

# 1. General Topics

# **1.1 Generally Accepted Accounting Principles (GAAP)**

# **1.2 Rules of Double-Entry Accounting/ Transaction Analysis/ Accounting Equation**

# **1.3 The Accounting Cycle**

## **1.4 Business Ethics**

## **1.5 Purpose of, Presentation of, and Relationships Between Financial Statements**

## **1.6 Forms of Business**

# **1.1 Generally Accepted Accounting Principles (GAAP)**

# ACCOUNTING



**GAAP**  
**GENERALLY**  
**ACCEPTED**  
**ACCOUNTING**  
**PRINCIPLES**



- **(GAAP) are a set of principles where they are a set of rules considered vital in the realm of Accounting**

- **GAAP were created by the Financial Accounting Standards Board (FASB)**

# Balance Sheet

---

US-GAAP

## ASSETS

### CURRENT ASSETS

---

Cash

Accounts Receivable

Accounts



- **GAAP contain specific facts that must be adhered to, and they include:**

**1. Transactions get recorded twice**

**2. Financial  
statements report on  
the business entity  
only**

**3. Debts are paid  
within one year, or  
one business cycle,  
whichever is longer**

A person wearing a dark suit, white shirt, and dark tie is holding a black clapperboard. The clapperboard has a white and black striped top bar. The text on the clapperboard is in large, bold, white capital letters. The person's hands are visible, holding the clapperboard from the sides. The background is a plain, light gray color.

**END OF  
FINANCIAL  
YEAR**

- **GAAP contains Principles:**

- **Conservative Principle:**

- **Going-Concern Principle:**

- **Historical Cost Principle:**

- **Objectivity  
Principle:**

- **Stable Monetary  
Unit Principle:**

# FINANCIAL MANAGEMENT



# **1.1.1 Generally Accepted Accounting Principles (GAAP): Summary**

**GAAP standards  
created by the Financial  
Accounting Standards  
Board (FASB)**

**REMEMBER- FASB:**

- **Governing body**
- **Not gov't. entity**

# **GAAP: Stresses essential characteristics of accounting, which initiate regulations**

- **the identification, measurement, and communication of financial information, about;**
- **economic business-oriented entities, to;**
- **interested parties.**

# **GAAP's Primary Concern: Financial Statement Regulation**

- **Balance Sheet**
- **Income Statement**
- **Statement of Cash Flows**
- **Statement of Owners' or Stockholders' Equity**
- **Note Disclosures**

**What is the purpose of information presented in notes to the financial statements?**

- To provide disclosure required by generally accepted accounting principles.**

# **Summary of Financial Reporting: Information to help users with capital allocation decisions**

- **Who are the Users of info?**
- **Investors, creditors, and other users**
- **Capital Allocation**
  - **The process of determining how and at what cost money is allocated among competing interests**

## **GAAP Standard Setting: Summary**

- **WHO: Parties Involved in Standard Setting**
- **Four primary parties**
- **Securities and Exchange Commission (SEC)**
- **American Institute of Certified Public Accountants (AICPA)**
- **Financial Accounting Standards Board (FASB)**
- **Government Accounting Standards Board (GASB)**

## **SEC (Profile)**

- **Accounting and reporting for public companies**
- **Enforcement Authority for the Government in this area**
- **Encouraged private standard-setting body**
- **SEC requires public companies to adhere to GAAP, and performs a lot of Oversight**

# **Summary of Issues in Financial Reporting**

- **Standard Setting in a Political Environment**
- **SEC, IRS other Agencies ALL have a vested interest**
- **Expectation Gap**
  - **What the public thinks accountants should do vs. what accountants think they can do.**
- **Sarbanes-Oxley Act (2002)**
  - **(SOX): a system that auditors must test and evaluate**

- **Ethics in the Environment of Financial Accounting**
- **frequently encounter ethical dilemmas; doing right thing is not always easy or obvious**
- **GAAP does not always provide an answer**

# **Summary OF (3 Components of) : GAAP** **Principles**

- 1. Transactions get recorded twice**
- 2. Financial statements report on the business entity only**
- 3. Debts are paid within one year, or one business cycle, whichever is longer; Business Cycles do not always last one year**

- **GAAP's Primary Principles:**

## **Conservative Principle:**

- **Resolving financial statement uncertainty in least favorable way**
- **Anticipates future losses, not gains**
- **Understates net assets/net income**
- **Allows companies to play it safe**

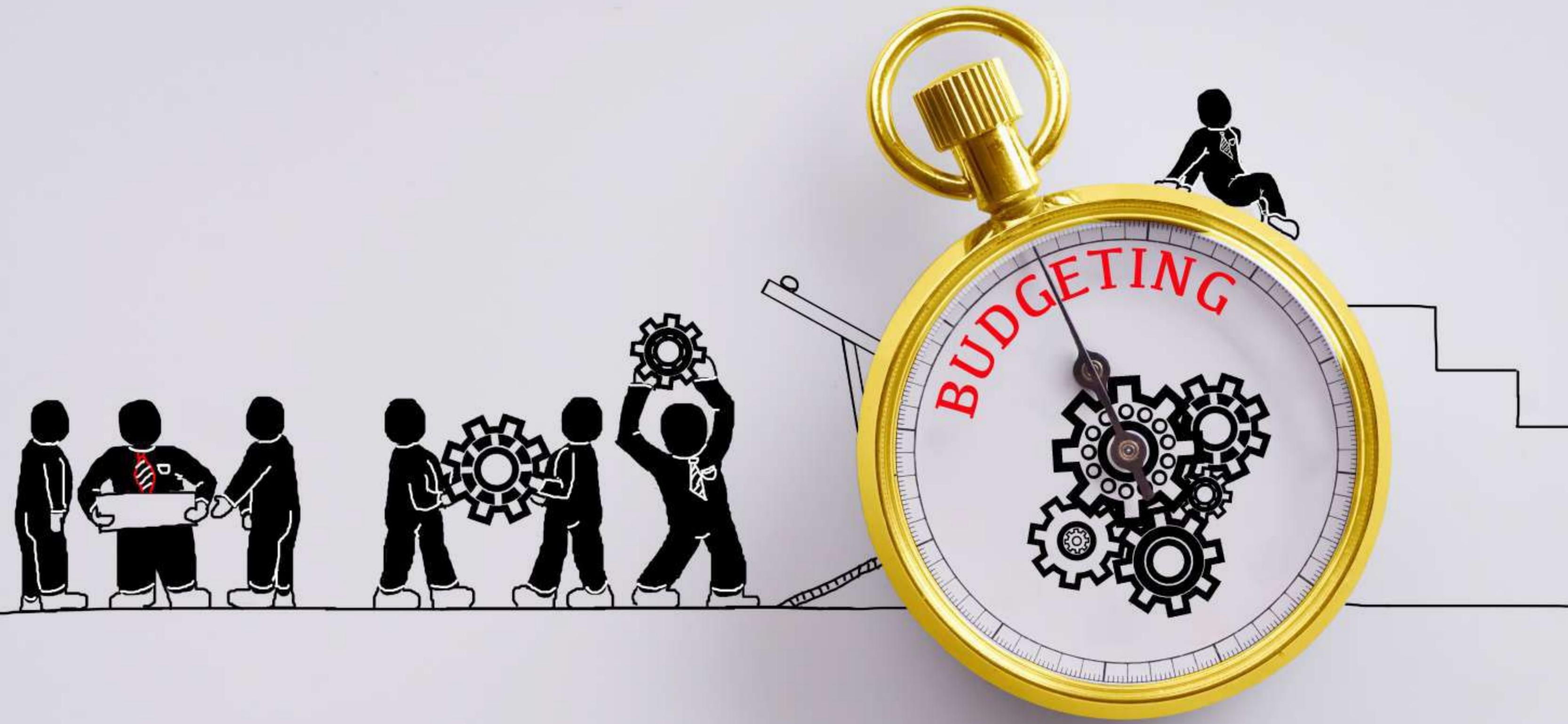
- **Going-Concern Principle:**  
financial statements are to assume that businesses will last indefinitely;
- **THIS IS DONE** in order to fulfill:
  - **Obligations**
  - **Commitments**
  - **Objectives**

# **Objectivity Principle: Business**

**Transactions are recorded using best objective evidence**

- **Organizational financial statements be based on solid evidence**
- **Prevent any accounting department of a business from documenting slanted information, based on bias**

**1.2 Rules of Double-Entry  
Accounting/Transaction Analysis  
Accounting Equation**



**1.2.1 Rules for Double-Entry Accounting**

**1.2.2 Rules of Transaction Analysis**

**1.2.3 Rules of the Accounting Equation**

# **1.2.1 Rules for Double-Entry Accounting**

- **Double-Entry accounting is a principle requiring that transactions gets recorded twice.**

- **Therefore equal debits and credits are made in accounts for all transactions.**

0001 001 212				
219902 001 221				
4219902 001 223				
4219902 001 225				
02 4219902 001 226				
702 4219902 001 290				
702 4219902 001 310				
0702 4219902 001 226				
0702 4219903 001 211				
0702 5200900 001 213				
0702 5200900 001 213				
0702 7950701 022 225				
0702 7950701 022 226				
0702 7950701 022 310				
0702 7950701 022 326				
	64	88 803,32	345 971,09	118 223,76
			345 971,09	13 328,00
				30 996,40
				379 868,02
				16 560,00
				11 000,00
				x

- **This principle of accounting includes factors which need to be monitored, such as:**

- **Where the money comes from, and;**
- **Where the money is going, and why**

- **Thus, the total debits will always equal the total credits in order for the accounting equation will always stay in balance.**



**WEALTH**



**MOBILE BANK**



**FUNDING**



**INVOICE**



**BALANCE**



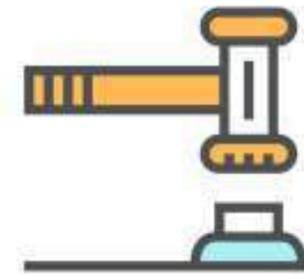
**ANALYSIS**



**VALUE**



**DEPOSIT**



**ATTORNEY**

## **1.2.2 Rules of Transaction Analysis**



200,100	702,015	535,084	32,405
1,452,600	1,355,900	1,002,155	320,535
25,305	30,500	95,025	647,383
20,620	20,350	52,600	152,000
1,698,025	1,686,350	20,203	1,350,552
2,770,836	2,688,505	18,067	25,000
32,062	20,658	75,000	
112,000	98,871	147,910	
255,000	245,600	25,600	
35,260	30,526	260,560	
34,322	395,655		
327,270			
400,000			

- **This concept is an examination of where transactions are identified, recorded, and summarized**

- **The Transaction Analysis is conducted in order to prepare financial statements for the accounting data received, and maintained**

- **For any business,  
an analysis of  
transactions must  
display two things:**

- **Clear and concise:**
  1. **increases, and;**
  2. **decreases within  
the statement**

# RULES OF DEBIT AND CREDIT



- **Any increases or decreases from business transactions should display where the assets, liabilities, and owner's equity are balanced**



ASSETS  
CURRENT ASSETS  
Cash



Income Statement  
Balance Sheet

# BALANCE SHEETS

	Consolidated		Separate	
	2015	2014	2015	2014
ASSETS				
CURRENT ASSETS				
Cash	45,104	54,581	35,180	24,408
Investment	15,985	258,462	584,800	254,800
	44,589	15,985	28,380	14,385
	105,678	229,028	118,360	293,513



## **1.2.3 Rules of the Accounting Equation**

$$z = \frac{1}{\sqrt{2\pi}}$$

$$XB = (D^N - B^N)$$

1 2 3 5 6 8 9

$$V_{i+1} = XB + R$$

- **The Accounting Equation are balanced calculations, to include three components:**

- **Assets**



- **Liabilities**



- **Owner's Equity**



- **There are three (3) ways to demonstrate the accounting equation in real-time**

- **Traditional examples of the equation are as follows:**

- **Assets = Liabilities + Owner's Equity, or;**

- **Owner's Equity =  
Assets – Liabilities,  
or;**

- **Liabilities = Asset – Owner's Equity**

## **1.3 The Accounting Cycle**



- **The accounting cycle is the process of recording and processing the accounting events of a business.**

- **It begins when transactions occur**

- **The Accounting Cycle also begins with the recording of the transactions**



- **The Accounting Cycle is continual throughout the Business Operating Cycle.**

- **The natural period of time occurs before certain business activities tend to repeat**

- **Transactions are recorded using entries, based on receipts, in recognition of a sale.**



RECEIPT

INVOICE

TOTAL \$

TOTAL

PAID

THANK YOU



- **After businesses post entries to accounts, a balance sheet is prepared**

- **Hence, the Balance Sheet ensures the total debits equals the total credits in the financial records.**



- **Adjustments are often made, followed by creating financial statements.**

- **Financial Statements allow for the following:**

- **Revenues and expenses are closed at the end of the accounting period.**



- **Net income transferred into earnings, as the business prepares to ensure debits and credits match**

# Financial Statements

```
graph TD; A[Financial Statements] --- B[Cash Flow]; A --- C[Balance Sheet]; A --- D[Income]; A --- E[Equity]
```

Cash  
Flow

Balance  
Sheet

Income

Equity

## **1.4 Business Ethics**



- **Ethics are internalized standards considered to be the legality of any action performed**

- **Ethics also initiate  
Internal Controls**

- **Internal Controls are not only allow for monitoring, but also allow for an increase in profit.**

*Revised Guidelines Released*

Companies must act

**How to comply**

**New Compliance Rules**

*Regulations take effect*

**Law Changes**

**How rules affect you**

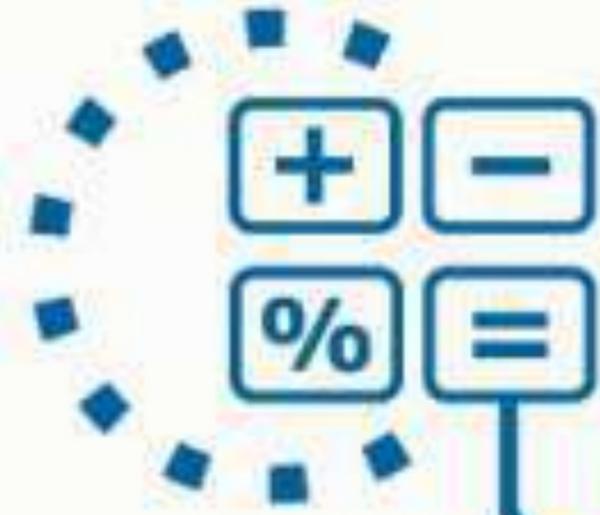
**Deadline Set for New Business Rules**

A close-up photograph showing a hand holding a wooden mallet with a metal head. The mallet is positioned to strike a small, rectangular wooden block. The block has the word "profitable" printed on it in a bold, black, sans-serif font. The background is blurred, showing what appears to be a workbench or a similar industrial setting.

**profitable**

- **Several primary internal controls for Accounting:**

- **Sarbanes-Oxley Act (SOX): a system that auditors must test and evaluate**



# assessment **AUDIT**



finance



evaluation



result



operations



procedure



quality



- **Code of ethics:**

- **Law:**

- **Full disclosure:**

- **Conflicts of interest:**

# ACCUMULATED EARNINGS AND PROFITS



# **1.5 Purpose of, Presentation of, and Relationships Between Financial Statements**

1.256.000,00	35.30
34.250.000,00	789.500,
841.500,00	
502.100,00	23.471
158.200,00	61.4
25.081.000,00	



## **1.5.1 Purpose of Financial Statements**

## **1.5.2 Presentation of Financial Statements**

## **1.5.3 Relationships Between Financial Statements**

## **1.5.1 Purpose of Financial Statements**

- **The objective of financial statements:**

- **Financial Statements also exhibit changes in financial position of an business**

1,020.03

-3,554.00

-9,632.55



**\$ LOSS**



- **Financial Statements are useful for making economic decisions**

- **Income statement:**

- **Statement of owner's equity:**

# ACCOUNTING



BUDGET



EXPENDITURE



LEDGER



PAYABLE



CREDIT



REVENUE



ASSESTS



REVIEW

## **1.5.2 Presentation of Financial Statements**



- **Financial Statements may be best demonstrated and displayed by:**

- **The specific rules used to govern the creation of the statements themselves.**

- **These rules include:**

- **All financial statements have a three-line heading**

**COMPANY NAME HERE**

**Balance Sheet**

For the Period Ended \_\_\_\_\_

<b>Assets</b>	<b>Amount</b>	<b>Liabilities</b>	<b>Amount</b>
Current Assets		Current Liabilities	
<b>Cash</b> _____ _____ _____		<b>Account Payable</b> _____ _____	
<b>Fixed Assets</b> _____ _____ _____		<b>Long Term Liabilities</b> _____ _____ _____	
<b>Intangible Assets</b> _____ _____ _____		<b>Share holders equity</b> _____ _____ _____	
<b>Other Assets</b> _____ _____		<b>Secured Loans's</b> _____ _____	
<b>TOTAL ASSETS</b>		<b>TOTAL LIABILITIES</b>	

- **The first line is the business name.**

- **The second is the name of the report.**

- **The third is the date,  
or period of time**

- **Financial statements start all computations by placing numbers in the column farthest to the right**



- **Next, to make a sub-calculation, move one column to the left;**

- **Draw a single line under the last number in a calculation;**

- **Put a double underline under final numbers**

- **Accountants place the results of a business calculation in one of three different places on the statement**

- **Accountants should use the method that allows for the clearest communication.**



Actual  
2011-12  
\$'000

Budget  
estimate  
2012-13  
\$,000

Future  
estimate  
2013-14  
\$'000

Future  
estimate  
2014-15  
\$'000

\$2,845  
\$7,425  
\$1,188  
\$11,458

\$2,870  
\$8,160  
\$1,360  
\$12,715

\$4,260  
\$5,000  
\$1,000

Assets

\$6,215  
\$5,305  
\$3,560  
\$1,176  
\$16,256  
\$27,714

\$1,176  
\$28,114

Liabilities

Assets

## **1.5.3 Relationships Between Financial Statements**

# Activity Based Costing



- **Financial statements, as there are various types, possess many common components**

- **Regardless of the industry, these components are ever-present and observable in accounting.**

- **Financial Statements for businesses show:**

- **Inventory**

- **Accounts, such as  
Income and  
Expenses**

**DUE!**

- **Costs of goods sold**

- **Net Income**

**FINANCIAL SECURITY**

**NEXT EXIT**



# **1.6 Forms of Business**



ACCOUNTING  
SERVICES

enter

return

"

'

?

/

alt

control

- **Similar to the concept of existing types of financial statements, businesses themselves vary, as well.**

- **Business variations are categorized based primarily on ownership.**

- **Sole Proprietor:**



# Small Business

- **Partnership:**



- **Corporation:**

日本



- **Corporation management is very regulated and structured**

- **Regulations and structure are good for handling up to thousands of individual stockholders.**

BUDGET

2017



## **2. The Income Statement**

**2.1 Presentation  
Format Issues**

**2.2 Recognition of  
Revenue and  
Expenses**

**2.3 Cost of Goods Sold**

## **2.4 Irregular Items (e.g. Discontinued Operations, Extraordinary Items, etc.)**

## **2.5 Profitability Analysis**

## **2.6 Summary**

## **2.1 Presentation Format Issues**



Ba3		93.00	7.89	-0.51	1.23
Ba3		88.00	9.35	-0.30	1.40
Ba3	B-				
Ba3			5.04	0.21	0.38
BBB		113.06	3.86	-0.01	0.23
Baa3		125.50	3.79	-0.02	0.1
Baa3	BBB-	117.63	4.31	-0.12	0
BBB		128.50		0.01	
			A6	0.03	

- **Multiple components of formatting accounting Income Statements, and other financial statements**

- **All of which affect the Income Statement, based on performance**
- **Affecting the Business itself, as an entity**

- **Organization and Alignment = Key Factor**

- **Accounting = Oversight**

**F**INANCIAL  
**S**TATUS  
**R**EPORT

**F**AIR  
**T**RADE

**F**IND  
**T**HE  
**M**ONEY

**F**LAT  
**V**ALUE

**F**UTURE  
**V**ALUE

**F**ACTORY  
**W**HOLESALE  
**P**PRICE

**G**ENERALLY  
**A**CCCEPTED  
**A**CCOUNTING  
**P**RINCIPLES

**G**ENERALLY  
**A**CCCEPTED  
**A**UDITING  
**S**TANDARDS

**G**ENERALLY  
**A**CCCEPTED  
**P**RINCIPLES  
**P**RACTICES

- **To re-iterate:**
- **Financial  
Accounting =  
Business  
Operations, not  
Individual Owners**

- **Income Statement**

# Income Statement



- **The financial report that shows the results of business operations over a period of time.**

- **This period of time can vary: Owner's discretion, or Fiscal Period**

- **A month, a quarter or a year.**

- **Statement that measures the outcomes**
- **Gauges Growth**
- **Growth occurs over time**

# Growth

Information vector graphics

Industry Income-Expense Statement



Legend for Industry Income-Expense Statement:

- Red line: Income
- Blue line: Expense
- Yellow line: Income
- Green line: Expense
- Black line: Income
- Orange line: Expense

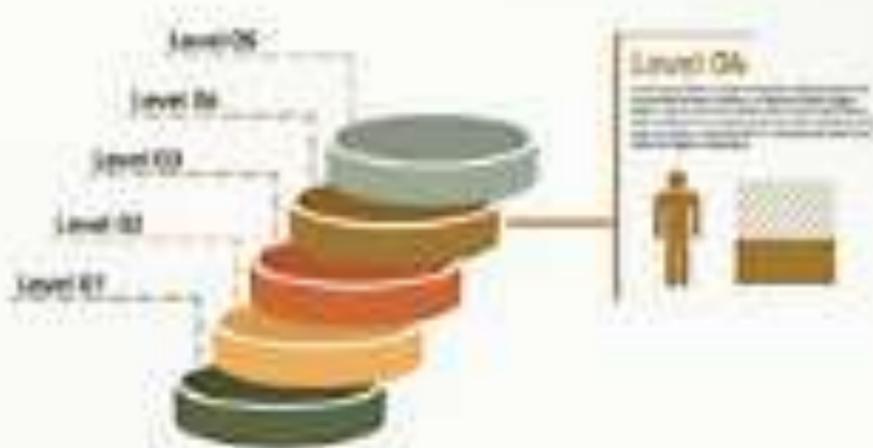
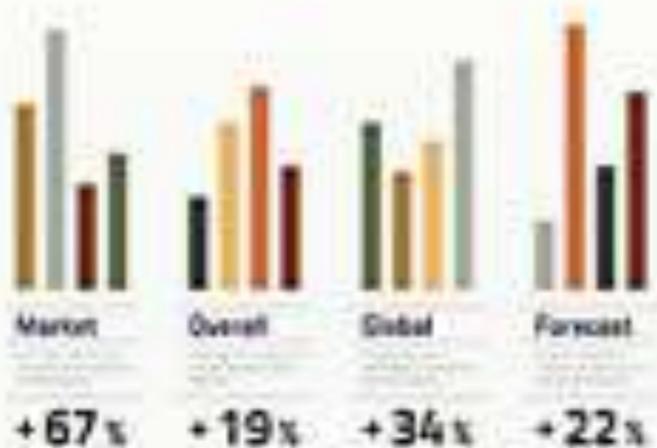
Small text block below the legend, likely providing a brief summary or disclaimer.

50%



30%

20%



- **Time period documentation:**
- **Can conflict with a Balance Sheet**

- **Balance Sheet:  
account balances  
for one exact date,  
by majority.**

- **Hence, a formatting  
“issue”**

ACCOUNTING  
Taxes  
Personal  
Financial  
Small Business  
Bookkeeping  
Payroll

- **Book keeping =  
Paramount**



*PAYROLL*

A blue binder with a white label that reads "PAYROLL" in a black, serif font. The binder is open, showing several pages of documents. In the foreground, a silver calculator with a red "C" button and a silver pen are visible. The scene is set on a wooden desk.

- **Net Income:**

- **Core of the Income Statement**



- **Accounts that explain why Assets went Up**

- **Stems from  
business  
operations**

- **Assets “Up”:**

- **Profit Sales**

# INVOICE

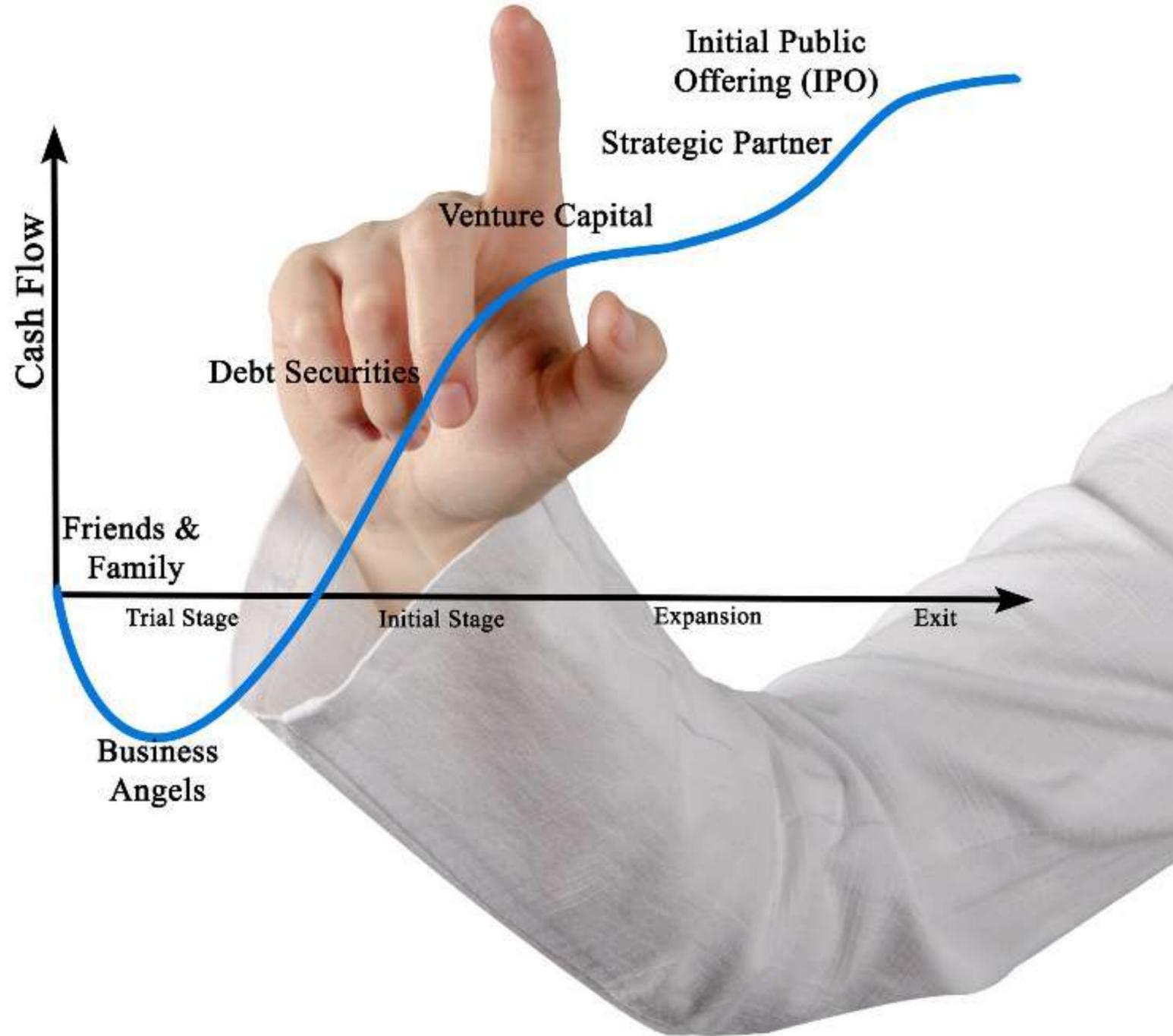


- **Liquidity**

- **And even possibly:**

- **Investments**

# Financing of Company Development



- **Another account goes up as well:**

- **Owner's Equity**
- **Must be accounted for**
- **Most important:  
Owner/Investors**

- **Both accounts = Value**

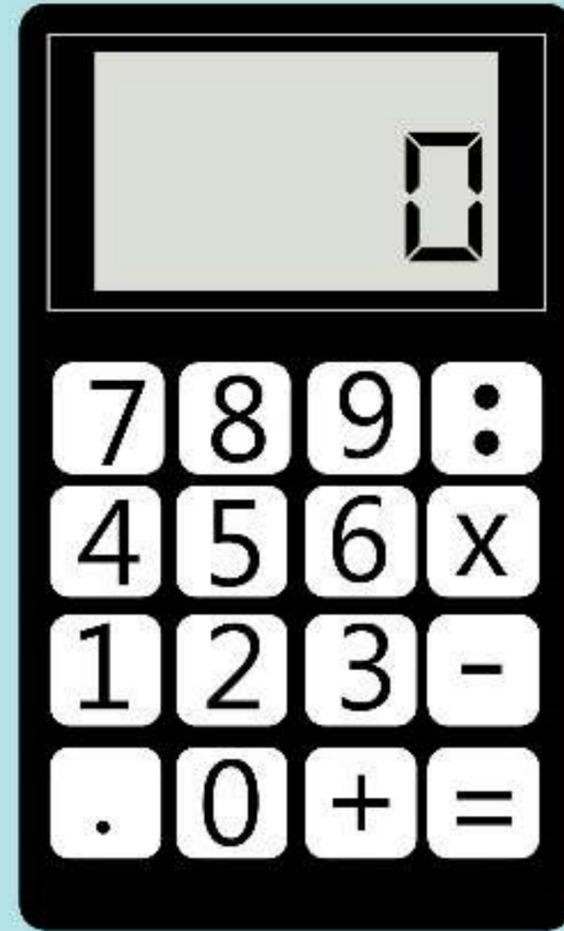
**NET PROFIT**



- **Alleviating  
formatting issues**

- **Accountants simply use a historical, yet traditional diagram, or chart, of sorts:**

CHART  
OF  
ACCOUNTS



- **T-Account**

- **This is a tool to keep track of the ups and downs in accounts, often called a:**

Accounts  
Payable Ledger



- **General ledger**

- **Debtor's ledger**

- **Wage Expense  
ledger**

- **Payroll ledger**

- **The Ups go on one side of the T**
- **The Downs on the other side of the T**
- **Here's an example:**

## **2.2 Recognition of Revenue and Expenses**



- **The income statement is essentially, as Summary.**

- **It summarizes all the revenue, and expense accounts, into a single number.**

- **This number is vital,  
as previously  
mentioned:**

- **“Net Income” =  
Revenue**

- **Income and Expense accounts are actually just part of Owner's Equity**

- **Each help explain increases in Equity, based on earnings**

- **Income Statement:**
  - **Take the number that appears in the Statement of Owner's Equity**

- **Income Statement:**
  - **gets combined into the Final number for Income and Expenses**

- **Income Statement:**
  - **called “owner’s equity—end of period”**

- **“Owner’s equity—  
End of period”**
- **Appears in the  
Balance Sheet  
simultaneously**

- **Liability section**

- **Expenses are accounts that explain why assets went down from operations.**

# EXPENSE REPORT

# EXPENSE REPORT

## PREPARATION

- Direct materials
- Rent of production facilities
- Depreciation
- Repair and Maintenance
- Utility costs
- Property taxes

## COMPENSATION

Payroll

# EXPENSE REPORT

## PRODUCTION

- Direct materials
- Rent of production facilities
- Depreciation
- Repair and Maintenance
- Utility costs
- Property taxes

## COMPENSATION

- Payroll
- Benefits
- Pension plan
- Health & safety
- Sales commissions

## COSTS

1,220.35  
10,987.22  
2,768.78  
76,897

1,203,081  
39,000  
20,000

	SALES	ACCOU
	161,891.69	67,
	147,449.77	68,
	166,428.29	69,
	168,747.22	68,
	142,769.47	69,
	148,861.71	66,
	138,377.73	68,
	150.98	68,

599,878.65  
45,000.00  
67,090.21  
47,879.02  
62,344.36  
12,887.90

127,544.29  
33,243.00  
32,549.28  
15,749.25  
30,021

239,100

- **Expense accounts explain the decreases in equity as a result of using up assets.**

- **The final part of the liability section includes accounts called Deferred Revenues**

- **Deferred Revenues are liabilities that result from receiving cash prior to earning the income.**

- **Annuities**

- **Charges**

# TAXES



- **Other income**

## **2.3 Cost of Goods Sold**

2014

2015

2016

budget 2017

2018

2019

2020



- **Cost of goods sold (CGS)**
- **Accounting concept**
- **Businesses calculate on the Income Statement**

- **For businesses that buy and resell goods**
- **Cost of goods sold**
- **A single number on the Income Statement**

- **Cost of goods sold**
- **The actual cost to the business =**
  - **“Goods” that it sells**

- **Other Businesses**
  - **Doctors and Lawyers**
  - **Sell services**
  - **They do not calculate cost of goods sold**

- **Manufacturers**
- **Cost of goods sold usually includes:**
- **Three amounts (3)**

- **Materials**

- **Labor**

- **Overhead**

- **Cost of Goods Sold:**
- **Two (2) important formulas**

# 1. Gross Profit Formula:

## **2. Income Statement**

### **Formula:**

## **2.4 Irregular Items (e.g. Discontinued Operations, Extraordinary Items, etc.)**



- **Discontinued operations:**

- **Both the income and expenses from discontinued operations =**
- **Netted into a single number**

- **Then reduced by income tax expense, or income tax savings.**

- **Extraordinary gains and losses:**

- **Losses lower income taxes at a certain point**

- **In this section,  
gains and losses:**
  - **On business  
equipment, or;**
  - **Per results of  
lawsuits:**
    - **NOT included**

## **2.5 Profitability Analysis**

# CRISIS



BUSINESS STRATEGY



IDEA

MARKETING

RISK

PLAN

ANALYZE

QUALITY



€ + \$ = ?

# OIL



- **Profitability analysis**

- **Allows businesses to forecast the lucrativeness of an existing project**

- **Profitability analysis also:**
- **Permits an anticipation of sales potential specific to such elements, like:**

- **Customer age**

- **Geography**

- **Product types**



- **3 Types of Profitability Analysis**

- **Horizontal Analysis**

- **Ratio Analysis**

0.6	-4.50	4,294,800	14,405	1,916	38.00	13.2
72	+0.70	4,248,800	69,707	13,360	37.47	15.2
3.38	0.00	4,232,200	21,306	34,665	231.91	2.1
16.7	+2.45	4,218,000	19,106	29,687	231.91	2.1
5.05	+1.00	4,140,000	19,106	29,687	231.91	2.1
4.6	-0.86	4,140,000	19,106	29,687	15.61	
4.6	-0.86	4,029,900	13,462	1,352	25.02	
3.26	-2.40	4,009,000	91,360	19,814	32.88	
				1,342		

- **Vertical Analysis**

## **2.6 Summary**

- **PROFITABILITY ANALYSIS**

- **Allows businesses to forecast the lucrativeness of an existing project**
- **Permits an anticipation of sales potential specific to such elements**
- **BOTH are applicable to Financial Statements and Business Operations**

# **Sales potential:**

- 1. Specific to formula that I will display for the exam in a few minutes, and;**
- 2. Three particular Elements**

# Customer Age

- **Trends per ages (toys, technology, clothing)**
- **Needs (infants, toddlers, pre-teen, adult, elderly)**
- **Motivations (based: Education level/Social Status)**

## **Geography:**

- **Urban**
- **Suburban**
- **Rural**

**Each type of jurisdiction has the potential to drive sales, and allow for forecasting**

# Product Types

- **What business activity is geared towards**

## **Example: Fidget Spinner (Patented)**

- **Side Note: That means it will also have a specific LIFE SPAN**
- **Selling for \$5-\$10 a pop**
- **1,500 specialty retail shops in the nation**
- **By May, each gross \$130,000-\$150,000 revenue, each!**
- **\$500,000,000 in profits**

# **3 Types of Profitability Analysis**

## Horizontal analysis:

- **Used when a company compares its current results to a previous year**
- **LESS COMPUTATION**

## **Ratio analysis:**

- **Used when a company computes a ratio from various numbers on the financial statements in order to analyze results.**
- **INVOLVES THE MOST MATH AND COMPUTATION**

## **Vertical analysis:**

- **Used when a company compares all the numbers of a financial report with a key number from the report**
- **SECOND MOST COMPUTATION**

***Gross margin* tells you about the profitability of your goods and services. It tells you how much it costs you to produce the product.**

**It is calculated by dividing your gross profit (GP) by your net sales (NS) and multiplying the quotient by 100:**

**Exam Question:**

**Gross profit margin is useful for  
evaluating....?**

**Answer: Profitability**

**Gross Margin = Gross Profit/Net Sales \* 100**

**GM = GP / NS \* 100**

**Example: Imagine that you run a company that sold \$50,000,000 in running shoes last year and had a gross profit of \$7,000,000. What was your company's gross margin for the year?**

$$\text{GM} = \$7,000,000 / \$50,000,000 * 100$$

$$\text{GM} = .14 * 100$$

$$\text{GM} = 14\%$$

**For every dollar in shoe sales, you earned 14 cents in profit but spent 86 cents to make it.**

# **3. The Balance Sheet**

A red pencil with a sharpened wooden tip is positioned diagonally from the top left towards the center of the frame. The pencil's tip is pointing directly at the word 'Balance' in the text below. The background is a plain, light-colored surface.

**Balance Sheet**

## **3.1 Cash and Internal Controls**

## **3.2 Valuation of Accounts/Notes Receivable (Including Bad Debts)**

## **3.3 Valuation of Inventories**

## **3.4 Acquisition and Disposal of Long- Term Assets**

## **3.5 Depreciation/ Amortization/ Depletion**

**3.6 Intangible Assets  
(e.g., Patents,  
Goodwill, etc.)**

**3.7 Accounts and  
Notes Payable**

**3.8 Long-Term  
Liabilities (e.g.  
Bonds Payable)**

## **3.9 Owner's Equity**

### **3.10 Preferred and Common Stock**

### **3.11 Retained Earnings**

### **3.12 Liquidity, Solvency, and Activity Analysis**

### **3.12 Summary**

## **3.1 Cash and Internal Controls**



RIGHT  
GREAT  
QUALITY

COMPLIANCE

- **As stated, Cash is generated from various sources.**

- **Since cash is an asset acquired and generated from business activity, internal controls must be attributed and created**

- **As mentioned previously, this is for compliance purposes, which are regulated**

- **Nonetheless, this implementation allows for an increase in:**

# Profit



- **There are other reasons to possess Internal Controls, besides safeguarding assets such as Cash:**

- **Accurate financial statements:**

- **Adherence to policies:**
- **Legal protection:**

- **Separate accounting from operations:**
- **Separate accounting from custody of assets:**

## **3.2 Valuation of Accounts/Notes Receivable (Including Bad Debts)**

## **3.2.1 Valuation of Accounts Receivable**

## **3.2.2 Valuation of Notes Receivable (Including Bad Debts)**

## **3.2.1 Valuation of Accounts Receivable**

# Balance Sheet

---

---

## ASSET

### Current asset

Cash

Accounts receivable

Inventory

Prepaid expenses

Other current assets

Total current assets

Property, plant, and equipment

Intangible assets

Other non-current assets

Total assets

Liabilities and equity

Current liabilities

Long-term liabilities

Equity

Total liabilities and equity

Total

- **Accounts receivable (universally abbreviated as A/R), is a Control Account**

- **This A/R Control Account contains the amounts that all customers owe the business.**

- **Elements include:**

- **Sell on account:**

- **Collect from customers:**

- **Warning of uncollectability:**

- **Accrual accounting:**

- **A Write-off:**
- **Estimate uncollectible accounts:**

- **May include allowance for doubtful accounts:**

- **Contra-asset account:**

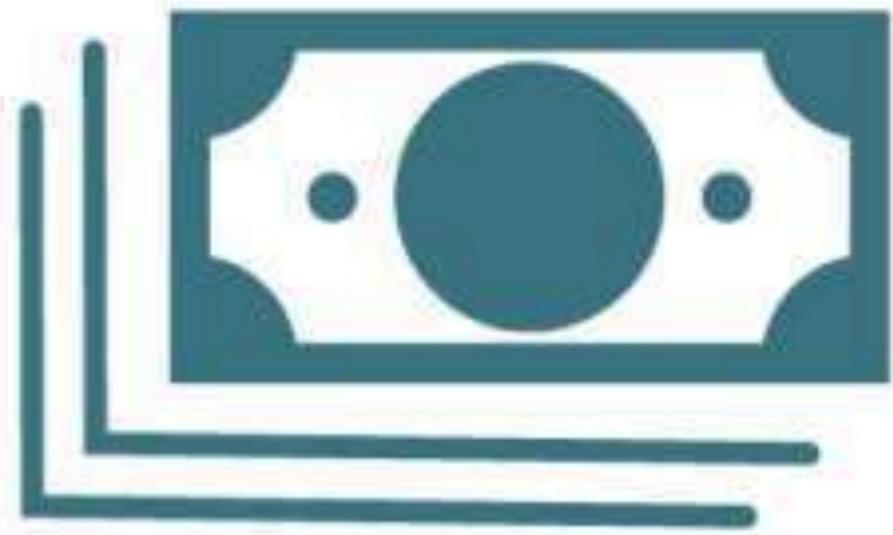
- **It measures the decrease in the value of accounts receivable.**

- **Percentage of accounts receivable method:**

- **The method of estimating the allowance for uncollectible accounts.**

- **The equation is:**  
 **$A/R \times Est\% = \text{What}$**   
**allowance should be –**  
**What allowance is**  
**= Adjustment**

## **3.2.2 Valuation of Notes Receivable (Including Bad Debts)**



BANKNOTES

- **Notes receivable are a current asset when they mature within one year.**

- **Notes are recorded at their present value of each dollar amount.**

- **To discount a note is to sell a note to a bank that subtracts a discount**

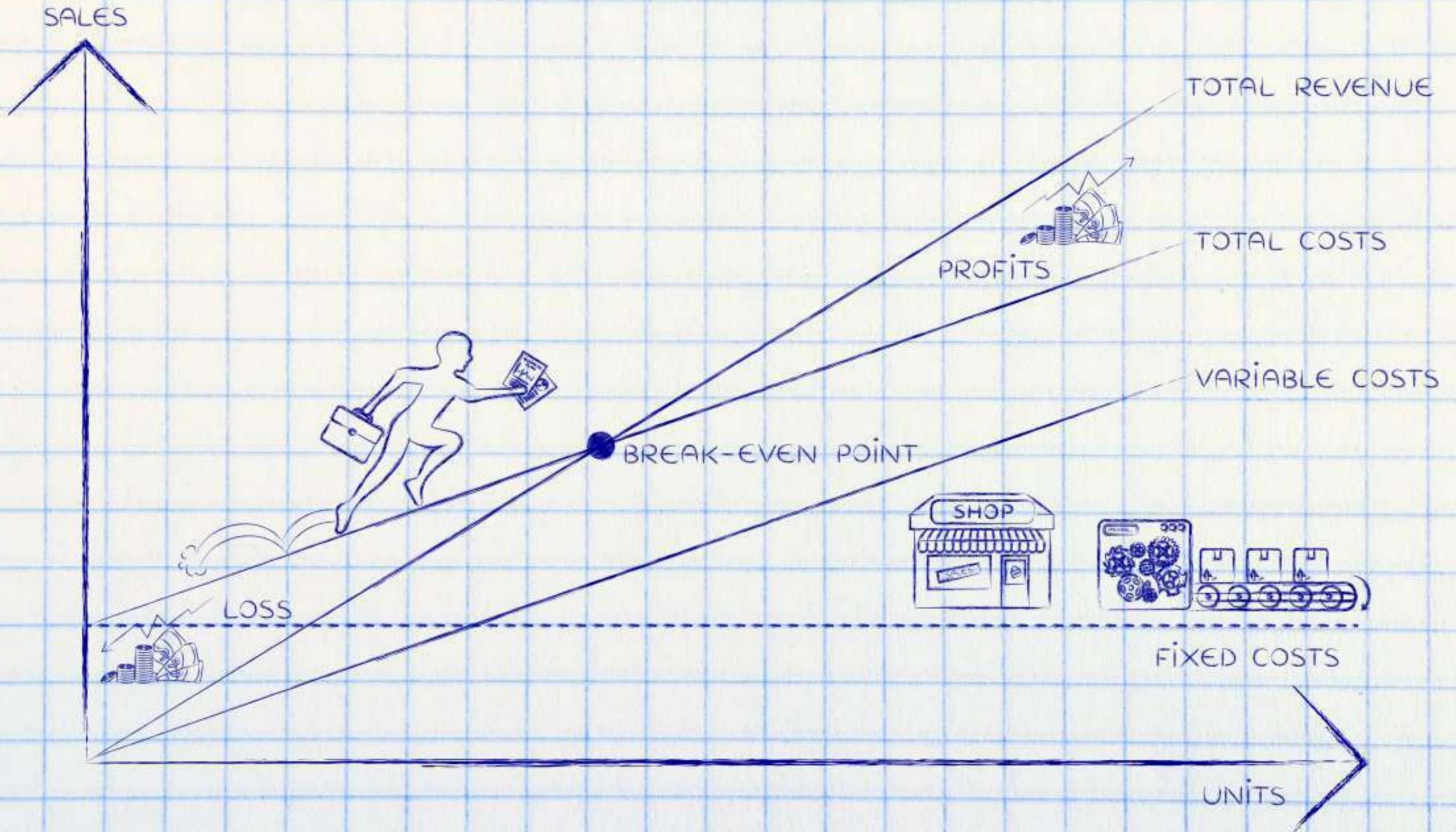
- **Discounting gives the seller the proceeds.**

- **Components of a Note Receivable:**

**Face amount:**

**Face interest:**

- **Future value of a note:**
- **Interest-bearing note:**



## **3.3 Valuation of Inventories**



**COST OF**  
**OWNERSHIP**

- **Inventory Valuation is the dollar amount associated with the items contained in a company's inventory**

- **Also the cost of the items defined as all of the costs necessary to get the inventory items in place and ready for sale.**

- **Inventory valuation will include the costs of:**

- **Production**
- **Materials**
- **Labor**
- **Overhead**

- **Methods to Track Inventory:**

- **Periodic inventory method:**

- **Perpetual inventory method:**

- **Days in Inventory:**

- **Inventory turnover:**

## **3.4 Acquisition and Disposal of Long-Term Assets**

## **3.4.1 Acquisition of Long-Term Assets**

## **3.4.2 Disposal of Long-Term Assets**

## **3.4.1 Acquisition of Long-Term Assets**

- **Long-term assets may also known as Plant assets, Capital assets or Fixed assets**

- **These are assets that have a life longer than one year.**

- **Long-term assets, by in large, allow for the transition of Capital.**
- **These assets that help a business or a person make money.**

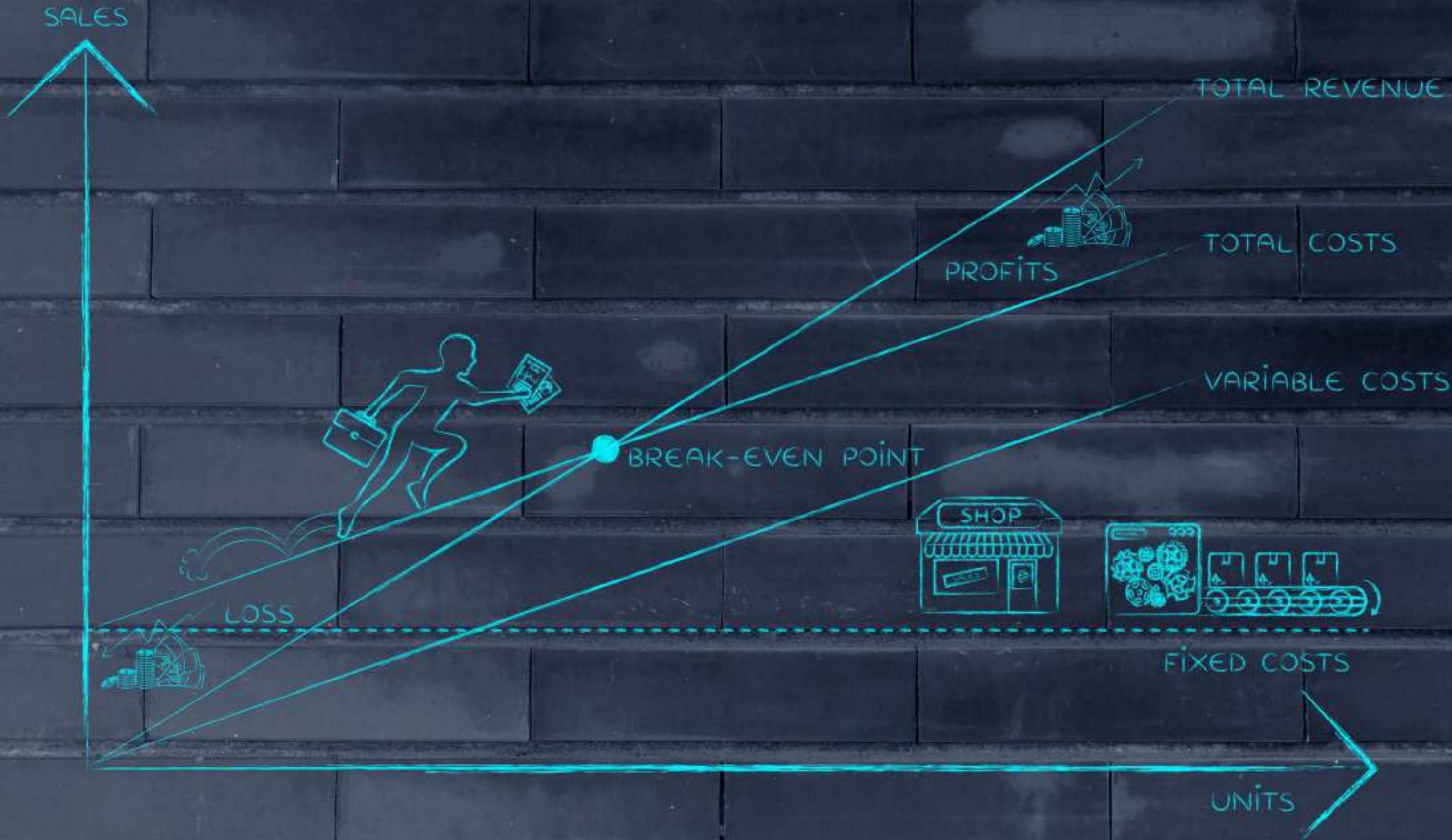
A hand is shown in the foreground, pointing towards the right. The background is a blurred image of a person wearing a white lab coat, suggesting a medical or scientific setting. The text 'CAPITAL ASSETS' is prominently displayed in the center-right of the image.

**CAPITAL ASSETS**

- **Long-term assets, as well as money, are changed into another asset that helps the business make money**

- **This is when an asset is termed Capitalized.**

## **3.4.2 Disposal of Long-Term Assets**



- **A business can dispose an asset by selling it.**
- **However, one must know the value, as it is needed**

- **Book value (BV):**  
**The book value of an asset is the historical cost, i.e. on the books at less accumulated depreciation for that asset.**

A roll of yellow paper is unrolled, revealing the text "ASSET DEPRECIATION" printed in white, bold, serif capital letters. The paper is set against a dark, textured background. The roll of paper is positioned on the right side of the frame, with the unrolled portion extending towards the left. The text is centered on the unrolled portion of the paper.

**ASSET DEPRECIATION**

- **The formula for computing the gain or loss on the disposal of an asset is:**

- **Amount received –  
Book value give up =  
Gain or Loss**

BALANCE SHEET FOR THE YEAR ENDING 31ST DECEMBER, 1893.

RECEIPTS.	£	s.	d.		EXPENDITURE.	£	s.	d.
To Balance in Bank 31st December, 1892—					By Exploration .. .. .	383	7	3
Net Balance .. .. .	£390	10	1		Printing and Binding, including the <i>Quarterly Statement</i> .. .. .	518	1	4
Subscriptions paid in 1892 in advance for 1893 .. .. .	23	0	10		Maps, Lithographs, Illustrations, Photographs, Casts, and Slides .. .. .	385	7	11
	413	10	11		Management, including Rent, Salaries, Wages, Advertising, Insurance, Stationery, and Sundries .. .. .	628	18	2
Donations and Subscriptions .. .. .	1,574	14	5		Postage and Carriage of <i>Quarterly Statements</i> , Books, Maps, Parcels, &c. .. .. .	137	19	6
Proceeds of Lectures .. .. .	16	12	1		Liabilities paid off during the year .. .. .	218	9	4
Sales of Maps .. .. .	252	9	10		Subscriptions paid in 1893 in advance for 1894 .. .. .	£20	14	0
Sales of Books published by the Society .. .. .	364	4	1		Net Balance .. .. .	397	13	10
Sales of Photographs, Casts, and Slides .. .. .	69	0	0			£418	7	10
					Balance in Bank 31st December, 1893 .. .. .	418	7	10
	£2,690	11	4			£2,690	11	4

Examined and found correct,

W. MORRISON, *Treasurer.*

## **3.5 Depreciation/Amortization/Depletion**

**3.5.1 Depreciation**

**3.5.2 Amortization**

**3.5.3 Depletion**

## **3.5.1 Depreciation**

# Depreciation



- **Depreciation is the official name for a type of expense**

- **This expense which is the recording of the amount of long-lived assets used up during business operations**

- **It is must be allocated for future financial periods.**

- **Depreciation is not an attempt to show the decline in the value of assets.**
- **Some assets, like buildings, may actually appreciate during the year.**

Is A Chinese Depreciation  
Still A Threat To Global  
Markets?

Yes

No


- **Let's remember:**

- **Businesses depreciate all fixed assets (except land) every year.**
- **Depreciation is not money set aside to replace aging assets.**

## **3.5.2 Amortization**

**AMORTIZATION**



- **Amortization is also an expense**

- **Amortization is the amount of an intangible asset is used up during the period.**

THE CO

# AMORTIZATION SCHEDULE FOR MONTHLY PAYMENTS

Number of Years

5	6	7	8	9	10	11
.0152	.0132	.0117	.0106	.0097	.0099	.0099



- **The credit for amortization directly lowers intangible asset**

- **There is no accumulated amortization account.**

+278

23

18

71,23

522/4

130,5

**Loan**

**Amortization**

---

- **Bottom line, to be fully amortized, an intangible asset's total cost will have been allocated to past fiscal periods**

## **3.5.3 Depletion**

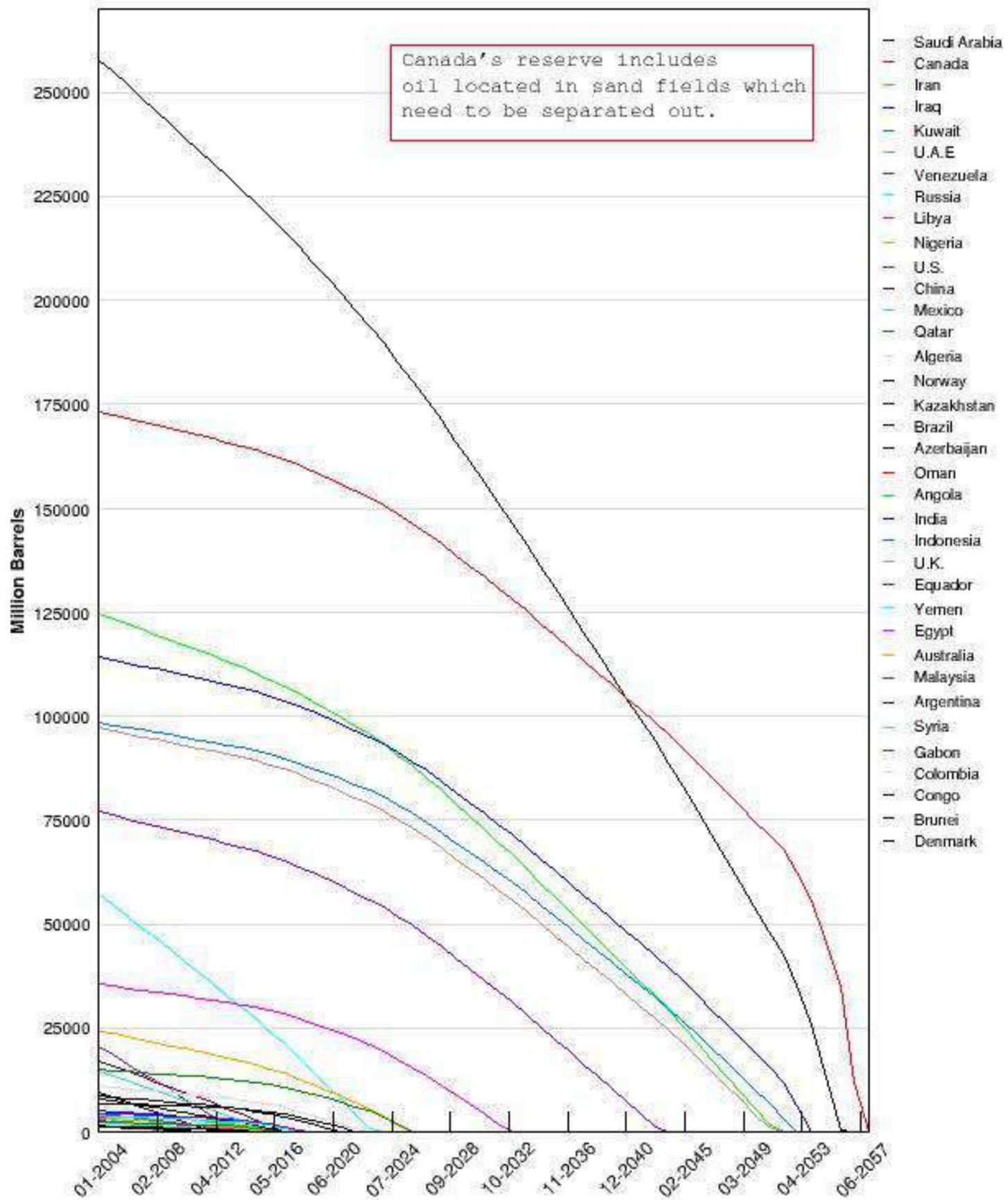


- **Depletion is another expense**

- **It is where the amount of a natural resource is used up during the financial period.**

# World Oil Depletion Per Major Producer

Reserves: 1,250B; Depletion: 23.3B/year; Source: 'National Geographic' 6/2004



- **Book value = Zero**

- **They are also contra-asset accounts which get subtracted from other accounts.**



**EARNINGS BEFORE  
INTEREST TAXES  
DEPRECIATION AND  
AMORTIZATION (EBITDA)**

## **3.6 Intangible Assets (e.g. Patents, Goodwill, etc.)**



Intangible Assets

- **Intangible assets have no physical form, yet they offer value to the business for a long time.**

- **The total cost of an intangible asset is everything necessary to make it useful.**



- **Examples of types of costs that often end up in intangible assets are:**

- **Legal fees, design, artwork, engineering, software, franchise contracts, and marketing programs**

- **FACT:**

- **If the life of an intangible asset is known, such as a franchise term or a copyright limit, then the cost of the intangible asset is spread over the useful life (not legal life)**

**Knowledge**

**Creativity**

**Trademarks**

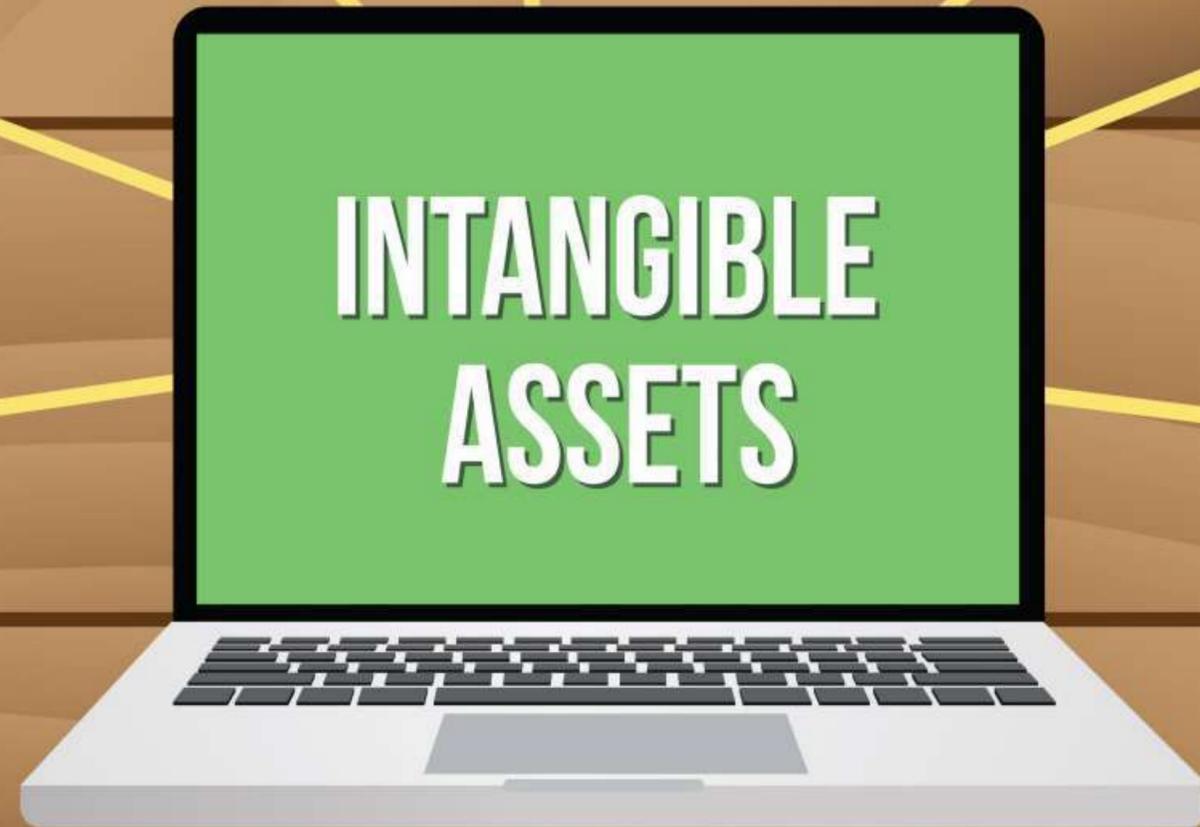
**Brands**

**Idea**

**Talent**

**Patent**

**INTANGIBLE  
ASSETS**

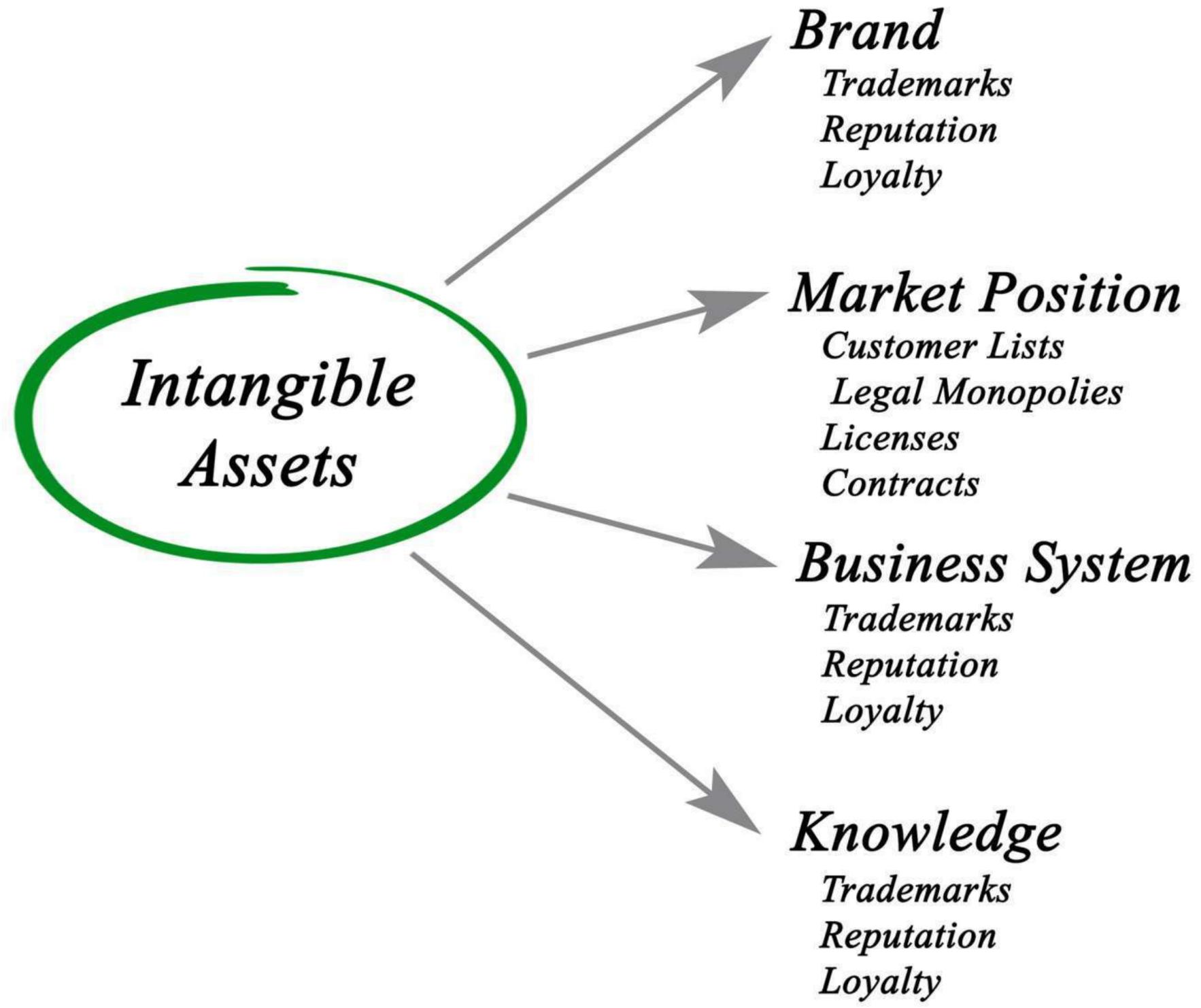


- **Some intangible assets have indefinite lives.**

- **They are not amortized.**
- **In the future, if these intangible assets are impaired (lose their value)**
- **They are written down.**
- **They are never written up.**

- **Patents: The exclusive right to produce and sell an invention.**
- **The legal right may be 20 years, but the useful life may be shorter.**

- **Copyrights: The exclusive right to publish, perform, or reproduce music, art, film, books, or software.**



- **Legal life can be more than 100 years, but the opportunity to make money from the copyright may be 3 to 5 years.**

- **Trademarks and trade names: Special identifications that are protected against infringement.**
- **Many have indefinite lives.**

- **Goodwill: The extra cost a business pays for another business as recognition for being unusually profitable.**
- **It has an indefinite life.**

- **Franchises and licenses: Contracts or government grants that give the owner special rights.**
- **Many have indefinite lives.**

## **3.7 Accounts and Notes Payable**

# Accounts Payable



**3.7.1 Accounts Payable**

**3.7.2 Notes Payable**

## **3.7.1 Accounts Payable**

- **Accounts payable, or (A/P), is a liability account.**

- **Even though no cash changes hands, Accounts Payable gets credited due to an accrual occurring.**

## **3.7.2 Notes Payable**

- **Payment on a note is exhibited when a business or a person borrows money**

- **In writing states a promise to pay in the money back in the future.**

- **The amount borrowed, or the principal, separate from the interest, if any, is called the Present Value of a Note.**
- **Once paid, this must be credited on the sheet.**



- **A note can be defaulted on.**
- **All bank agreements require the discountor to guarantee collection on the note.**

## **3.8 Long-Term Liabilities (e.g. Bonds Payable)**

CORPORATE  
BOND

GOVERNMENT  
BOND

FIXED  
INCOME

# BOND MARKET

MUNICIPAL  
BOND

HIGH  
YIELD  
DEBT

BOND  
VALUATION

- **Liabilities, a core component of the accounting equation as we now know, can often be viewed as Long-Term.**

- **Also, as stated, the liabilities possess a separate and important section on the statement.**

- **Credits are stored in the liability section, often broken it into two accounts:**

- **Deferred warranty revenues, as current, and;**
- **Deferred warranty revenue, as long-term.**

- **Later, such credits will move to the revenue section as they will not always last as long-term liabilities.**

- **Bonds are also within the long-term liability category.**

- **Bonds are a way to borrow large amounts of money from a large number of people.**



# Treasury Bonds



bonds (T-Bonds, or have a

- **The normal four-step process is as follows:**

- **Step 1. A corporation (or a government) prints up a number of paper bond**

- **Step 2. The corporation sells the bonds.**

- **Step 3. The corporation makes regular cash payments on the payment dates**

- **Step 4. On the maturity date, the corporation pays the bondholder the face amount.**

ust  
ate deb  
Cor  
al paper  
nmerc

# Corporate Bonds

bond is a bond issued by  
as to ongoin



- **The bondholder is the current investor in the bond.**

- **The bond payable account and the discount on bonds payable are both in the long-term debt section of the balance sheet.**

- **A discount has a debit normal balance because it is a contra-liability account.**
- **It represents a reduction of the bond liability.**



		4581.21
		3452.20
		4574.52
		7581.21
		452.20
		7825.66
		3285.20
		758
		6035.
		1255.1.



# Municipal Bonds

count  
municipal

high  
bond is a  
ce its cap

- **For example, a \$1,000,000 bond payable, less a \$106,775 discount, represents the bond book value, or the true liability, of \$893,225 (1,000,000 – 106,775).**

- **If the company wanted to eliminate this debt, it could buy the bonds back for the same price of \$893,225.**

# Bonds



## **3.9 Owner's Equity**



- **Owner's equity is the official name for the owner's claim on the assets in the business.**

- **The statement of owner's equity contains net income from the income statement, and that number covers a period of time**

- **Therefore, the statement of owner's equity covers the same period of time as the income statement.**

**The equation of the statement of owner's equity is always the same:**

## **3.10 Preferred and Common Stock**



**3.10.1 Preferred Stock**

**3.10.2 Common Stock**

## **3.10.1 Preferred Stock**

# PREFERRED STOCK

The image features a man in a dark suit and tie, pointing his right index finger upwards. A white rectangular box with a thin border is superimposed over his hand, containing the text 'PREFERRED STOCK' in a bold, white, sans-serif font. The background is a dark blue gradient with several semi-transparent elements: a world map on the left, a network of white dots and lines, a bar chart with a grid on the right, a line graph with two upward-trending lines in the center, and a candlestick chart on the bottom right. Binary code (0s and 1s) is scattered throughout the background. The overall aesthetic is professional and financial.

- **Corporations may wish to attract more cautious investors by issuing preferred stock.**
- **Preferred stock is stock with special privileges.**

- **Corporations have total freedom to mix and match these privileges to suit investors.**

11100DY'S

- **Preferred stock commonly has a steady price**

- **It does not go up when the corporation does well, nor does it drop much when the company does poorly.**

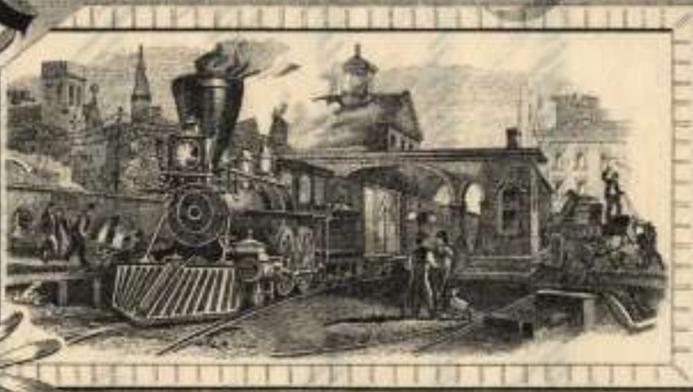
- **Preferred stockholders usually do not get to vote in stockholder meetings**

NUMBER  
383

# THE COLUMBUS SOUTHERN

100  
SHARES

## Railway



## Company.

*This Certifies that* \_\_\_\_\_ *is the*  
*holder of One hundred shares of the full paid Preferred Capital Stock of* THE COLUMBUS SOUTHERN RAILWAY COMPANY,  
*of the par value of One Hundred Dollars each, transferable only on the books of said Company in person*  
*or by Attorney upon surrender of this certificate.*

*This preferred stock shall be entitled to receive from the net earnings of the Company dividends not exceeding five per centum per annum, non-cumulative in any fiscal year that the Company may have net earnings applicable to dividends, before any dividend whatsoever shall be declared on the Common Stock; and whenever the net earnings applicable to the payment of dividends shall be in excess of the sum required to pay a dividend of five percent on the Preferred and Common Stock for the current year, such surplus shall be divided pro rata between the Preferred and Common Stock.*

*In Witness Whereof the said Company has caused this certificate to be signed by its President and Treasurer*  
*this* \_\_\_\_\_ *day of* \_\_\_\_\_ *18* \_\_\_\_\_

Treasurer

President

SHARES \$100 EACH

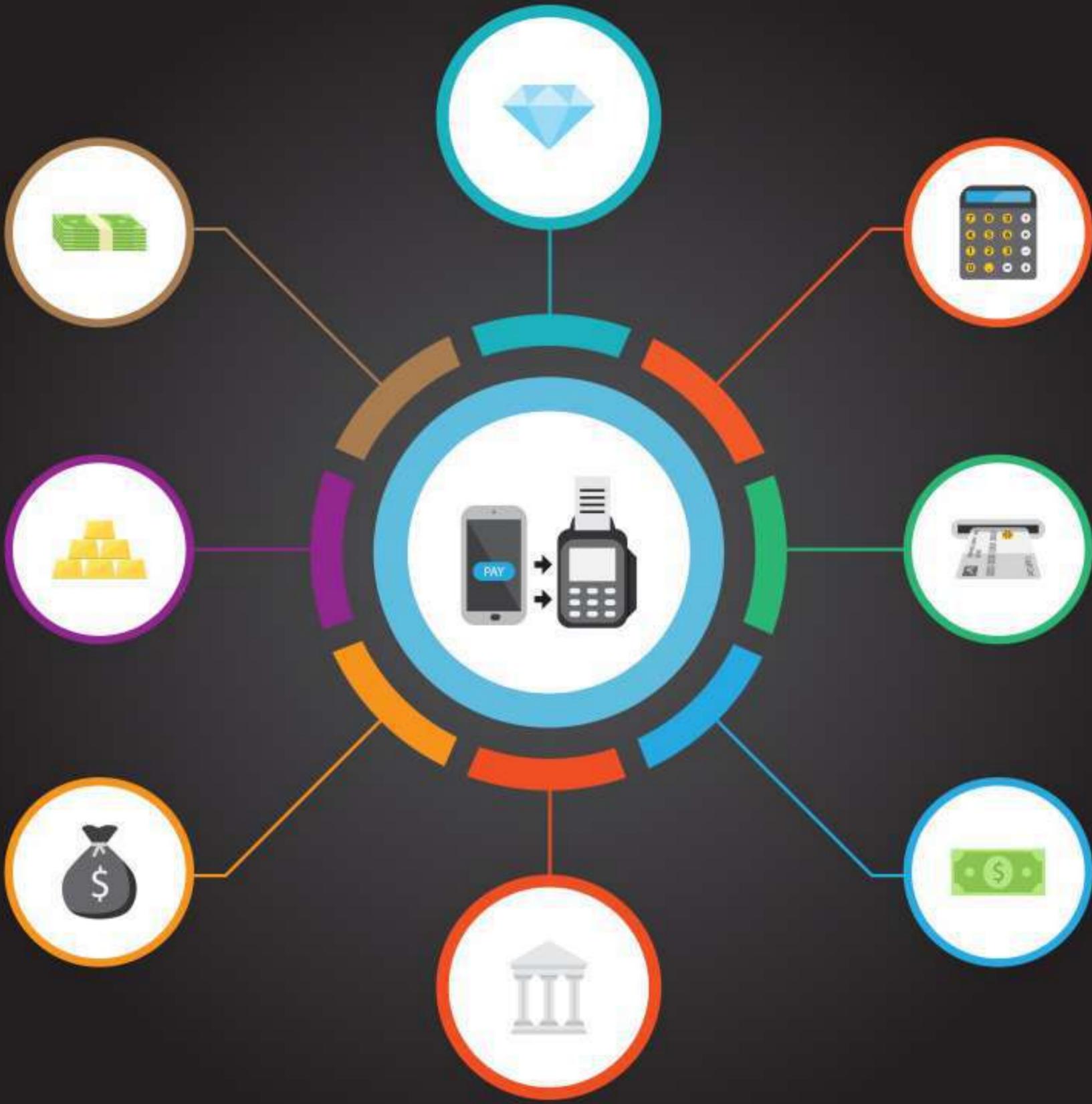
- **Examples of privileges for preferred stockholders are:**

- **The first right to cash dividends before common stockholders**

- **The right to participate in corporate profits the same as common stockholders**

- **The right to be paid dividends in arrears if years go by without paying a dividend**

- **The right to convert preferred stock into common stock**



## **3.10.2 Common Stock**

- **Corporation law grants to common stockholders certain rights:**

- **Right to vote**
- **Right to share in dividends**

- **Right to a certain percentage of the corporation upon liquidation**

- **The preemptive right, which is the choice to buy a portion of each new issuance of stock in order to maintain the same ownership percentage**

- **Common Stock:**

COMMON STOCK

NUMBER  
**A265068**



SHARES  
**5**

# The Baltimore and Ohio Railroad Company

Incorporated by the State of Maryland, February 28, 1827.

This Certifies that Joost, Patrick + Co  
the owner of FIVE

shares of the par value of One Hundred Dollars each, full paid and non-assessable, of the Common Capital Stock of the Baltimore and Ohio Railroad Company, transferable only on the books of the Company at its transfer office by the holder hereof in person or by duly authorized attorney upon the surrender of this certificate. The holders of Preferred Capital Stock to the amount of Sixty Million Dollars (\$60,000,000) now issued and such additional amounts as may be lawfully issued from time to time by the President and Directors of the Company pursuant to the resolutions of the stockholders duly adopted (April 11, 1899) are entitled to receive in each year out of the surplus net profits of the Company for the current year such yearly dividend (non-cumulative) as the Board of Directors of said Railroad Company may declare up to but not exceeding four per centum, before any dividends shall be set apart or paid upon the Common Stock. In Witness Whereof, the said Company has caused this Certificate to be signed by its duly authorized officers this OCT 14 1927

OCT 15 1927  
REGISTERED  
BANKERS TRUST COMPANY, INC. SECRETARY

*[Signature]*  
TRANSFER AGENT

*[Signature]*  
FOR THE SECRETARY

SHARES \$100. EACH

TENS UNITS  
1 1  
2 2  
3 3  
4 4  
5 0  
6 6  
7 7  
8 8  
9 9  
0 0  
TENS UNITS

- **Every corporation must have common stock.**
- **Common stock represents the basic ownership of a corporation.**

- **Sometimes corporations issue a second class of common stock (normally called Class B Common Stock) with different rights than Class A Common Stock.**

S & P 500

The image features the text "S & P 500" rendered in a bold, gold-colored, three-dimensional font. The characters are placed on a dark, textured wooden surface with prominent grain patterns. The lighting is dramatic, coming from the upper left, which creates strong highlights on the top surfaces of the letters and deep shadows on the wood and the undersides of the characters. The overall composition is a close-up, angled shot that emphasizes the texture of both the wood and the metallic letters.

## **3.11 Retained Earnings**

RETAINED  
EARNINGS

- **Retained earnings are located in the equity account in a corporation**

- **Retained earnings contain all the earnings all the corporation has ever earned**

- **However, they have not yet distributed to stockholders.**

## **3.12 Liquidity, Solvency, and Activity Analysis**

**3.12.1 Liquidity Analysis**

**3.12.2 Solvency Analysis**

**3.12.3 Activity Analysis**

## **3.12.1 Liquidity Analysis**

# Liquidity Ratio



- **Liquidity is defined as the ability of a company to meet its financial obligations as they come due.**

- **It also allows for a capability to sell assets quickly to raise cash.**

- **An analysis of liquidity, or the ratio of paying all financials outright, is a computation.**

- **This computation is used to measure a company's ability to pay its short-term debts.**

- **Investors often take a close look at liquidity ratios when performing fundamental analysis on a firm.**

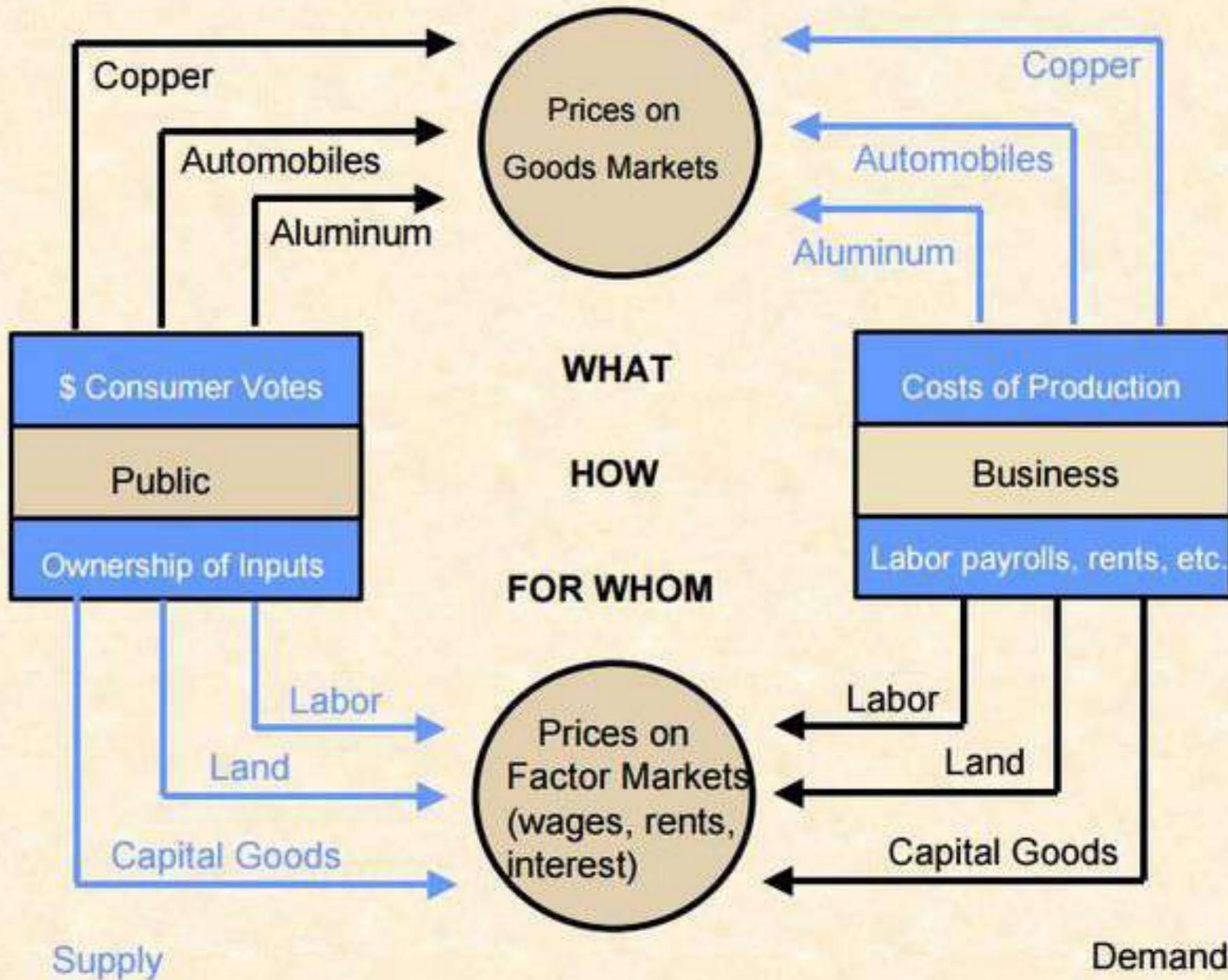


- **If a company is having trouble meeting its short-term debt, it is at a higher risk of bankruptcy.**

- **Liquidity ratio analysis are a good measure of whether a company will be able to continue as a operational entity.**

Demand

Supply



## **3.12.2 Solvency Analysis**

**SOLVENCY**

- **Solvency is the ability of a company to meet its long-term financial obligations, primarily, as opposed to short-term.**

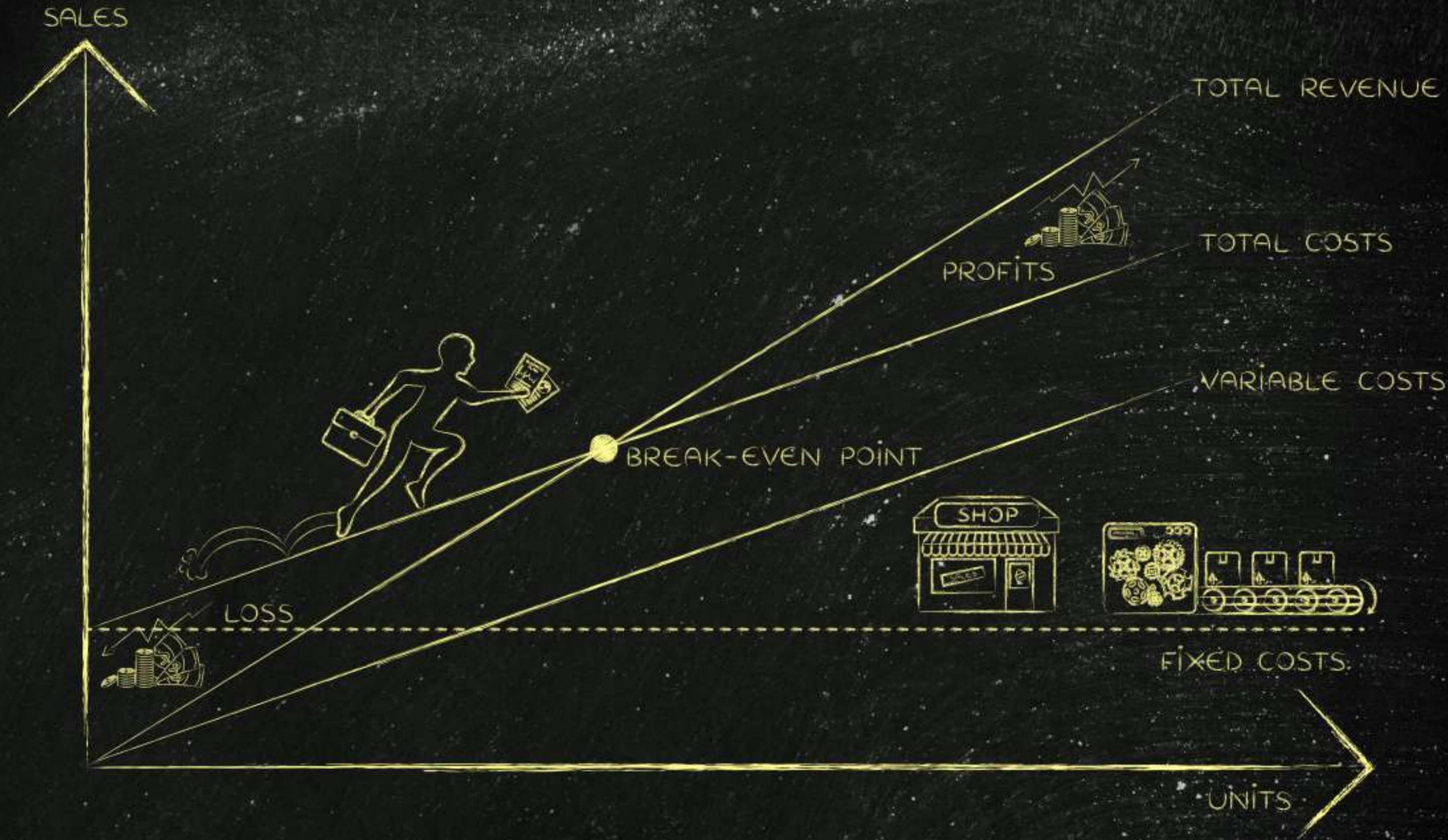
- **The Analysis of Solvency is used to measure an enterprise's ability to meet its debt obligations.**

- **The solvency ratio analysis indicates whether the lower a company's solvency ratio, the greater the probability that it will default on its debt obligations.**

- **The measure is usually calculated as follows:**

- **Solvency Ratio = Net  
Income +  
Depreciation**
  - **Divided by**
- **Short-term Liabilities  
+ Long-term  
Liabilities**

## **3.12.3 Activity Analysis**



- **Activity ratios are financial analysis tools**

- **Measure the ability of a business to alter various asset, liability and capital accounts into cash, or sales.**



# Capital Surplus

- **The faster a business is able to convert its assets into cash or sales, operations run better.**



## **3.13.1 Summary**

# **Inventory Valuation:**

**The dollar amount associated with the items contained in a company's inventory**

- **Can be separated into the cost of the items in place and ready for sale.**

# **Inventory valuation will include the costs of:**

- **Production**
- **Materials**
- **Labor**
- **Overhead**

- **Methods to Track Inventory: Two Primary**

## **Periodic inventory method:**

- **keeps track of merchandise costs in various purchases, then computes cost of goods sold on the income statement.**

## **Perpetual inventory method:**

- **increases the inventory account with every purchase, and lowers the inventory account with every sale.**

## **3.13.2 Summary**

## **Days in Inventory:**

- **Measures the average number of days before merchandise sells.**

## **Inventory turnover:**

- **Measures the number of times inventory completely sells per year.**

## **FIFO:**

- **Accounting method: first in, first out**
- **Cost of inventory on balance sheet represents the inventory most recently purchased**
- **Oldest items recorded sold first, yet may not have been sold**

# **LIFO**

- **Last in, first out**
- **Most recently produced items recorded as sold first (Costs of Goods Sold attributed)**
- **Only allowed in US; GAAP APPROVED**

**Exam:**

**In a period of rising prices, which of the following inventory methods results in the highest cost of goods sold?**

**(A) FIFO**

**(B) LIFO**

**(C) Average cost**

**(D) Periodic inventory**

**(E) Perpetual inventory**

**Exam:**

**An inventory valuation method such as FIFO or LIFO affects?**

- (A) the cost of goods sold but not the balance sheet**
- (B) the balance sheet but not the cost of goods sold**
- (C) both the income statement and the balance sheet (CGS is located on IC)**
- (D) neither the income statement nor the balance sheet**
- (E) the cost of goods sold but not the income statement**

# **4. Statement of Cash Flows**



**4.1 Indirect Method**

**4.2 Cash Flow  
Analysis**

**4.3 Operating,  
Financing, and  
Investing Activities**

**4.4 Summary**

## **4.1 Indirect Method**

- **The Indirect Method is the usual method of computing cash flow from business operations**

- **The Indirect Method starts with net income**

**NET PROFIT**



- **Indirect Method**  
**then uses the**  
**changes in the**  
**asset and liability**  
**accounts to adjust**  
**net income**

Assets

Liabilities



- **This adjustment allows for net income to transfer into cash flow from business operation activity.**

- **A line for total cash flow from financing activities uses a single line under it.**

- **This means that the total is not part of the calculation below it:**

- **By adding total net cash flow to the beginning cash account balance, we get the value for “cash—end of period.”**

- **This number must equal the balance in the cash account at the end of the period.**



## **4.2 Cash Flow Analysis**

- **Cash flow analysis is utilized for reporting purposes in the cash flow statement.**

# CASH FLOW RELATIONSHIPS



- **Cash flow analysis exhibits a starting balance**

- **Then will display an ending balance after accounting for cash expenses in the period**

- **The Cash Flow Statement shows where the cash came from, and where it went during the period**

- **It appears at bottom of cash flow worksheet, include interest incurred.**



Other long-term  
Net cash from operations  
Financing  
debt repayments,  
90 days or less, net  
**Investing**  
Additions to property,  
Acquisition of companies,  
cash acquired, and purchases of  
intangible and other assets  
Purchases of investments  
Maturities of investments  
Sales of investments  
Securities lending payable  
Net cash used in investing  
Cash and cash equivalents, end of  
period

	0	(1,000)	0	(1,000)
	208	660	544	837
	(1,042)	(5,052)	(2,976)	(9,451)
	(1,683)	(1,363)	(3,024)	(2,481)
	(2,513)	(6,751)	(5,382)	(7,390)
	(498)	(491)	(934)	(1,055)
	(8,627)	(69)	(9,502)	(69)
	(10,047)	(5,896)	(21,346)	(13,313)
	6,061	1,836	8,886	2,706
	7,835	2,603	15,371	4,030
	(292)	447	(358)	1,174
	(5,568)	(1,570)	(7,883)	(6,527)
	\$ 10,610	\$ 4,023	\$ 10,610	\$ 4,023

- **The Cash Flow Statement displays cash flow from the following areas:**

- **Cash flow from Operations**

- **Cash flow from investing activities**

- **Cash flow from financing activities**



- **The calculation for the Cash Flow Statement utilizes the components of:**

**(1) net cash flow**

**(2) cash—end of period.**

**The formula used in  
this analysis is as  
follows:**

- **Cash from operations + Cash from investing activities + Cash From Financing Activities = Total change in cash + Cash—Beginning Of Period = Cash—End Of Period.**



Save



Close



Back



Forward



Reload



Stop



Add Report



Export



Options



Accounts

Cash Flow

## Cash Flow - 01/01/08 to 02/25/08

### Selected Accounts

- [Assets](#)
- [Assets:Current Assets](#) and selected subaccounts
- [Imbalance-USD](#)

Money into selected accounts comes from

<a href="#">Equity:Opening Balances</a>	\$10,000.00
<a href="#">Income:Bonus</a>	\$2,000.00
<a href="#">Income:Salary</a>	\$5,000.00
Money In	<b>\$17,000.00</b>

Money out of selected accounts goes to

<a href="#">Expenses:Adjustment</a>	\$750.00
<a href="#">Expenses:Books</a>	\$3.00
Money Out	<b>\$753.00</b>

Difference **\$16,247.00**

## **4.3 Operating, Financing, and Investing Activities**

**4.3.1 Operating Activities**

**4.3.2 Investing Activities**

**4.3.3 Financing Activities**

## **4.3.1 Operating Activities**

- **Operational Activity is found in the first section of the Cash Flow Statement.**

- **“Operations” refers to what a business normally does to make money**



## **4.3.2 Investing Activities**

- **Investing Activities appear in the second section of the cash flow statement**

- **Investing Activity displays a business' income-producing sources, such as properties.**



- **On the cash flow statement, it is normal to observe a negative number pertaining to an investment**

7+  
+  
+  
-  
+  
6+  
96+  
4.25+  
854.96-  
4253.61-

36,492.86-  
436,869.36-  
785,649.2-  
2,679,234.98-  
4,567.3+  
346.825+  
46,798.25+  
4,587.1+  
895.36+

45,237.5-  
5,985.63+  
856.36-  
239.25-  
172.01+  
98.63-  
37.2+  
95.7-  
.54+  
.45-  
63+

89,468.7-  
5,732.2+  
895.63-  
987.5-  
51.9-  
45.5+  
.97+  
67  
69-  
36-  
9-  
+  
6+  
5+  
6-  
47+  
69-  
36-  
41-  
36-  
45+

- **It signifies that cash went out of the company to purchase assets**

## **4.3.3 Financing Activities**

- **Appears in the third section of the cash flow statement**

- **It's the process of finding money for the business from sources other than normal operations:**

- **Primary Source 1:**

- **Lenders**



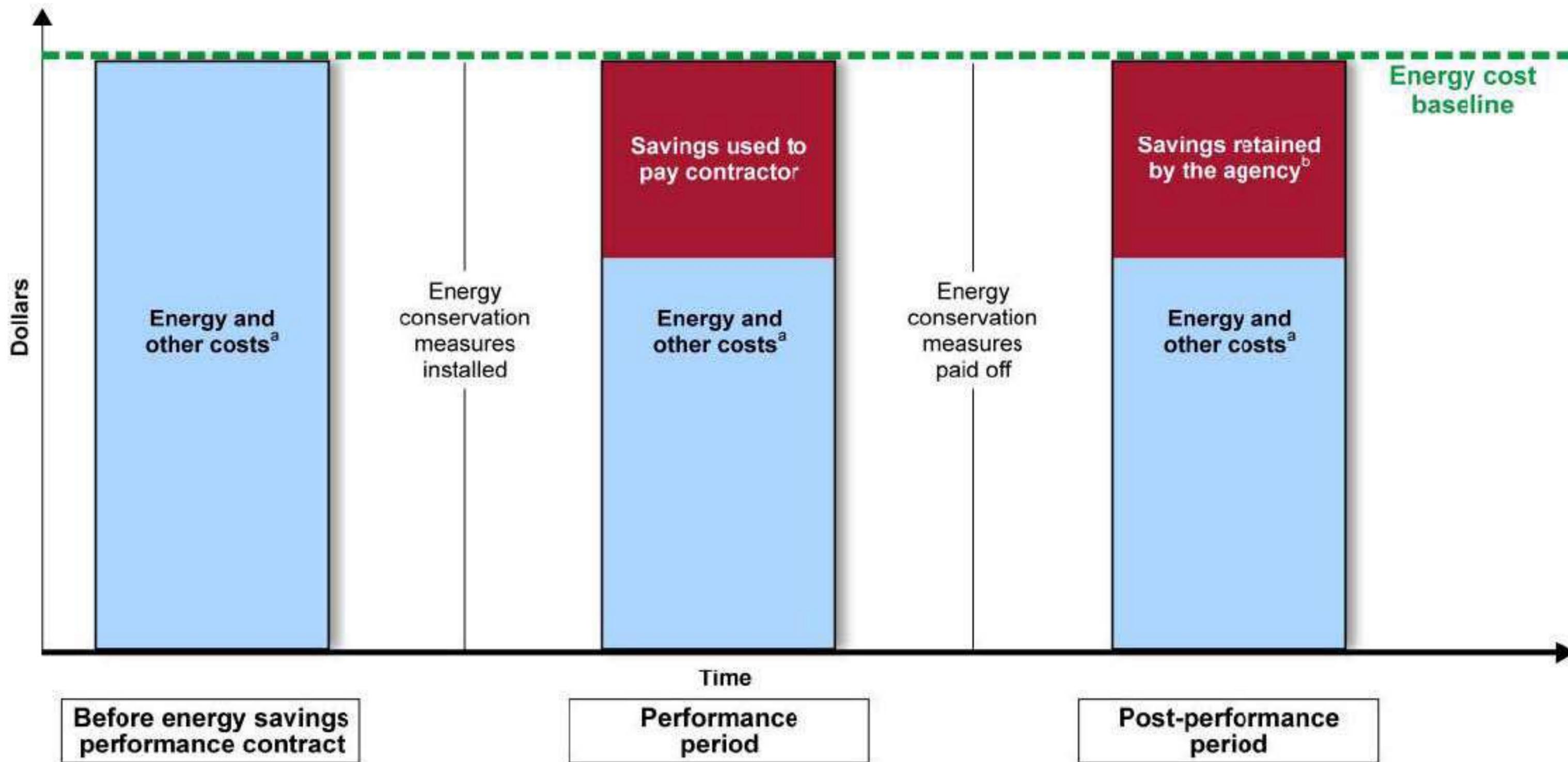
- **Primary Source 2:**

- **Investors**



- **This activity will display all reports on money returned to investors:**

- **This is where money is paid to the principal on a loan from a lender.**



Source: GAO, based on review of DOE documents. | GAO-15-436

## **4.4 Summary**

**Cash flow analysis is utilized for reporting purposes, as applied in the cash flow statement.**

- **Cash flow analysis exhibits a starting balance**
- **Then will display an ending balance after accounting for cash expenses in the period**
- **The Cash Flow Statement shows where the cash came from, and where it went during the period**
- **It appears at bottom of cash flow worksheet, include interest incurred**

**The Cash Flow Statement displays cash flow from the following areas:**

- Cash flow from Operations**
- Cash flow from investing activities**
- Cash flow from financing activities**

**The calculation for the Cash Flow Statement utilizes the components of:**

**(1) net cash flow**

**(2) cash—end of period.**

- **The formula used in this analysis is as follows:**

- **Cash from operations +**
- **Cash from investing activities +**
- **Cash From Financing Activities (net cash flow) =**
- **Total change in cash + Cash—Beginning Of Period = Cash—End Of Period**

**Exam:**

**The financial statement that includes classifications for operating, financing, and investing activities of a business entity for a period of time is called the:**

**(A) Income Statement**

**(B) Statement of Retained Earnings**

**(C) Balance Sheet**

**(D) Statement of Changes in Owners' Equity**

**(E) Statement of Cash Flows**

# **5. Miscellaneous Accounting Components**

**5.1 Investments**

**5.2 Contingent  
Liabilities**

**5.3 Summary**

# 5.1 Investments

# INVESTMENT



- **Investments are uses of a business's money to buy assets.**

- **Businesses also possess the option to sell assets**

- **One type of Investment:**
- **Long-term investments**



- **Another term representing Long-term:**
  - **Held-to-Maturity investments**



- **Another type of Investment**
- **Short-term investments**

- **These are also assets, and they may include:**

# **1. Certificates of deposit (CD)**

## **2. Stock**



- **An investment is any source that can change into cash within, or slightly over one year**

- **Trading Investments**
- **Available-for-Sale Investments**

0.6	-4.50	4,294,800	14,405	1,916	38.00	13.2
72	+0.70	4,248,800	69,707	13,360	37.47	15.2
3.38	0.00	4,232,200	21,306	34,665	231.91	2
16.7	+2.45	4,218,000	19,106	29,687	231.91	2
5.05	+1.00	4,140,000	19,106	29,687	231.91	2
4.6	-0.86	4,140,000	19,106	29,687	15.61	
4.6	-0.86	4,029,900	13,462	1,352	25.02	
3.26	-2.40	4,009,000	91,360	19,814	32.88	
				1,342		

## **5.2 Contingent Liabilities**

- **A Contingent Liability is a potential, yet unknown cost, that may, or may not incur.**



- **There are three categories of Contingent Liabilities**

- **High Probability:**



**PROPERTY**

- **Medium Probability:**

- **Low Probability:**

- **Important Example:**

- **Your client sold a faulty product**
- **Had significant warranty claims as a result.**



HELP

- **Its OK= Low Probability**
- **If your client has:**
  - **Isolated the bad product**
  - **Recalled it**
  - **Settled the related warranty claims**

- **Chances are LOW for dealing with similar warranty issues on that product in the future.**

## **5.3 Summary**

- **First, lets talk.....:**
- **Contingent Liabilities**

## **A Contingent Liability is a:**

- **1. potential, yet;**
- **2. unknown cost, that;**
- **3. may, or may not incur**

- **These particular liabilities are not recorded in a company's accounts, or shown in the balance sheet, unless:**

- **The scenario presents these liabilities as both probable, and reasonably estimable as 'contingency', or;**
- **deemed 'worst case' financial outcome.**

**Three examples of contingent liabilities include:**

- 1. Warranty of a company's products**
- 2. The guarantee of another party's loan, and;**
- 3. Lawsuits filed against a company**

- **There are three categories of Contingent Liabilities**

**High Probability: the costs can be estimated and loss must be disclosed and described in financial statements.**

## **High Probability example:**

- **Property**
  - **Mortgage, home improvement, a catastrophe, or a sale will deem allow for a cost to be estimated, and the loss 100% is documented**

**Medium Probability: costs must be disclosed in statements if the contingency is probable, yet not necessarily probable.**

## **Medium Probability example:**

- **Lawsuits**
  - **Sometimes a contingent liability can arise suddenly, catching both management and investors by surprise.**

- **The billions in liabilities for BP related to the Deep Horizon oil spill and Volkswagen's massive liabilities from its 2015 emissions scandal are two such scenarios**

**Low Probability: No reporting required due to low likelihood of cost being triggered.**

## **Low Probability example:**

- **Your client sold a faulty product; Had significant warranty claims as a result.**
- **Its OK= Low Probability**
- **If your client has:**
  - **isolated the bad product**
  - **recalled it**
  - **settled the related warranty claims**

**Chances are LOW for dealing with similar warranty issues on that product in the future.**