

**19<sup>th</sup>  
Edition**

# **Chapter 3**

# **The Balance Sheet and Notes to the Financial Statement**

## **Intermediate Accounting**

**James D. Stice   Earl K. Stice**

**EX** 3-1 COCA-COLA'S BALANCE SHEET

The Coca-Cola Company and Subsidiaries  
**Consolidated Balance Sheets**  
**December 31, 2009 and 2008**  
(In millions except par value)

<b>ASSETS</b>	<b>2009</b>	<b>2008</b>
CURRENT ASSETS . . . . .		
Cash and cash equivalents . . . . .	\$ 7,021	\$ 4,701
Short-term investments . . . . .	2,130	—
TOTAL CURRENT ASSETS . . . . .	<u>9,151</u>	<u>4,701</u>
INVESTMENTS		
Marketable securities . . . . .	62	278
Trade accounts receivable, less allowances of \$55 and \$51, respectively . . . . .	3,758	3,090
Inventories . . . . .	2,354	2,187
Prepaid expenses and other assets . . . . .	<u>2,226</u>	<u>1,920</u>
TOTAL CURRENT ASSETS . . . . .	<u>17,551</u>	<u>12,176</u>
EQUITY METHOD INVESTMENTS . . . . .	6,217	5,316
OTHER INVESTMENTS, PRINCIPALLY BOTTLING COMPANIES . . . . .	538	463
OTHER ASSETS . . . . .	1,976	1,733
PROPERTY, PLANT AND EQUIPMENT—net . . . . .	9,561	8,326
TRADEMARKS WITH INDEFINITE LIVES . . . . .	6,183	6,059
GOODWILL . . . . .	4,224	4,029
OTHER INTANGIBLE ASSETS . . . . .	<u>2,421</u>	<u>2,417</u>
<b>TOTAL ASSETS . . . . .</b>	<b><u>\$48,671</u></b>	<b><u>\$40,519</u></b>

(continued)

## EX 3-1 COCA-COLA'S BALANCE SHEET

### LIABILITIES AND EQUITY

#### CURRENT LIABILITIES

Accounts payable and accrued expenses . . . . .	\$ 6,657	\$ 6,205
Loans and notes payable . . . . .	6,749	6,066
Current maturities of long-term debt . . . . .	51	465
Accrued income taxes . . . . .	264	252
<b>TOTAL CURRENT LIABILITIES . . . . .</b>	<b>13,721</b>	<b>12,988</b>
<b>LONG-TERM DEBT . . . . .</b>	<b>5,059</b>	<b>2,781</b>
<b>OTHER LIABILITIES . . . . .</b>	<b>2,965</b>	<b>3,011</b>
<b>DEFERRED INCOME TAXES . . . . .</b>	<b>1,580</b>	<b>877</b>
<b>THE COCA-COLA COMPANY SHAREOWNERS' EQUITY</b>		
Common stock, \$0.25 par value; Authorized—5,600 shares; Issued—3,520 and 3,519 shares, respectively . . . . .	880	880
Capital surplus . . . . .	8,537	7,966
Reinvested earnings . . . . .	41,537	38,513
Accumulated other comprehensive income (loss) . . . . .	(757)	(2,674)
Treasury stock, at cost—1,217 and 1,207 shares, respectively . . . . .	(25,398)	(24,213)
<b>EQUITY ATTRIBUTABLE TO SHAREOWNERS OF THE COCA-COLA COMPANY . . . . .</b>	<b>24,799</b>	<b>20,472</b>
<b>EQUITY ATTRIBUTABLE TO NONCONTROLLING INTERESTS . . . . .</b>	<b>547</b>	<b>390</b>
<b>TOTAL EQUITY . . . . .</b>	<b>25,346</b>	<b>20,862</b>
<b>TOTAL LIABILITIES AND EQUITY . . . . .</b>	<b>\$48,671</b>	<b>\$40,519</b>

# Learning Objective 1

---

Describe the specific elements of the balanced sheet (assets, liabilities, and owners' equity), and prepare a balance sheet with assets and liabilities.

# Elements of the Balance Sheet

---

- Identification and measurement of assets and liabilities is fundamental to the practice of accounting.
- Assets and liabilities are usually separated into current and noncurrent categories.
- Current items are those expected to be used or paid within one year.

(continued)

# Elements of the Balance Sheet

---

- A **balance sheet** presents a listing of an organization's **assets** and **liabilities** at a certain point in time.
- The difference between assets and liabilities is called **equity**.
- The balance sheet is designed using the basic accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

# Elements of the Balance Sheet



## 3-2 DEFINITIONS OF ASSET, LIABILITY, AND EQUITY

### Balance Sheet

---

**Asset:**

Probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

**Liability:**

Probable future sacrifice of economic benefit arising from a present obligation of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

**Equity:**

Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.

**Source:** *Statement of Financial Accounting Concepts No. 6*, "Elements of Financial Statements." pars. 25, 35, and 49.

# Elements of the Balance Sheet



## 3-2 DEFINITIONS OF ASSET, LIABILITY, AND EQUITY

### Balance Sheet

#### Asset:

Probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

#### Liability:

Probable future sacrifice of economic benefit arising from a present obligation of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

#### Equity:

Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.

**Source:** *Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements."* pars. 25, 35, and 49.

Accounting is not a science.

# Elements of the Balance Sheet



## 3-2 DEFINITIONS OF ASSET, LIABILITY, AND EQUITY

### Balance Sheet

#### Asset:

Probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

#### Liability:

Probable future sacrifice of economic benefit arising from a present obligation of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

#### Equity:

Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.

Source: Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements," para. 25, 35, and 49.

The primary purpose of the balance sheet is to help forecast the future.

# Elements of the Balance Sheet



## 3-2 DEFINITIONS OF ASSET, LIABILITY, AND EQUITY

### Balance Sheet

#### Asset:

Probable future economic benefit  
obtained or controlled by a  
particular entity as a result  
of past transactions or events.

#### Liability:

Probable future sacrifice of economic  
benefit arising from a present  
obligation of a particular entity to  
transfer assets or provide services to  
other entities in the future as a result  
of past transactions or events.

#### Equity:

Residual interest in the assets of  
an entity that remains after deducting  
its liabilities. In a business enterprise,  
the equity is the ownership interest.

elements of Financial Statements." pars. 25, 35, and 49.

If a company economically controls the future economic benefits association with an item, that item qualifies as an asset whether it is legally owned or not.

# Elements of the Balance Sheet



## 3-2 DEFINITIONS OF ASSET, LIABILITY, AND EQUITY

### Balance Sheet

#### **Asset:**

Probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

#### **Liability:**

Probable future sacrifice of economic benefit arising from a present obligation of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

#### **Equity:**

Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.

**Source:** *Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements."* pars. 25, 35, and 49.

This term includes legal commitments as well as moral, social, and implied obligations.

# Elements of the Balance Sheet



## 3-2 DEFINITIONS OF ASSET, LIABILITY, AND EQUITY

### Balance Sheet

#### Asset:

Probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

#### Liability:

Probable future sacrifice of economic benefit arising from a present obligation of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

Most liabilities involve an obligation to transfer assets in the future. However, an obligation to provide a service is also a liability.

#### Equity:

Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.

Elements of Financial Statements." pars. 25, 35, and 49.

# Elements of the Balance Sheet



## 3-2 DEFINITIONS OF ASSET, LIABILITY, AND EQUITY

### Balance Sheet

**Asset:**

Probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

**Liability:**

Probable future sacrifice of economic benefit arising from a present obligation of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

**Equity:**

Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.

Assets and liabilities arise from transactions or events that have already happened.

49.



## 3-3 CATEGORIES OF A CLASSIFIED BALANCE SHEET

### ASSETS

#### Current assets:

- Cash

- Investment securities

- Accounts and notes receivable

- Inventories

- Other current assets, such as prepaid expenses

#### Noncurrent assets:

- Investments

- Property, plant, and equipment

- Intangible assets

- Other noncurrent assets, such as deferred income tax assets

(continued)



## 3-3 CATEGORIES OF A CLASSIFIED BALANCE SHEET

### LIABILITIES

#### Current liabilities:

- Accounts and notes payable
- Accrued expenses
- Current portion of long-term obligations
- Other current liabilities, such as unearned revenues

#### Noncurrent liabilities:

- Long-term debt, such as notes, bonds, and mortgages payable
- Long-term lease obligations
- Deferred income tax liabilities
- Other noncurrent liabilities, such as pension obligations

(continued)



## 3-3 CATEGORIES OF A CLASSIFIED BALANCE SHEET

### OWNERS' EQUITY

Contributed capital:

- Capital stock

- Additional paid-in capital

Retained earnings

Other equity, such as treasury stock (a subtraction)

Accumulated other comprehensive income

(concluded)

# Working Capital

---

- The difference between current assets and current liabilities is referred to as the company's *working capital*.
- Working capital is the liquid buffer available in meeting financial demands and contingencies of the near future.
- The division of assets and liabilities into current and noncurrent is in some sense an arbitrary partition.

# Current Assets

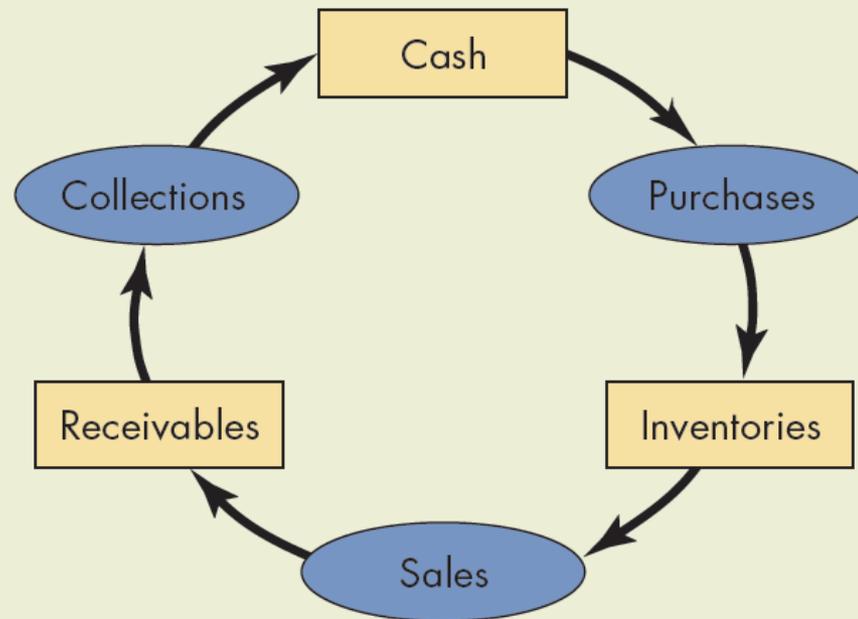
---

Cash and resources expected to be converted to cash during the entity's normal operating cycle or one year, whichever is longer, are ***current assets***:

- Cash
- Receivables
- Inventories

# Operating Cycle

## EX 3-4 OPERATING CYCLE



# Current Assets

---

The *normal operating cycle* involves the use of cash to purchase inventories, the sale of inventories resulting in receivables, and ultimately the cash collection of those receivables.

# Current Assets

---

- In addition to cash, receivables, and inventories, current assets typically include prepaid expenses and investments in certain securities.
- Debt and equity securities (often called bonds and stocks) that are purchased mainly with the intent of reselling these securities in the short term are called *trading securities*.

# Current Assets

---

- Current assets are normally listed on the balance sheet before the noncurrent assets and in the order of their liquidity, with the most liquid items first.
- *Liquid* refers to those closest to cash.
- This order is a tradition, not a requirement.

# Noncurrent Assets

---

Assets not qualifying for presentation under the current heading are classified under a number of noncurrent headings. Noncurrent assets may be listed under separate headings, such as:

- Investments
- Property, Plant, and Equipment
- Intangible Assets
- Other Noncurrent Assets

# Investments

---

- Investments held for such long-term purposes as regular income, appreciation, or ownership control are reported under the heading *Investments*.
- The Investment heading also includes other miscellaneous investments not used directly in the operations of the business.

# Property, Plant, and Equipment

---

## *Property, Plant, and Equipment*

includes properties of a tangible and relatively permanent nature that are used in the normal business operations, such as:

- Land
- Buildings
- Machinery
- Tools

# Intangible Assets

---

*Intangible assets* are long-term rights and privileges of a nonphysical nature acquired for use in business operations, such as:

- Goodwill
- Patents
- Trademarks
- Franchises
- Patents
- Formulas

# Other Noncurrent Assets

---

Those noncurrent assets not suitably reported under any of the previous classifications may be listed under the general heading “Other Noncurrent Assets”:

- Long-term advances to officers
- Long-term receivables
- Deposits made with taxing authorities and utility companies
- Deferred income tax assets

# Deferred Income Tax Assets

---

*Deferred income tax assets* arise when taxable income exceeds reported income for the period and the difference is expected to “reverse” in future periods.

# Current Liabilities

---

***Current liabilities*** are those obligations that are reasonably expected to be paid using current assets or by creating other current liabilities, such as:

- Accounts and notes payable
- Salaries payable
- Wages, interest, and taxes payable
- Current portion of long-term obligations

# Not Normally Current Liabilities

---

## Sinking Fund

Debts to be liquidated from a noncurrent sinking fund. A *sinking fund* is comprised of cash and investment securities that have been accumulated for the stated purpose of repaying a specific loan.

# Not Normally Current Liabilities

---

## Short-Term Obligations

### *Short-term obligation to be refinanced.*

If a short-term loan is expected to be refinanced or paid back with the proceeds of a replacement loan, the existing short-term loan will not require the use of current assets even though it is scheduled to mature within a year.

# International Standard

---

- The international standard for classification of short-term obligations to be refinanced is slightly different.
- According to **IAS 1**, for the obligation to be classified as long-term the refinancing must take place by the balance sheet date.

# Callable Obligations

---

- A *callable obligation* is one that is payable on demand and thus has no specified due date.
- If the terms of an agreement specify that an obligation is due on demand or will become due on demand within one year from the balance sheet date, the obligation ***should be classified as current.***

# Objective Acceleration Clauses

---

- Loan agreement clauses that identify specific deficiencies that can cause a loan to be immediately callable are referred to as ***objective acceleration clauses***.
- If these deficiencies exist as of the balance sheet date, the associated liability should be classified as current unless the lender has agreed to waive the right by the time the financial statements are issued.

# Subjective Acceleration Clauses

---

- In some cases, the debt agreement does not specifically identify the circumstances under which a loan will become callable, but it does indicate some general conditions that permit the lender to accelerate the due date. This type of provision is known as ***subjective acceleration clauses***.
- If invoking the clause is considered to be reasonably possible but not probable, only a note disclosure is necessary.

# Noncurrent Liabilities

---

Obligations not reasonably expected to be paid or otherwise satisfied within 12 months are classified as *noncurrent liabilities*. They are usually listed under separate headings, such as:

- Long-Term Debt
- Long-Term Lease Obligations
- Deferred Income Tax Liability
- Other Noncurrent Liabilities

# Long-Term Debt

---

- Long-term notes, bonds, mortgages, and similar obligations not requiring the use of current funds for their retirement are generally reported on the balance sheet under the heading Long-Term Debt.
- When the amount borrowed is not the same as the amount ultimately required to be repaid, called the *maturity value*, a discount or premium is included as an adjustment to the maturity value.

# Long-Term Debt

---

- A discount should be subtracted from the amount reported for the debt.
- A premium should be added to the amount reported for the debt.
- When a note, a bond issue, or a mortgage formerly classified as a long-term obligation becomes payable within a year, it should be reclassified as a current liability except when the obligation is to be refinanced.

# Long-Term Lease Obligations

---

- Some leases of property, plant, and equipment are financially structured so that they are essentially debt-financed purchases.
- The FASB has established criteria to determine which leases are to be accounted for as purchases, or capital leases, rather than as ordinary leases.

# Deferred Income Tax Liability

---

- A *deferred income tax liability* can be thought of as the income tax expected to be paid in future years on income that has already been reported in the income statement but which, because of the tax law, has not been taxed.
- The liability is valued using the enacted income tax rates expected to prevail in the future when the income is taxed.

# Other Noncurrent Liabilities

---

Those noncurrent liabilities not suitably reported under the separate headings outlined earlier may be listed under this general heading or may be listed separately under special descriptive headings.

Examples are:

- Pension plans
- Obligations resulting from advance collections on long-term contracts

# Contingent Liability

---

- Past activities or circumstances may give rise to possible future liabilities although obligations do not exist on the balance sheet date. These possible claims are known as ***contingent liabilities***.
- If the future payment is considered probable, the liability should be recorded by a debit to a loss account and a credit to a liability account.
- If future payment is possible, the contingent nature of the loss is disclosed in a note to the financial statements.

(continued)

# Contingent Liability

---

**Probable:** This category means that the future event will likely occur.

For example, the IRS examination is winding down, and because of the volume of tax code and court cases the government has provided to date supporting its position, your client is fairly certain that additional tax will be assessed.

# Contingent Liability

---

**Reasonably possible:** The chance of the future event happening is more than remote but less than probable.

For example, your audit client is involved in a lawsuit, but at this point in the proceedings, not enough evidence has been presented in court to rule out a judgment for or against the company.

# Contingent Liability

---

**Remote:** The chance of the future event taking place is remote.

For example, your client selling a faulty product and having significant warranty claims as a result. If your client has isolated the bad product, recalled it, and settled the related warranty claims, chances are slim that it will need to deal with similar warranty issues on that product in the future.

# Contingent Liability

---

- If the future payment is remote, no accounting action is necessary.
- A contingent liability is distinguished from an estimated liability.
- An *estimated liability* is a definite obligation with only the amount of the obligation in question and subject to estimation at the balance sheet date.
- **Examples of estimated liabilities – also called provisions – include income tax payable and warranty liability.**

# Owners' Equity

---

- **Proprietorships**—The owner's equity in assets is reported by means of a single capital account.
- **Partnerships**—Capital account balances summarize the investments and withdrawals and shares of past earnings and losses of each partner.

**Seventy percent of U.S. businesses are organized as sole proprietorships.**

(continued)

# Owners' Equity

---

- In a corporation, the difference between assets and liabilities is referred to as ***stockholders' (shareholders') equity***.
- Generally divided into two parts:
  - ***Contributed capital*** or ***paid-in-capital***
  - The equity originating from earnings is referred to as ***retained earnings***

# Contributed Capital

---

Two parts of contributed capital:

1. **Capital stock**—The number of shares  $\times$  the par value
  - a. Preferred stock
  - b. Common stock
2. **Additional paid-in capital**

# Preferred Stock

---

In essence, *preferred stock* is an investment that has some of the characteristics of a loan:

- Fixed periodic payment
- No vote for the board of directors
- Higher priority than common stock in case of bankruptcy liquidation

# Common Stock

---

Common stockholders are the real owners of the corporation:

- They vote for the board of directors
- Have legal ownership of the corporate assets after the claims of all creditors and preferred stockholders have been satisfied.

# Additional Paid-In Capital

---

- Additional paid-in capital represents investments by stockholders in excess of the par or stated value of the capital stock.
- It is also affected by a whole host of diverse transactions such as:
  - Stock repurchases
  - Stock dividends
  - Share retirements and conversions

# Retained Earnings

---

- **Retained earnings (RE)** is the amount of undistributed earnings of past periods.
- A **deficit** is an excess of dividends and losses over earnings resulting in a negative retained earnings balance.
- Portions of retained earnings are sometimes reported as restricted and unavailable for dividends.
- Retained earnings restrictions can be part of a loan agreement or can be voluntarily adopted by a company (called an **appropriation**).

**EX** 3-5 LARGE POSITIVE AND NEGATIVE RETAINED EARNINGS BALANCES FOR THE YEAR 2009 (IN MILLIONS)



Company Name	Retained Earnings
Exxon	\$276,937
General Electric	126,363
Citigroup	77,440
Qwest	(42,953)
JDS Uniphase	(68,538)
Time Warner	(97,148)



Source: Standard and Poor's *COMPUSTAT*.

# Treasury Stock

---

- When a company buys back its own shares, accountants call the repurchased shares *treasury stock*.
- Treasury shares can be retired, or they can be retained and reissued later.
- Treasury stock is usually shown on the balance sheet as a subtraction from total stockholders' equity.

# Accumulated Other Comprehensive Income

---

- The FASB requires companies to summarize changes in owners' equity exclusive of net income and contributions by, and distributions to, owners.
- This summary, termed *other comprehensive income*, is typically provided by companies as part of their statement of stockholders' equity.

# Unrealized Gains and Losses on Available-for-Sale Securities

---

- Available-for-sale securities are those that were not purchased with the immediate intention to resell but also are not meant to be held permanently.
- These securities are reported in the balance sheet at their current market value.
- The unrealized gains and losses from market fluctuations are shown as a separate equity item.

# Foreign Currency Translation Adjustments

---

This adjustment arises from the change in the equity of foreign subsidiaries (as measured in terms of U.S. dollars) that occurs during the year as a result of changes in foreign currency exchange rates.

# Unrealized Gains and Losses on Derivatives

---

A *derivative* is a financial instrument, such as an option or a future, that derives its value from the movement of a price, an exchange rate, or an interest rate associated with some other item:

- Stock option
- Right to purchase foreign currency

# Minority Interest

---

- In the consolidated balance sheet, *minority* (or *noncontrolling*) *interest*, is the amount of equity investment made by outside shareholders to consolidated subsidiaries that are not 100% owned by the parent corporation.
- The minority interest is reported as part of owners' equity, but it is clearly listed separately from the parent's owners' equity.

# International Reserves

---

*International reserves* are merely different equity categories similar in nature, depending on the reserve, to additional paid-in capital or to restricted retained earnings.

# Offsets on the Balance Sheet

---

A number of balance sheet items are reported at gross amounts not reflecting their actual values, thus requiring the recognition of offset balances in arriving at proper valuations.

- Accounts Receivable/Allowance for Bad Debts
- Building/Accumulated Depreciation, Building
- Maturity value of loan/loan discount
- Total stockholders' equity/Treasury Stock

# Learning Objective 2

---

Identify the different formats used to present balance sheet data.

# Format of the Balance Sheet

---

- Generally, assets and liabilities are presented in their order of liquidity.
- Some industries with significant investments in land and buildings will list these items first on the balance sheet.
- Because long-term financing is so important in industries, such as utilities, the equity capital and long-term debt obtained to finance plant assets are listed before current liabilities.

(continued)

**Consolidated Edison, Inc.  
Consolidated Balance Sheet  
December 31, 2008 and 2007**

(Millions of Dollars)	At December 31,	
	2008	2007
<b>Assets</b>		
<b>Utility Plant, at Original Cost (Note A)</b>		
Electric .....	\$17,483	\$15,979
Gas .....	3,696	3,403
Steam .....	1,849	1,755
General .....	1,795	1,732
<b>Total</b> .....	<u>24,823</u>	<u>22,869</u>
Less: Accumulated depreciation .....	5,079	4,784
Net .....	19,744	18,085
Construction work in progress .....	1,109	1,028
<b>Net Utility Plant</b> .....	<u><b>20,853</b></u>	<u><b>19,113</b></u>
<b>Non-Utility Plant (Note A)</b>		
Non-utility property, less accumulated depreciation of \$40 and \$36 in 2008 and 2007, respectively .....	20	18
Non-utility property held for sale (Note V) .....	—	778
Construction work in progress .....	1	5
<b>Net Plant</b> .....	<u><b>20,874</b></u>	<u><b>19,914</b></u>

**(continued)**



## 3-6 CONSOLIDATED EDISON, INC.

### Current Assets

Cash and temporary cash investments (Note A) . . . . .	74	210
Accounts receivable—customers, less allowance for uncollectible accounts of \$58 and \$47 in 2008 and 2007, respectively. . . . .	952	970
Accrued unbilled revenue (Note A) . . . . .	131	149
Other receivables, less allowance for uncollectible accounts of \$6 in 2008 and 2007 . . . . .	339	288
Fuel oil, at average cost. . . . .	37	44
Gas in storage, at average cost . . . . .	325	215
Materials and supplies, at average cost . . . . .	154	146
Prepayments . . . . .	697	119
Fair value of derivative assets . . . . .	162	98
Recoverable energy costs (Notes A and B) . . . . .	172	213
Deferred derivative losses . . . . .	260	45
Current assets held for sale (Note V) . . . . .	—	40
Other current assets . . . . .	16	13

### Total Current Assets

**3,319**                      **2,550**

### Investments (Note A)

**356**                      **378**

### Deferred Charges, Regulatory Assets and Noncurrent Assets

Goodwill (Note K). . . . .	411	408
Intangible assets, less accumulated amortization of \$2 and \$1 in 2008 and 2007, respectively . . . . .	5	2
Regulatory assets (Note B) . . . . .	8,105	4,511
Noncurrent assets held for sale (Note V) . . . . .	—	88
Other deferred charges and noncurrent assets . . . . .	428	411

### Total Deferred Charges, Regulatory Assets and Noncurrent Assets

**8,949**                      **5,420**

### Total Assets

**\$33,498**                      **\$28,262**



# 3-6 CONSOLIDATED EDISON, INC. (Continued)

## Consolidated Edison, Inc. Consolidated Balance Sheet

(Millions of Dollars)	At December 31,	
	2008	2007
<b>Capitalization and Liabilities</b>		
<b>Capitalization</b>		
Common shareholders' equity (See Statement of Common Shareholders' Equity) . . . . .	\$ 9,698	\$ 9,076
Preferred stock of subsidiary (See Statement of Capitalization) . . . . .	213	213
Long-term debt (See Statement of Capitalization) . . . . .	9,232	7,611
<b>Total Capitalization</b> . . . . .	<b>19,143</b>	<b>16,900</b>
<b>Minority Interests</b> . . . . .	—	43
<b>Noncurrent Liabilities</b>		
Obligations under capital leases (Note J) . . . . .	17	22
Provision for injuries and damages (Note G) . . . . .	169	161
Pensions and retiree benefits . . . . .	4,511	938
Superfund and other environmental costs (Note G) . . . . .	250	327
Uncertain income taxes . . . . .	118	155
Asset retirement obligations (Note R) . . . . .	115	110
Fair value of derivative liabilities . . . . .	120	15
Noncurrent liabilities held for sale (Note V) . . . . .	—	61
Other noncurrent liabilities . . . . .	79	95
<b>Total Noncurrent Liabilities</b> . . . . .	<b>5,379</b>	<b>1,884</b>

(continued)



## 3-6 CONSOLIDATED EDISON, INC. (Continued)

### Current Liabilities

Long-term debt due within one year . . . . .	482	809
Notes payable . . . . .	363	840
Accounts payable . . . . .	1,161	1,187
Customer deposits . . . . .	265	249
Accrued taxes . . . . .	57	26
Accrued interest . . . . .	139	149
Accrued wages . . . . .	88	82
Fair value of derivative liabilities . . . . .	192	76
Deferred derivative gains (Note B) . . . . .	23	10
Deferred income taxes—recoverable energy costs (Note L) . . . . .	70	86
Current liabilities held for sale (Note V) . . . . .	—	28
Other current liabilities . . . . .	365	309

### Total Current Liabilities

**3,205** **3,851**

### Deferred Credits and Regulatory Liabilities

Deferred income taxes and investment tax credits (Notes A and L) . . . . .	4,999	4,465
Regulatory liabilities (Note B) . . . . .	737	1,097
Other deferred credits . . . . .	35	22

### Total Deferred Credits and Regulatory Liabilities

**5,771** **5,584**

### Total Capitalization and Liabilities

**\$33,498** **\$28,262**

(concluded)

**British Telecommunications  
Balance Sheet  
At 31 March 2009**

	<b>2009</b> <b>(In millions of British pounds)</b>
<b>Non current assets</b>	
Intangible assets . . . . .	£ 3,788
Property, plant and equipment . . . . .	15,405
Derivative financial instruments . . . . .	2,456
Investments . . . . .	55
Retirement benefit asset . . . . .	—
Associates and joint ventures . . . . .	132
Trade and other receivables . . . . .	322
Deferred tax assets . . . . .	1,103
	<b>23,261</b>
<b>Current assets</b>	
Inventories . . . . .	121
Trade and other receivables . . . . .	4,185
Derivative financial instruments . . . . .	244
Investments . . . . .	163
Cash and cash equivalents . . . . .	1,300
	<b>6,013</b>

**(continued)**



## 3-7 2009 BALANCE SHEET OF BRITISH TELECOMMUNICATIONS

### Current liabilities

Loans and other borrowings . . . . .	1,542
Derivative financial instruments . . . . .	340
Trade and other payables . . . . .	7,215
Current tax liabilities . . . . .	1
Provisions . . . . .	254
	<u>9,352</u>
<b>Total assets less current liabilities . . . . .</b>	<b><u>£19,922</u></b>

### Non current liabilities

Loans and other borrowings . . . . .	£12,365
Derivative financial instruments . . . . .	427
Retirement benefit obligations . . . . .	3,973
Other payables . . . . .	794
Deferred tax liabilities . . . . .	1,728
Provisions . . . . .	466
	<u>19,753</u>

### Equity

Ordinary shares . . . . .	408
Share premium . . . . .	62
Capital redemption reserve . . . . .	27
Other reserves . . . . .	1,301
Retained (loss) earnings . . . . .	(1,656)
<b>Total parent shareholders' equity . . . . .</b>	<b><u>142</u></b>
Minority interests . . . . .	27
<b>Total equity . . . . .</b>	<b><u>169</u></b>
	<u>£19,922</u>

# Format of Foreign Balance Sheets

---

- Foreign balance sheets are frequently presented with property, plant, and equipment and intangibles listed first.
- They frequently list the current assets and current liabilities together and label the difference between the two as net current assets or net working capital.



# 3-8 TECHTRONICS' BALANCE SHEET, WITH AND WITHOUT CLASSIFICATION

**Techtronics Corporation**  
**Balance Sheet**  
**December 31, 2013**

WITHOUT CLASSIFICATION	WITH CLASSIFICATION
<b>Assets</b>	<b>Assets</b>
Buildings and equipment (net of accumulated depreciation of \$228,600) . . . . .	Current assets:
\$ 732,900	Cash . . . . . \$ 52,650
Cash . . . . .	Investment securities . . . . . 67,350
52,650	Receivables (less allowance for bad debts) . . . . . 363,700
Intangible assets . . . . .	Inventories . . . . . 296,000
165,000	Prepaid expenses . . . . . 32,900
Inventories . . . . .	Total current assets . . . . . <u>\$ 812,600</u>
296,000	Noncurrent assets:
Investments . . . . .	Investments . . . . . \$ 128,000
128,000	Land . . . . . 76,300
Investment securities . . . . .	Buildings and equipment (net of accumulated depreciation of \$228,600) . . . . . 732,900
67,350	Intangible assets . . . . . 165,000
Land . . . . .	Other noncurrent assets . . . . . 37,800
76,300	Total noncurrent assets . . . . . <u>\$1,140,000</u>
Other noncurrent assets . . . . .	Total assets . . . . . <u><u>\$1,952,600</u></u>
37,800	
Prepaid expenses . . . . .	
32,900	
Receivables (less allowance for bad debts). . . . .	
363,700	
Total assets . . . . . <u><u>\$1,952,600</u></u>	

(continued)

**EX 3-8** TECHTRONICS' BALANCE SHEET, WITH AND WITHOUT CLASSIFICATION

<b>Liabilities</b>	
Accounts payable . . . . .	\$ 312,700
Accrued expenses . . . . .	46,200
Bonds payable . . . . .	165,000
Current portion of long-term debt . . . . .	62,000
Deferred tax liability . . . . .	126,700
Long-term lease obligations . . . . .	135,000
Notes payable—current . . . . .	50,000
Notes payable—noncurrent . . . . .	100,000
Other current liabilities . . . . .	28,600
Other noncurrent liabilities . . . . .	72,500
Total liabilities . . . . .	<u>\$1,098,700</u>

<b>Stockholders' Equity</b>	
Additional paid-in capital . . . . .	\$ 375,000
Common stock . . . . .	170,000
Retained earnings . . . . .	<u>308,900</u>
Total stockholders' equity . . . . .	<u>\$ 853,900</u>
Total liabilities and stockholders' equity . . . . .	<u>\$1,952,600</u>

<b>Liabilities</b>	
Current liabilities:	
Notes payable . . . . .	\$ 50,000
Accounts payable . . . . .	312,700
Accrued expenses . . . . .	46,200
Current portion of long-term debt . . . . .	62,000
Other current liabilities . . . . .	<u>28,600</u>
Total current liabilities . . . . .	<u>\$ 499,500</u>
Noncurrent liabilities:	
Notes payable . . . . .	\$ 100,000
Bonds payable . . . . .	165,000
Long-term lease obligations . . . . .	135,000
Deferred tax liability . . . . .	126,700
Other noncurrent liabilities . . . . .	<u>72,500</u>
Total noncurrent liabilities . . . . .	<u>\$ 599,200</u>
Total liabilities . . . . .	<u>\$1,098,700</u>

<b>Stockholders' Equity</b>	
Contributed capital:	
Common stock . . . . .	\$ 170,000
Additional paid-in capital . . . . .	<u>375,000</u>
	\$ 545,000
Retained earnings . . . . .	<u>308,900</u>
Total stockholders' equity . . . . .	<u>\$ 853,900</u>
Total liabilities and stockholders' equity . . . . .	<u>\$1,952,600</u>

# Learning Objective 3

---

Analyze a company's performance and financial position through the computation of financial ratios.

# Balance Sheet Information is Analyzed in Two Major Ways

---

- Relationships between balance sheet amounts
- Relationships between balance sheet and income statement amounts

In general, relationships between financial statement amounts are called financial ratios.

# Liquidity

---

- **Liquidity** is the ability of a firm to satisfy its short-term obligations.
- A common indicator of the overall liquidity of a company is the current ratio. The **current ratio** is computed by dividing total current assets by total current liabilities.

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

# Liquidity

---

The WITH CLASSIFICATION section of *Exhibit 3-8* will serve as the source of information for all ratios in *Slides 3-78, 3-81, 3-84, and 3-85*.

Assets	
Current assets:	
Cash .....	\$ 52,650
Investment securities .....	67,350
Receivables (less allowance for bad debts) .....	363,700
Inventories .....	296,000
Prepaid expenses .....	32,900
Total current assets .....	<u>\$ 812,600</u>
Noncurrent assets:	
Investments .....	\$ 128,000
Land .....	76,300
Buildings and equipment (net of accumulated depreciation of \$228,600) .....	732,900
Intangible assets .....	165,000
Other noncurrent assets .....	37,800
Total noncurrent assets .....	<u>\$1,140,000</u>
Total assets .....	<u><u>\$1,952,600</u></u>

Liabilities	
Current liabilities:	
Notes payable .....	\$ 50,000
Accounts payable .....	312,700
Accrued expenses .....	46,200
Current portion of long-term debt .....	62,000
Other current liabilities .....	28,600
Total current liabilities .....	<u>\$ 499,500</u>
Noncurrent liabilities:	
Notes payable .....	\$ 100,000
Bonds payable .....	165,000
Long-term lease obligations .....	135,000
Deferred tax liability .....	126,700
Other noncurrent liabilities .....	72,500
Total noncurrent liabilities .....	<u>\$ 599,200</u>
Total liabilities .....	<u><u>\$1,098,700</u></u>

## Current Ratio

---

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

\$812,600

\$499,500

= 1.63

Current ratios for successful companies today are frequently less than 1.0.

# Liquidity

---

Another ratio used to measure a firm's liquidity is the **quick ratio**, also known as the **acid-test ratio**. It indicates how well a firm can satisfy existing short-term obligations with assets that can be converted into cash without difficulty.

$$\text{Quick ratio} = \frac{\text{Cash} + \text{Securities} + \text{Receivables}}{\text{Current liabilities}}$$

Assets	
Current assets:	
Cash .....	\$ 52,650
Investment securities .....	67,350
Receivables (less allowance for bad debts) .....	363,700
Inventories .....	296,000
Prepaid expenses .....	32,900
Total current assets .....	<u>\$ 812,600</u>
Noncurrent assets:	
Investments .....	\$ 128,000
Land .....	76,300
Buildings and equipment (net of accumulated depreciation of \$228,600) .....	732,900
Intangible assets .....	165,000
Other noncurrent assets .....	37,800
Total noncurrent assets .....	<u>\$1,140,000</u>
Total assets .....	<u><u>\$1,952,600</u></u>

Liabilities	
Current liabilities:	
Notes payable .....	\$ 50,000
Accounts payable .....	312,700
Accrued expenses .....	46,200
Current portion of long-term debt .....	62,000
Other current liabilities .....	28,600
Total current liabilities .....	<u>\$ 499,500</u>
Noncurrent liabilities:	
Notes payable .....	\$ 100,000
Bonds payable .....	165,000
Long-term lease obligations .....	135,000
Deferred tax liability .....	126,700
Other noncurrent liabilities .....	72,500
Total noncurrent liabilities .....	<u>\$ 599,200</u>
Total liabilities .....	<u><u>\$1,098,700</u></u>

## Quick Ratio

(Cash + Sec. + Rec.)

Current liabilities

\$483,700

\$499,500

= 0.97

## EX 3-9 SELECTED 2009 RATIOS



	Coca-Cola	Disney	McDonald's	Microsoft	eBay
Current ratio	1.28	1.33	1.14	1.82	2.32
Debt ratio	47.92%	43.87%	53.57%	49.21%	25.10%
Asset mix—PP&E*	19.64%	36.00%	71.24%	9.67%	7.14%
Asset turnover	0.64	0.57	0.75	0.75	0.47
Return on assets	14.02%	5.24%	15.06%	18.71%	12.98%
Return on equity	27.52%	9.80%	32.43%	36.83%	17.33%

\* PP&E = property, plant, and equipment



# Overall Leverage

---

- Comparing the amount of liabilities to the amount of assets held by a business indicates the extent to which borrowed funds have been used to *leverage* the owners' investments and increase the size of the firm.
- One frequently used measure of leverage is the *debt ratio*.

(continued)

### Assets

Current assets:	
Cash .....	\$ 52,650
Investment securities .....	67,350
Receivables (less allowance for bad debts) .....	363,700
Inventories .....	296,000
Prepaid expenses .....	32,900
Total current assets .....	<u>\$ 812,600</u>
Noncurrent assets:	
Investments .....	\$ 128,000
Land .....	76,300
Buildings and equipment (net of accumulated depreciation of \$228,600) .....	732,900
Intangible assets .....	165,000
Other noncurrent assets .....	37,800
Total noncurrent assets .....	<u>\$1,140,000</u>
Total assets .....	<u><u>\$1,952,600</u></u>

### Liabilities

Current liabilities:	
Notes payable .....	\$ 50,000
Accounts payable .....	312,700
Accrued expenses .....	46,200
Current portion of long-term debt .....	62,000
Other current liabilities .....	28,600
Total current liabilities .....	<u>\$ 499,500</u>
Noncurrent liabilities:	
Notes payable .....	\$ 100,000
Bonds payable .....	165,000
Long-term lease obligations .....	135,000
Deferred tax liability .....	126,700
Other noncurrent liabilities .....	72,500
Total noncurrent liabilities .....	<u>\$ 599,200</u>
Total liabilities .....	<u><u>\$1,098,700</u></u>

## Debt Ratio

Total liabilities

Total assets

\$1,098,700

\$1,952,600

= 0.56

Techtronics  
borrowed 50% of  
the money it  
needed to buy its  
assets.

# Asset Mix

---

A company's *asset mix*, the proportion of total assets in each asset category, is determined to a large degree by the industry in which the company operates.

$$\text{Asset mix} = \frac{\text{Asset category}}{\text{Total assets}}$$

(continued)

# Asset Mix for Building and Equipment

## Building and Equipment

Total assets

\$732,900

\$1,952,600

= 0.38

Techtronics holds 38% of its assets in the form of buildings and equipment.

Assets	
Current assets:	
Cash .....	\$ 52,650
Investment securities .....	67,350
Receivables (less allowance for bad debts) .....	363,700
Inventories .....	296,000
Prepaid expenses .....	32,900
Total current assets .....	<u>\$ 812,600</u>
Noncurrent assets:	
Investments .....	\$ 128,000
Land .....	76,300
Buildings and equipment (net of accumulated depreciation of \$228,600) .....	732,900
Intangible assets .....	165,000
Other noncurrent assets .....	37,800
Total noncurrent assets .....	<u>\$1,140,000</u>
Total assets .....	<u><u>\$1,952,600</u></u>

Liabilities	
Current liabilities:	
Notes payable .....	\$ 50,000
Accounts payable .....	312,700
Accrued expenses .....	46,200
Current portion of long-term debt .....	62,000
Other current liabilities .....	28,600
Total current liabilities .....	<u>\$ 499,500</u>
Noncurrent liabilities:	
Notes payable .....	\$ 100,000
Bonds payable .....	165,000
Long-term lease obligations .....	135,000
Deferred tax liability .....	126,700
Other noncurrent liabilities .....	72,500
Total noncurrent liabilities .....	<u>\$ 599,200</u>
Total liabilities .....	<u><u>\$1,098,700</u></u>

# Relationships Between Balance Sheet and Income Statement Amounts

---

Financial ratios comparing balance sheet and income statement amounts reveal information:

- about a firm's overall profitability and
- about how efficiently the assets are being used.

(continued)

# Efficiency

A financial ratio that gives an overall measure of company efficiency is called ***asset turnover***. Techtronic's balance sheet reveals that it has \$1,952,600 in assets. Assuming sales of \$4,000,000, the turnover is calculated as follows:

$$\frac{\text{Sales}}{\text{Total assets}} = \frac{\$4,000,000}{\$1,952,600} = 2.05$$

Techtronics generates \$2.05 in sales for each dollar of assets.

# Overall Profitability

---

To appropriately measure profitability, net income must be compared to some measure of the size of the investment. Two financial ratios used to assess a firm's overall profitability are *return on assets* and *return on equity*.

(continued)

# Overall Profitability

---

## Return on Assets

$$\frac{\text{Net income}}{\text{Total assets}} = \frac{\$150,000}{\$1,952,600} = 7.7\%$$

This means that one dollar of Techronics' assets generated 7.7 cents in net income.

(continued)

# Overall Profitability

---

## Return on Equity

$$\frac{\text{Net income}}{\text{Stockholders' equity}} = \frac{\$150,000}{\$853,900} = 17.6\%$$

Techronics' stockholders earned 17.6 cents per each dollar of equity invested.

# Proposed New Balance Sheet Format

---

- The FASB and the IASB are currently engaged in a long-term project to restructure the way information is presented in financial statements.
- A restructured balance sheet for Techtronics found in **Exhibit 3-8** has been reformatted and now appears in **Exhibit 3-10**.

(continued)

**Techtronics Corporation**  
**Balance Sheet (restructured according to FASB-IASB proposal)**  
**December 31, 2013**

**BUSINESS**

**Operating**

Current assets:

Receivables (less allowance for bad debts) . . . . .	\$ 363,700	
Inventories . . . . .	296,000	
Prepaid expenses . . . . .	32,900	
<b>Total short-term assets . . . . .</b>	<b>692,600</b>	<b>\$ 692,600</b>
Land . . . . .	\$ 76,300	
Buildings and equipment (net of accumulated depreciation of \$228,600) . . . . .	732,900	
Intangible assets . . . . .	165,000	
Other long-term assets . . . . .	37,800	
<b>Total long-term assets . . . . .</b>	<b>1,012,000</b>	<b>1,012,000</b>
Accounts payable . . . . .	\$ (312,700)	
Accrued expenses . . . . .	(46,200)	
Other current liabilities . . . . .	(28,600)	
<b>Total short-term liabilities . . . . .</b>	<b>(387,500)</b>	<b>(387,500)</b>
Other long-term liabilities . . . . .		(72,500)
<b>Net operating assets . . . . .</b>		<b>1,244,600</b>

**(continued)**

**EX** 3-10

**Investing**

Investment securities (short-term) . . . . .	\$ 67,350		
Investments (long-term) . . . . .	<u>128,000</u>		
<b>Total investing assets.</b> . . . . .		<u>195,350</u>	
<b>NET BUSINESS ASSETS</b> . . . . .			<b>\$1,439,950</b>

**FINANCING**

Financing assets . . . . .			
Cash . . . . .		52,650	
Financing liabilities . . . . .			
Notes payable . . . . .	\$ (50,000)		
Current portion of long-term debt . . . . .	<u>(62,000)</u>		
Total short-term financing liabilities . . . . .		(112,000)	
Notes payable . . . . .	\$ (100,000)		
Bonds payable . . . . .	(165,000)		
Long-term lease obligations . . . . .	<u>(135,000)</u>		
Total long-term financing liabilities . . . . .		<u>(400,000)</u>	
Total financing liabilities . . . . .		(512,000)	
<b>NET FINANCING LIABILITIES</b> . . . . .			<b>(459,350)</b>

**INCOME TAXES**

Deferred tax liability . . . . .			<u>(126,700)</u>
<b>NET ASSETS.</b> . . . . .			<b><u>\$ 853,900</u></b>

**EQUITY**

Common stock . . . . .	\$ (170,000)		
Additional paid-in capital . . . . .	(375,000)		
Retained earnings . . . . .	<u>(308,900)</u>		
<b>TOTAL EQUITY</b> . . . . .			<b><u>\$ (853,900)</u></b>

# Proposed New Balance Sheet Format

---

- The balance sheet contains four major sections: business, financing, income taxes, and equity. A fifth section for a company that has ceased operations is called “discontinued operations.”
- Items related to activities associated with a company’s financial operations are reported separated from items related to actual day-to-day functions of the business.

(continued)

# Proposed New Balance Sheet Format

---

- Items related to income taxes are also highlighted and reported separately.
- The format makes it a little difficult to add up the traditional measures of total assets and total liabilities. The proposed restructuring would also require supplemental disclosure of these traditional numbers.

# Learning Objective 4

---

Recognize the importance of the notes to the financial statements, and outline the types of disclosures made in the notes.

# Typical Notes to the Financial Statements

---

- Summary of significant accounting policies.
- Additional information to support summary totals found on the financial statements, usually the balance sheet.
- Information about items that are not reported on the basic statements because the item fails to meet recognition criteria but are still important for users in their decision making.
- Supplementary information required by the FASB or the SEC to fulfill the full disclosure principle.

# Subsequent Events

---

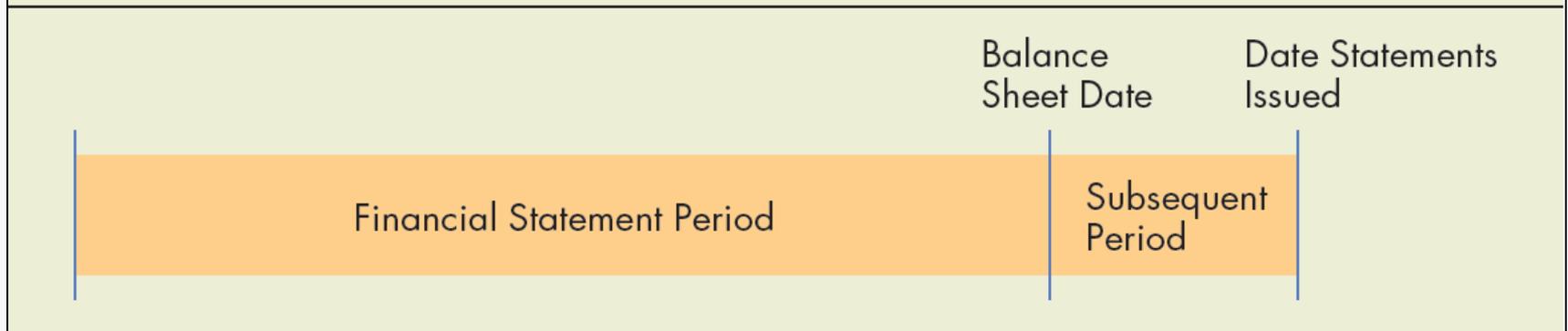
- The SEC requires large publicly traded companies to file their financial statements within 60 days of fiscal year-end.
- Business continues during this “subsequent period” and events could take place that have an impact upon the firm’s financial statements for the preceding year.
- These events are referred to in the accounting literature as *subsequent events* or *post-balance sheet events*.

# Subsequent Events

---

**EX**

## 3-11 SUBSEQUENT EVENT INTERVAL



# International Accounting for Subsequent Events

---

- The IASB has released **IAS 10**, dealing specifically with the accounting for subsequent events.
- **IAS 10** requires that companies adjust the reported amount of assets and liabilities if events occurring after the balance sheet date provide additional information about conditions that existed at the balance sheet date.

(continued)

# International Accounting for Subsequent Events

---

- **IAS 10** requires that disclosure be made of significant subsequent events even if those events do not impact the valuations reported in the balance sheet.

# Learning Objective 5

---

Understand the major limitations of the balance sheet.

# Limitations of the Balance Sheet

---

- Balance sheets do not generally reflect the current value of a business.
- A favorite ratio among followers of the stock market is the *book-to-market ratio*, which reflects the difference between the balance sheet value of a company and the company's actual market value.



# 3-12 AVERAGE BOOK-TO-MARKET RATIO OF COMPANIES LISTED IN THE DOW JONES INDUSTRIAL AVERAGE: 1924-2008



Source: *The Wall Street Journal*, March 30, 1999, p. C14. The original source has been augmented with data from [www.djindexes.com](http://www.djindexes.com).

# Chapter 3

---



