Describe the objectives of financial reporting.

Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.

The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.¹

¹Statement of Financial Accounting Concepts (SFAC) No. 1

(b) REFLECT INFORMATION ON CASH FLOWS

Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans.

Since investors’ and creditors’ cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.¹

¹Statement of Financial Accounting Concepts (SFAC) No. 1

(c) REFLECT THE FINANCIAL POSITION OF THE ENTITY

Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners’ equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources.¹

¹Statement of Financial Accounting Concepts (SFAC) No. 1
Describe the qualitative characteristics of accounting information.

### Relevance and Reliability

**OBJECTIVES**
1. Useful in investment and credit decisions
2. Useful in assessing future cash flows
3. About enterprise resources, claims to resources, and changes in them.

**CHARACTERISTICS**
- Relevance
- Reliability
- Comparability
- Consistency

**ECONOMICS IN ACTION**
New GAAP standard was written to provide guidance on how to determine fair value. The guidance is intended to result in more standardized fair value measurements:
- "Market Participant" approach, using the most advantageous and active market, and
- 3 levels of inputs:
  - Level 1: Active market for the item
  - Level 2: Active market for similar items
  - Level 3: "Unobservable" inputs.

### FUNDAMENTALS OF GAAP

- **Consistency/Comparability:** All companies for all periods account for things the same.
- **Monetary Unit:** Only items which can be expressed in money are reflected.
- **Economic Entity:** The entity can be separated.
- **Time Period/Periodicity:** At least annually.
- **Historical Cost:** Items are reported at their cost and depreciated if appropriate... but changes in value are excluded.
Relevance and reliability are the two primary qualities that make accounting information useful for decision making.

Adherence to the concept of consistency requires that the same accounting principles be applied to similar transactions by all companies and for all periods?

True or False?

True

True or False?

TRUE
What is the underlying concept that supports the immediate recognition of a contingent loss?

a. Substance over form.
b. Consistency.
c. Matching.
d. Conservatism.

The operating cycle is how long it takes a company to initiate, perform, and deliver their primary product or service. Take a wholesaler for instance. First they buy inventory, then they sell it on account, and ultimately they collect the cash owed from their customer. The period of time it takes to accomplish this is the "Operating Cycle".

Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

Balance Sheet

Assets

ASSETS, EXAMPLES AND MORE

CASH
PROCESS CULMINATES
ACCOUNTS RECEIVABLE, ON BALANCE SHEET BY:
SALES
OFF THE BALANCE SHEET WHEN:
COLLECTED, OR WRITTEN OFF
INVENTORY, ON BALANCE SHEET BY:
PURCHASES
OFF THE BALANCE SHEET WHEN:
SOLD, COGS
FIXED ASSETS, ON BALANCE SHEET BY:
PURCHASES
OFF THE BALANCE SHEET AS IT IS:
DEPRECIATED, DEPRECIATION EXPENSE
PREPAID EXPENSES, ON BALANCE SHEET BY:
PAYMENT
OFF THE BALANCE SHEET AS IT IS:
CONSUMED, "BENEFIT IS REALIZED"; IE INSURANCE EXPENSE
An asset that is expected to be realized in cash or sold or consumed during the operating cycle or within one year, if the cycle is shorter than one year.

OR more commonly stated:
An asset that is expected to be realized in cash or sold or consumed within one year or the operating cycle, whichever is longer.

Defined:
An obligation that will be satisfied within the next operating cycle or within one year, if the cycle is shorter than one year.

OR more commonly stated:
An obligation that will be satisfied within one year or the operating cycle, whichever is longer.

Liabilities are probable future economic sacrifices obtained or controlled by a particular entity as a result of past transactions or events.

Current Assets

Defined:
An asset that is expected to be realized in cash or sold or consumed within one year or the operating cycle, whichever is longer.

OR more commonly stated:
An asset that is expected to be realized in cash or sold or consumed within one year or the operating cycle, whichever is longer.

Current Liabilities

Defined:
An obligation that will be satisfied within the next operating cycle or within one year, if the cycle is shorter than one year.

OR more commonly stated:
An obligation that will be satisfied within one year or the operating cycle, whichever is longer.

A Classified Balance Sheet

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Balance Sheet</th>
<th>As of DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Cash</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Total current assets</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Fixed assets</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Other long term assets</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Long-term debt, excluding current portion</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Common stock</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>APIC</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>xxx</td>
<td></td>
</tr>
<tr>
<td>Total Liabilities &amp; Equity</td>
<td>xxx</td>
<td></td>
</tr>
</tbody>
</table>
A Multiple Step Income Statement

<table>
<thead>
<tr>
<th>Company Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Statement</td>
</tr>
<tr>
<td>FOR THE PERIOD ...</td>
</tr>
<tr>
<td>Revenue</td>
</tr>
<tr>
<td>Cost of Revenue</td>
</tr>
<tr>
<td>Gross Profit</td>
</tr>
<tr>
<td>Selling general &amp; administrative (SG&amp;A) expense</td>
</tr>
<tr>
<td>Depreciation expense</td>
</tr>
<tr>
<td>Other operating expenses</td>
</tr>
<tr>
<td>Income before income tax provision</td>
</tr>
<tr>
<td>Tax provision</td>
</tr>
<tr>
<td>Income from continuing operations</td>
</tr>
<tr>
<td>Discontinued operations, net of tax</td>
</tr>
<tr>
<td>Income before extraordinary items</td>
</tr>
<tr>
<td>Extraordinary items, net of tax</td>
</tr>
<tr>
<td>NET INCOME OR LOSS</td>
</tr>
</tbody>
</table>

Analysis using a Classified Balance Sheet

Liquidity = the ability of a company to pay its debts as they come due.

A comparison of current assets and current liabilities is a starting point in evaluating the ability of a company to meet its obligations.

Working Capital = Current Assets - Current Liabilities

Company’s strive for a balance in managing its working capital – not too much or too little.

Analysis using a Classified Balance Sheet

The current ratio indicates the amount of current assets available at the balance sheet date relative to obligations coming due during that period.

Current Ratio = \[
\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{118,000}{59,900} = 1.97 \text{ to } 1
\]

Composition of current asset and current liabilities important.

Statement of Retained Earnings Exercise

Landon Corporation was organized on January 2, 2002, with the investment of $100,000 by each of its two stockholders. Net income for its first year of business was $85,200. Net income increased during 2003 to $125,320 and to $145,480 during 2004. Landon paid $20,000 in dividends to each of the two stockholders in each of the three years.

<table>
<thead>
<tr>
<th>LO 4</th>
<th>Use a classified balance sheet to analyze a company’s financial position.</th>
</tr>
</thead>
<tbody>
<tr>
<td>LO 7</td>
<td>Prepare and identify the components of the statement of retained earnings.</td>
</tr>
</tbody>
</table>
Elements of the Annual Report

**BASIC - ALL AUDITED FINANCIAL STATEMENTS MUST INCLUDE:**

- Financial statements
- Notes to financial statements
- Report of independent accountants

**PUBLIC COMPANIES ALSO MUST INCLUDE:**

- Management's assertions (SOX 403)
- Report of independent accountants on internal controls (SOX 404)
- Management discussion & analysis
- Summary of financial data
- Letter to stockholders

http://www.starbucks.com/