

FA Module 4: The balance sheet (statement of financial position) – overview 4th edition

(The attached PDF file has better formatting.)

(Readings from the fourth 4th edition of the Robinson text.)

Reading: chapter 4, “Understanding Balance Sheets,” *excluding*

- ! Example 2 (Analysis of Deferred Revenue)
- ! Example 3 (Measuring Intangible Assets)
- ! Example 4 (goodwill impairment)
- ! Exhibit 16 (Apple’s statement of changes in shareholders’ equity)
- ! Exhibit 18 (common-size balance sheet statistics for the S&P 500 by S&P / MSCI GICS sector)

The measurement base of assets and liabilities – historical cost vs fair value – affects most modules. GAAP uses historical cost (or depreciated cost or amortized cost) for fixed assets; IFRS allows fair value for some fixed assets. Both GAAP and IFRS use a mix of historical cost and fair value for financial asset and liabilities.

This chapter uses the GAAP terms to classify financial assets. The IFRS 9 classification is somewhat different and is covered in a later module.

For some items, the balance sheet uses fair value and the income statement uses historical cost, with the difference reported in other comprehensive income.

- ! Unrealized capital gains and losses are on the balance sheet and other comprehensive income, but not on the income statement.
- ! Foreign currency translation causes a translation adjustment on the balance sheet (other comprehensive income) with the current rate method, but a remeasurement gain or loss on the income statement (flowing to retained earnings on the balance sheet) with the temporal method. *Foreign currency translation is not on the syllabus for this course.*

Final exam questions also deal with

- ! Inventory costing methods
- ! Accounting for gains and losses on marketable securities
- ! Deferred tax assets and liabilities
- ! Accounts receivable and accounts payable (eg. Example 1)
- ! Classification of assets and liabilities: current vs non-current
- ! Goodwill
- ! Financial assets
- ! Tangible vs intangible assets: trademarks, patents, copyrights, goodwill
- ! Statement of changes in shareholders’ equity
- ! Common-size analysis
- ! Simple versus complex capital structures; financial leverage

Exhibits 1 and 2 show the format of the balance sheet. Compare these exhibits with those of the income statement so that you know what entries appear in each financial statement. The format of the statements is not specified in GAAP or IFRS; you will not be tested on the format.

Review Example 1 Analysis of Accounts Receivable. This example is elementary, but the concept is used repeatedly in this course, especially in cash flow analysis.

Review Exhibit 6 SAP Group Consolidated Statements of Financial Position (Excerpt: Current Liabilities Detail) and Exhibit 7 Apple Inc. Consolidated Balance Sheet (Excerpt: Current Liabilities Detail). Know the meaning of Accounts payable, Accrued expenses, Deferred revenue, Current liabilities, Noncurrent liabilities.

Know well Exhibit 19 Balance Sheet Ratios. Final exam problems often require you to compute financial ratios. The financial leverage ratio = total assets ÷ total equity often uses total average assets ÷ total average liabilities, particularly for Dupont analysis. The Dupont analysis problems on the final exam expect you to use average assets and liabilities; other final exam problems will tell you whether to use average assets and liabilities or year-end figures.

The chapters on the income statement and the balance sheet introduce the concepts and the terms; all the mathematics is covered in later chapters. Dupont analysis, accumulated depreciation, deferred tax assets and liabilities, goodwill, and financial leverage are tested on the final exam, but the material is in later modules.