset Turnover Calculations Illustrated

Plant and Equipment Turnover ($ millions)

Sales (net revenues) for 1996	$20,847
Plant and equipment, 12/28/96	8,487
Plant and equipment, 12/30/95	7,471

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Intel Corporation's Asset Turnover Calculations Illustrated

Plant and Equipment Turnover ($ millions)

Sales (net revenues) for 1996	$20,847
Plant and equipment, 12/28/96	8,487
Plant and equipment, 12/30/95	7,471

$$\text{Plant and equipment turnover} = \frac{\text{Sales}}{\text{Average plant and equipment}}$$

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Intel Corporation's Asset Turnover Calculations Illustrated

Plant and Equipment Turnover ($ millions)

Sales (net revenues) for 1996	$20,847
Plant and equipment, 12/28/96	8,487
Plant and equipment, 12/30/95	7,471

$$\text{Plant and equipment turnover} = \frac{\$20{,}847}{(\$8{,}487 + \$7{,}471)/2}$$

= **2.6 times**

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Profitability Measures

KEY QUESTIONS

- What rate of return has been earned on assets or owners' equity?
- How expensive is the firm's common stock relative to the common stock of other companies, and what has been the dividend experience?

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Profitability Measures

PROFITABILITY MEASURES

> ROI--return on investment
> ROE--return on equity
> Price/earnings ratio (earnings multiple)
> Dividend yield
> Dividend payout ratio

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Profitability Measures

KEY IDEAS

- ✓ Factors in ROI calculation may differ among companies (net income or operating income in the numerator); what is important is the consistency of definition, and **trend** of ROI.
- ✓ ROE is based on the net income applicable to, and the equity of, **common stockholders.**

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Intel Corporation's Profitability Measures

Price/Earnings Ratio

$$\text{Price/earnings ratio (or earnings multiple)} = \frac{\text{Market price of common stock}}{\text{Earnings per share of common stock}}$$

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Intel Corporation's Profitability Measures

Price/Earnings Ratio

$$\text{Price/earnings ratio (or earnings multiple)} = \frac{\$131.00}{\$5.81}$$

$$= \mathbf{22.5}$$

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Cruisers, Inc.

Dividend Yield

$$\text{Dividend yield: Common stock} = \frac{\text{Annual dividend per share}}{\text{Market price per share of stock}}$$

$$\text{Dividend yield: Preferred stock} = \frac{\text{Annual dividend per share}}{\text{Market price per share of stock}}$$

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Cruisers, Inc.

Dividend Yield

Dividend yield: Common stock $= \frac{\$1.98}{\$60.00} = \mathbf{3.3\%}$

Dividend yield: Preferred stock $= \frac{\$3.50}{\$56.00} = \mathbf{6.25\%}$

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Cruisers, Inc.

Dividend Payout Ratio

Dividend payout ratio $= \frac{\text{Annual dividend per share}}{\text{Earnings per share}}$

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Cruisers, Inc.

Dividend Payout Ratio

Dividend payout ratio $= \frac{\$1.98}{\$5.56} = \mathbf{35.6\%}$

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Financial Leverage Ratios

KEY IDEAS

- ✧ Financial leverage refers to the use of debt (instead of owners' equity) to finance the acquisition of assets for the firm.
- ✧ The interest rate on debt is fixed, so if the ROI earned on the borrowed funds is greater than the interest rate owed, ROE will increase. This is referred to as "positive" financial leverage.
- ✧ If the ROI earned on borrowed funds is less than the interest rate owed, ROE will decrease. This is referred to as "negative" financial leverage.

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Financial Leverage Ratios

KEY QUESTIONS

- How much financial leverage is the firm using?
- How much risk of financial loss to creditors and owners is there?

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Financial Leverage Ratios

KEY QUESTIONS

- How much financial leverage is the firm using?
- How much risk of financial loss to creditors and owners is there?

FINANCIAL LEVERAGE RATIOS

- Debt ratio
- Debt/equity ratio
- Times interest earned ratio

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Other Analytical Techniques

Book Value Per Share of Common Stock

KEY IDEA

An easily calculated amount based on the balance sheet amount of owners' equity, but not very useful in most cases because balance sheet amounts do not reflect market values or replacement values.

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Other Analytical Techniques

Book Value Per Share of Common Stock

KEY IDEA

An easily calculated amount based on the balance sheet amount of owners' equity, but not very useful in most cases because balance sheet amounts do not reflect market values or replacement values.

$$\text{Book value per share of common stock} = \frac{\text{Common stockholders' equity}}{\text{Number of shares of common stock outstanding}}$$

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Other Analytical Techniques

Common Size Financial Statements

KEY IDEA

Comparisons between firms (or between periods for the same firm) can be more easily understood if financial statement amounts are expressed as percentages of total assets or total revenues.

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Other Analytical Techniques

Other Operating Statistics

KEY IDEA

Not all decisions and informed judgments about an entity are based on financial data. Nonfinancial statistics are frequently relevant and useful.

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