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VII. FINANCIAL STATEMENTS

A. Balance Sheet:
1. Definition: Summarizes a company’s economic resources, economic obligations, and equity and their relationships on a particular date.
2. Assets: Probable future economic benefits obtained or controlled as a result of past transactions or events.
3. Liabilities: Probable future sacrifices of economic benefits arising from present obligations to transfer assets or provide services in the future as a result of past transactions or events.
4. Equity: Residual interest of owners in assets after deducting liabilities.
5. Measurement Methods: Alternative valuation methods of assets (and liabilities) include: (a) Historical Cost: Amount of cash (or equivalent) paid to acquire asset, (b) Current Cost: Amount of cash (or equivalent) that would be paid currently to acquire same asset, (c) Current Market Value: Amount of cash (or equivalent) that could be obtained currently by selling asset in orderly liquidation, (d) Net Realizable Value: Amount of cash (or equivalent) into which asset is expected to be converted in ordinary course of business, less direct conversion costs, and (e) Present Value: Present value of future net cash flows expected from conversion of asset in ordinary course of business.

B. Income Statement:
1. Definition: Summarizes the results of a company’s income-producing operations for an accounting period.
2. Revenues: Inflows of assets or settlement of liabilities during a period from delivering or producing goods, rendering services, or other activities involving ongoing major operations.
3. Expenses: Outflows of assets or incurrences of liabilities during a period from delivering or producing goods, rendering services, or other activities involving ongoing major operations.
4. Gains (Losses): Increases (decreases) in equity from peripheral or incidental transactions and from all other events and circumstances during a period except those resulting from revenues (expenses) or investments by (distributions to) owners.

C. Statement of Cash Flows:
1. Definition: Summarizes a company’s cash inflows, cash outflows, and net change in cash from its operating, investing, and financing activities during an accounting period, in a manner that reconciles the beginning and ending cash balances.
2. Operating Cash Flows: Inflows and outflows of cash from acquiring, producing, selling, and delivering goods for sale, as well as providing services. Reported under either indirect or direct method.
3. Investing Cash Flows: Inflows and outflows of cash from acquiring and selling investments, property, plant, and equipment, and intangibles, as well as from lending money and collecting on loans.
4. Financing Cash Flows: Inflows and outflows of cash from obtaining resources from owners and creditors, and providing a return on (and of) their investment, as well as repaying amounts borrowed on long-term credit.

D. Supporting Statements, Schedules, and Notes: Supplement the primary financial statements. May include: (1) statement of retained earnings, which primarily reconciles retained earnings for the net income and the dividends of the accounting period, (2) statement of changes in stockholders’ equity, which primarily itemizes the changes in the various components due to investments by and distributions to stockholders, (3) schedule of investing and financing activities not affecting cash, which summarizes the results of noncash investing and/or financing activities, and (4) notes describing a company’s required disclosures.

E. Elements: Items comprising a financial statement.
VIII. COMPREHENSIVE INCOME

A. Definition: A company’s net income plus its other comprehensive income.

B. Other Comprehensive Income: Includes: (1) unrealized increase (decrease) in market (fair) value of investments in available-for-sale securities, (2) change in excess of additional pension liability over unrecognized prior service cost, (3) certain gains (losses) on “derivative” financial statements, and (4) translation adjustment from converting the financial statements of foreign operations into U.S. dollars.

C. Reporting Alternatives: A company may report its comprehensive income: (1) on the face of its income statement, (2) in a separate statement of comprehensive income, or (3) in its statement of changes in stockholders’ equity. The chosen statement must be displayed as a major financial statement.

IX. REVENUE RECOGNITION CRITERIA

A. Criteria: Revenue is recorded and reported when: (1) realization has taken place, and (2) earning process is complete or nearly complete.

B. Realization: Process of converting noncash resources into cash or rights to cash. Includes (1) realized, the actual exchange of noncash resources into cash or near cash, or (2) realizable, the situation where noncash resources are readily convertible into known amounts of cash or claims to cash.

C. Earning Process: Process of acquisition, production and/or distribution, sales, and collection of cash. Is complete or nearly complete when the company has accomplished what it must do to be entitled to the benefits.

X. EXPENSE RECOGNITION CRITERIA

A. Matching: Allocation of expenses incurred (efforts) against revenues (benefits) earned during period.

B. Association of Cause and Effect: Costs recognized as expenses based on direct association with revenues.

C. Systematic and Rational Allocation: Costs recognized as expenses based on systematic and rational allocation.

D. Immediate Recognition: Costs recognized as expenses in current period because (1) there are no discernible future benefits, or (2) it is not useful to allocate to future periods.

XI. REVENUE RECOGNITION ISSUES

A. Economic Substance: Economic substance of event takes precedence over legal form of transaction.

B. Risks and Benefits: Risks and benefits of ownership have been transferred to the buyer.

C. Collectibility: Collectibility of receivable is reasonably certain.

XII. ALTERNATIVE REVENUE RECOGNITION METHODS

A. Accrual Method: Revenues are recognized at time of sale and expenses are matched against revenues in period of sale. Usual method of revenue and expense recognition. Primary alternatives are percentage-of-completion, proportional performance, installment, and cost recovery methods.

B. Percentage-of-Completion Method: Construction revenues and expenses are recognized each period during life of long-term construction contract in proportion to amount of contract completed during period.

C. Proportional Performance Method: Revenues on long-term service contract are recognized based on proportional performance of each service act. Service costs are categorized as (1) initial direct costs, (2) direct costs, or (3) indirect costs, and are recognized as expenses accordingly.

D. Installment Method: Gross profit is deferred in period of sale. A portion of deferred gross profit is recognized as gross profit each period based on the gross profit percentage and the cash collected.

E. Cost Recovery Method: Gross profit is deferred in period of sale. No gross profit is recognized until cost of product has been recovered; after the cost recovery, gross profit is recognized equivalent to cash receipts.