

Dutchess Community College
ACC 104 – Financial Accounting
Quiz Prep Chapter 2
A Further Look at Financial Statements

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Disclaimer

This *Quiz Prep* is provided as an outline of the key concepts from the chapter.

It is not intended to be comprehensive or exhaustive.

Quizzes may include material from the classroom lectures, the text or the homework assignments.

Classified Balance Sheet

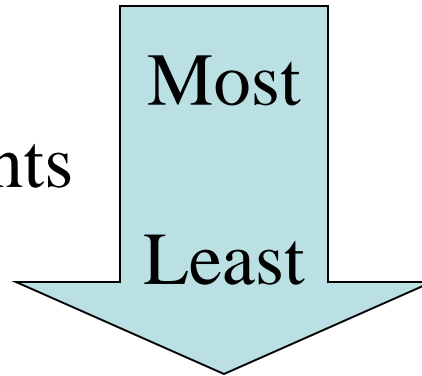
ASSETS

Current Assets

Long Term Investments

PP&E

Intangibles



Assets are listed in descending order of **liquidity** (how quickly it can be converted into cash)

LIABILITIES

Current Liabilities

Long Term Liabilities

STOCKHOLDERS EQUITY

Classified Balance Sheet

ASSETS

Current Assets

Long Term Investments

PP&E

Intangibles

LIABILITIES

Current Liabilities

Long Term Liabilities

STOCKHOLDERS EQUITY

Cash and everything that is expected to be converted to cash within 1 year, e.g.:

- Cash
- Short Term Investments
- Accounts Receivable
- Inventories
- Supplies
- Prepaids

Classified Balance Sheet

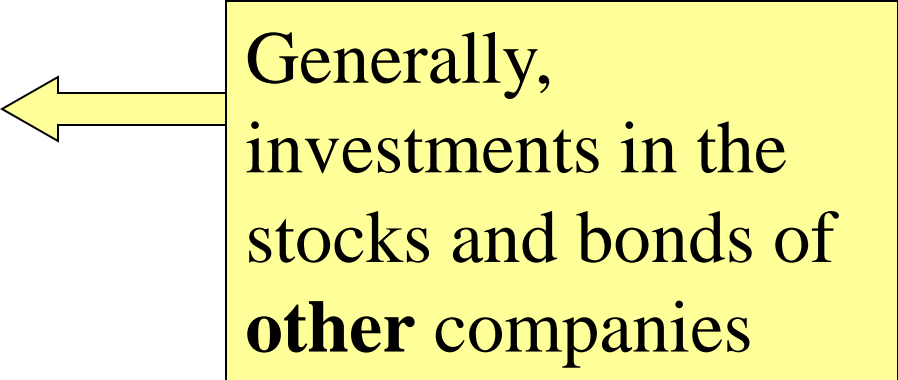
ASSETS

Current Assets

Long Term Investments

PP&E

Intangibles



Generally,
investments in the
stocks and bonds of
other companies

LIABILITIES

Current Liabilities

Long Term Liabilities

STOCKHOLDERS EQUITY

Classified Balance Sheet

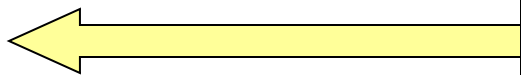
ASSETS

Current Assets

Long Term Investments

PP&E

Intangibles



LIABILITIES

Current Liabilities

Long Term Liabilities

STOCKHOLDERS EQUITY

Property, Plant &
Equipment

Assets with long useful
lives actively used in the
business, e.g.:

- Land
- Buildings
- Machines
- Motor Vehicles
- Office furniture

Classified Balance Sheet

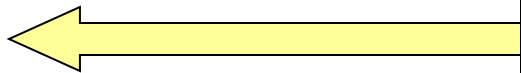
ASSETS

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Intangibles



LIABILITIES

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STOCKHOLDERS EQUITY

Special Note:

Accumulated

Depreciation is the

amount of the cost of

PP&E that has been

expensed in the Income

Statement. It is a *contra-*

asset account and is

subtracted from PP&E.

Classified Balance Sheet

ASSETS

Current Assets

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Intangibles

Assets without physical substance, e.g.:

- Patents
- Copyrights
- Trademarks
- Trade Names
- Good Will

LIABILITIES

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STOCKHOLDERS EQUITY

Classified Balance Sheet

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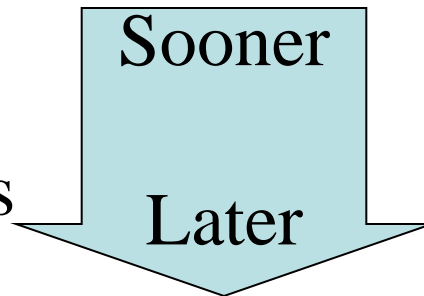
Intangibles

LIABILITIES

Current Liabilities

Long Term Liabilities

STOCKHOLDERS EQUITY



Liabilities are listed in ascending order of due date (i.e., the first one listed must be paid the soonest).

Classified Balance Sheet

ASSETS

Current Assets

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PP&E

Intangibles

LIABILITIES

Current Liabilities

Long Term Liabilities

Everything that must be paid within one year, e.g.:

- Accounts Payable
- Accruals
- Current Portion of Long Term Debt

STOCKHOLDERS EQUITY

Classified Balance Sheet

ASSETS

Current Assets

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Intangibles

LIABILITIES

Current Liabilities

Long Term Liabilities

Everything that does not need to be paid within one year, e.g.:

- Bonds Payable

STOCKHOLDERS EQUITY

Classified Balance Sheet

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PP&E

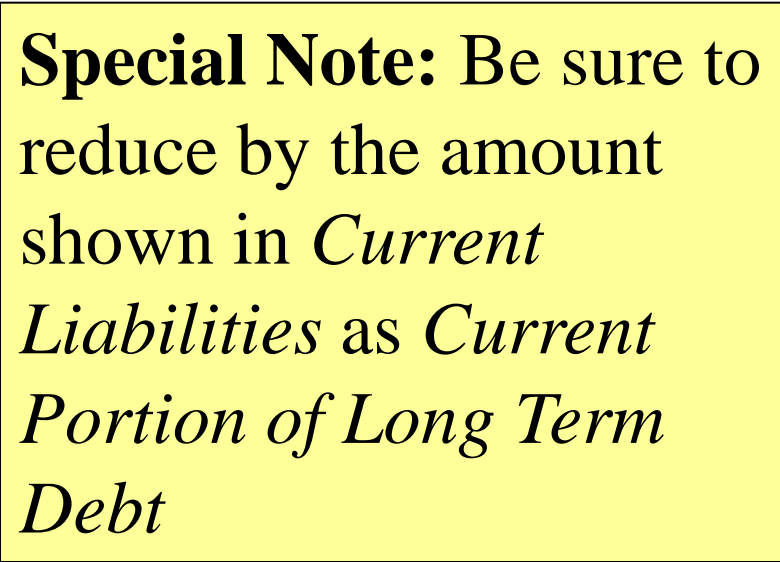
Intangibles

LIABILITIES

Current Liabilities

Long Term Liabilities

Special Note: Be sure to reduce by the amount shown in *Current Liabilities as Current Portion of Long Term Debt*

A yellow rectangular box with a black border is positioned on the right side of the slide. It contains the text 'Special Note: Be sure to reduce by the amount shown in Current Liabilities as Current Portion of Long Term Debt'. A yellow arrow points from the left side of the box to the text 'Long Term Liabilities' in the 'LIABILITIES' section.

STOCKHOLDERS EQUITY

Classified Balance Sheet

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Current Assets

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Intangibles

LIABILITIES

Current Liabilities

Long Term Liabilities

STOCKHOLDERS EQUITY

- Common Stock
- Retained Earnings

Working Capital

Working Capital =

Current Assets – Current Liabilities

Working Capital is a \$ measure of **liquidity**: how much cash and assets that can be converted into cash within 1 year does the company have relative to how much debt the company has to pay within 1 year.

Positive = Good
Negative = Bad

Ratios

Ratios are useful in comparing companies of different sizes.

In order to be meaningful, ratios must be compared to something:

Benchmarking - Comparison to another company or industry average

Trend Analysis – Comparison to previous periods

Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Similar to *Working Capital* (which is a dollar amount), the **Current Ratio** is a measurement of liquidity.

It tells you how many dollars of **Current Assets** a company has for each dollar of **Current Liabilities**.

Higher is Better

Debt to Total Assets Ratio

$$\text{Debt to Total Assets Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

The **Debt to Total Assets Ratio** tells you the percentage of the firm's assets that was financed by borrowing.

Unlike equity, debt has to be repaid at specified times, therefore

Lower is Better

Preferred Stock

Preferred Stock is another form of Equity Ownership.

Common Stock dividends are determined periodically and therefore vary and may not be paid at all.

Preferred Stock dividends are a set amount and must be paid before any Common Stock dividend.

Additionally, Preferred Stock ranks ahead of Common Stock in bankruptcy.

Earnings Per Share

Earnings Per Share (EPS) =

Net Income – Preferred Stock Dividends

Average **Common** Shares Outstanding

EPS tells you how much of the company's Net Income is attributable to one share of Common stock, therefore Preferred Stock Dividends must be subtracted from Net Income.

Higher is Better

Characteristics of Useful Information

Relevance – must be useful for making a decision timely

Reliability – Verifiable

Faithful Representation

Neutral

Comparability – comparable to other companies

Consistency – comparable to other time periods, e.g., last year vs. this year

Accounting Standards

Generally Accepted Accounting Principles (GAAP) are the standards for preparing financial statements in the United States.

GAAP is established by the **Financial Accounting Standards Board (FASB)**, pronounced *Fazz Bee*

The **International Accounting Standards Board (IASB)** is the international equivalent of FASB.

Accounting Standards

The Securities Exchange Commission (SEC) is the agency of the federal government that oversees publicly traded corporations and accounting standard-setting bodies.

The Public Company Accounting Oversight Board (PCAOB) determines auditing standards and reviews auditing firms (i.e. CPAs).

4 Assumptions

Monetary Unit – The financials will be in a defined currency, e.g., US Dollars

Economic Entity – The financials are for one specified entity

Time Period – The financials are for a specified time period, e.g., Year Ending December 31, 2006

Going Concern – The company is not in imminent danger of bankruptcy

2 Principals

Cost – transactions will be recorded at actual cost

Full Disclosure – any information that would be important to a user must be disclosed

2 Constraints

Materiality – If an item is too small to impact a decision, it is considered *immaterial*.

Conservatism – Given a choice among equally acceptable Generally Accepted Accounting Principals, a company should choose the one that is least likely to overstate assets or Income.