


Chapter 2, Module 1 – Financial Statements

Slide 1

Chapter 2 Module 1

AMIS 211
Introduction to Financial Accounting

Professor Marc Smith



The slide content is enclosed in a black rectangular border. At the top, there is a dark grey horizontal bar with the text "Chapter 2 Module 1" in white, italicized font. Below this bar, the text "AMIS 211" and "Introduction to Financial Accounting" is centered in a bold, black, sans-serif font. Underneath, "Professor Marc Smith" is centered in a smaller, black, sans-serif font. The logo for Ohio State University Fisher College of Business is centered below the text. The logo consists of a square with "OHIO STATE UNIVERSITY" inside and "FISHER COLLEGE OF BUSINESS" to its right. At the bottom of the slide content area, there is a light grey horizontal bar above a dark grey horizontal bar.

Hi everyone. Welcome back.

In this particular module, let's begin a discussion of those Financial Statements.

So, let's go ahead and go to the next slide with me.

Slide 2

Chapter 2 Module 1: Financial Statements

Financial Statements

Financial statements are a set of accounting reports that convey economic and financial information to outside users such as creditors and investors

4 Major Financial Statements:

- 1. Balance Sheet**
- 2. Income Statement**
- 3. Statement of Owners' Equity**
- 4. Statement of Cash Flows**

And, let's review really quickly.

Remember from the previous discussion, we defined Financial Statements as the set of Accounting Reports that are used to convey information to outside users.

And, we said that there are four (4) major Financial Statements; 1) the Balance Sheet, 2) the Income Statement, 3) the Statement of Owners' Equity, and 4) the Statement of Cash Flows.

One other thing to keep in mind before we begin our discussion:

These are important. These are a major topic that is covered in this course.

So, you really want to be comfortable with what these Statements are as we go through our discussions here through these different modules. Be comfortable with what they are, what sorts of things we find on these Statements, and what the important relationships are on the Financial Statements.

Let's go ahead to the next slide.

Slide 3

<p><i>Chapter 2 Module 1: Balance Sheet</i></p> <p><u>Balance Sheet (Statement of Financial Position)</u> The financial statement that portrays:</p> <ol style="list-style-type: none">1) The economic resources owned by a business2) The debts owed by a business3) The amount of the owners investment in the business <p>At a specific point in time (a 'snapshot')</p>
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And, let's start with the first one: 1) the Balance Sheet—also referred to as the Statement of Financial Position.

The Balance Sheet—let's give it a definition—is the financial statement that portrays—and we will see three (3) things on this financial statement.

It is the financial statement that portrays: 1) the economic resources owned by the company; 2) the debts that are owed by the company; and 3) the amount of the Owners investment in the company.

So, let's hear that again.

The Balance Sheet is the financial statement that portrays: 1) the resources owned; 2) the debts that are owed; and 3) the amount of the Owners' investment in the company as of a specific point in time.

The Balance Sheet is just like a snapshot.

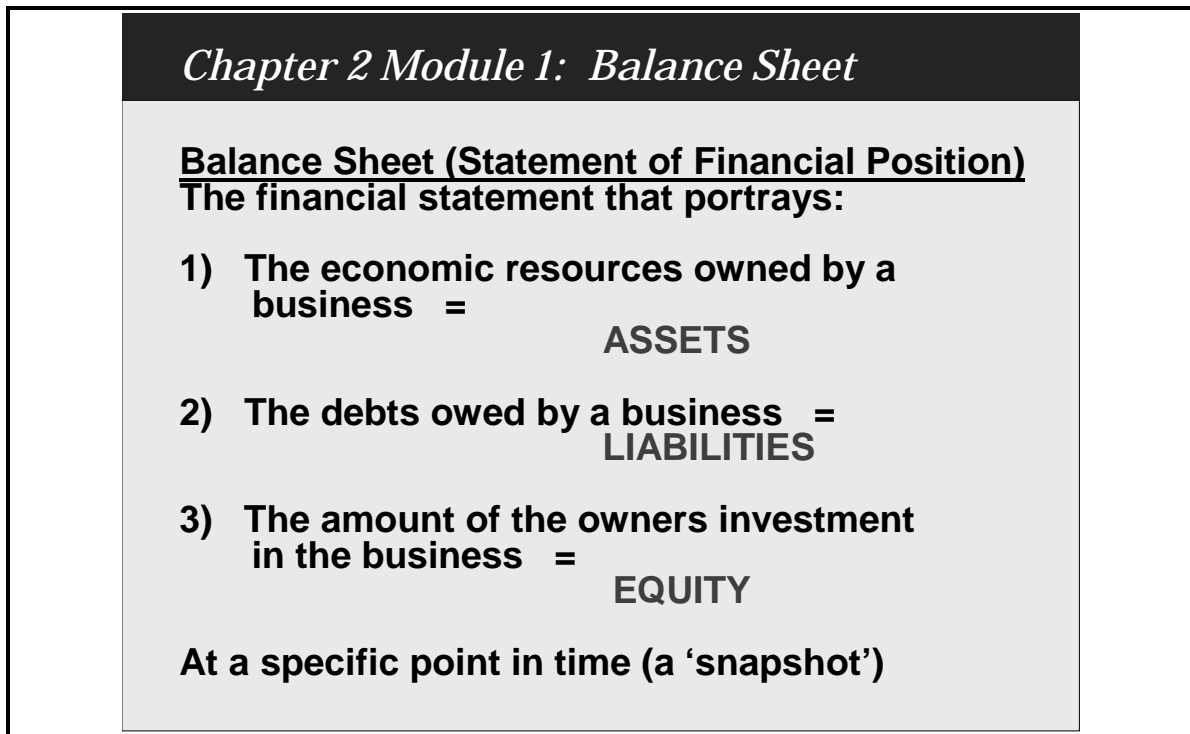
We come in today and <CLICK> we take a picture and it tells us what these resources, debts, and owners' investment are. Two months from now we will come back and take another picture and the resources, debts, and owners' investment will have changed.

So, the Balance Sheet is referred to as a Point-in-Time Financial Statement because it tells information about these three items as of that specific date or that specific point in time.

It is like a snapshot.

Go ahead to the next slide with me.

Slide 4

A rectangular box with a black border containing text. At the top, a dark grey header bar contains the text 'Chapter 2 Module 1: Balance Sheet' in white italicized font. Below this, the text 'Balance Sheet (Statement of Financial Position)' is underlined in bold. This is followed by 'The financial statement that portrays:' and a numbered list of three items. Each item is followed by an equals sign and a bolded term: 'ASSETS', 'LIABILITIES', and 'EQUITY'. At the bottom of the list, the text 'At a specific point in time (a 'snapshot')' is written in bold.

Chapter 2 Module 1: Balance Sheet

Balance Sheet (Statement of Financial Position)
The financial statement that portrays:

- 1) The economic resources owned by a business = ASSETS**
- 2) The debts owed by a business = LIABILITIES**
- 3) The amount of the owners investment in the business = EQUITY**

At a specific point in time (a 'snapshot')

And, there you see the definition of the Balance Sheet again.

It is the financial statement that portrays: and you see those three items we find and at a specific point in time.

Now, these three (3) items on the Balance Sheet are three very important items in Accounting—three very important definitions in Accounting.

Let's go through these.

The first one: the economic resources owned by the business. I will bet you know. Answer yourself real fast.

What do you call the economic resources the business owns?

Those are the company's Assets.

What do you call the debts that the company owes?

Those are the company's Liabilities.

And the amount of the investment in the company is referred to as either Equity or you may hear it called Stockholders' Equity or Owners' Equity.

It is all the same thing. It is just easier to refer to it as Equity rather than either of the others.

So, this Balance Sheet:

Let's rephrase our definition: The Balance Sheet is a financial statement that portrays the Assets, the Liabilities, and the Equity of the company at a specific point in time.

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Slide 5

Chapter 2 Module 1: Balance Sheet

Thus, the balance sheet is commonly defined as the financial statement that describes the company's resources (assets) and the claims against those resources by creditors (liabilities) and owners (equity).

Fundamental Accounting Equation

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

We might think of the Balance Sheet in a slightly different way.

We might think of the Balance Sheet as the statement that shows the resources that the company owns: the Assets; and the claims against those resources.

Who would have a claim against the Assets of the company?

You would have those folks who have lent the company money—the Creditors; that is your Liabilities. And, you would have those folks who have invested money into the company—the Owners; that is your Equity.

So, you have the Assets—the resources that we own; and then the claims against those Assets—the Creditor claims against the Assets of the business and the Owners' claims against the Assets of the business.

And, that brings us to a very important idea. And that idea is this fundamental accounting equation: the most important equation that we talk about in all of Accounting. In fact, virtually everything that we will do in this entire course will come back to this relationship: the relationship

between the Assets, the Liabilities, and the Equity—the relationship between the Assets and the two claims against those Assets.

This fundamental accounting equation is that the Assets—the resources—must always equal (=) the Liabilities (or debts) plus (+) the Equity (i.e., the Owners' investment in the company).

A must always equal (=) $L + E$. ($A = L + E$). Everything we do; everything we talk about must hold that equation true.

Assets always equal (=) Liabilities plus (+) Equity. ($A = L + E$). It is a fundamental accounting equation.

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Slide 6

Chapter 2 Module 1: Assets

ASSETS:

There are two major categories of assets:

- 1) Current Assets**
- 2) Long-Term (Non-current) Assets**

Current Assets - Assets that are expected to either be converted into cash or expire (be used up) within one year

Now that we know what the Balance Sheet is. It is the financial statement that portrays the Assets, Liabilities, and Equity of the company at a specific point in time.

Let's spend a little bit of time and go through the different pieces of the Balance Sheet.

Let's start with our Assets—our resources.

And, as you can see here on the slide (Slide 6), there are two (2) major categories of Assets.

There are 1) the Current Assets and there are the 2) Long-Term (or Non-Current) Assets.

Let's start our discussion with those that are Current.

We can define a Current Asset—before we give any examples—as an asset that is expected to be either converted into cash or expire (i.e. be used up) within one year.

Current Assets are assets that we expect to either convert into cash or we expect to use up within one year of the date of the Balance Sheet.

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Slide 7

Chapter 2 Module 1: Assets

Examples of Current Assets:

1. **Cash**
2. **Accounts receivable** - represent amounts owed to the company by its customers
3. **Inventory** - this is the product the company sells to its customers
4. **Supplies** - items used in the normal course of business (supplies are not the same as inventory)

And, let's list out some examples of Current Assets:

What could be assets that we are either going to use up or convert into cash within a short period of time—defined as this one year?

One example is 1) Cash. Cash is already cash. It is the most current of all Current Assets.

Another example is what is called 2) an Account Receivable (A/R). An Account Receivable represents money that is owed to the company by its customers.

For example: Maybe I hire you to come cut my grass, or come shovel snow, or whatever. So, I hire you to do something. You come out to my house. You do what you are supposed to do—you either cut the grass or you shovel the snow—but I do not pay you right away. I say: “Send me a bill.” At that point, I now owe you money. That is referred to as an Account Receivable (A/R).

It is considered a Current Asset as well.

Another Current Asset is 3) Inventory. Inventory represents the product that we sell to our customers.

A fourth Current Asset is: 4) Supplies.

Now, do not get Supplies confused with Inventory.

Supplies are simply items that we use in the normal course of business. They are not Inventory. We do not sell Supplies. We are not in the business of selling supplies. If we were; if we were selling supplies, they would be classified as our Inventory.

Inventory is what we sell. Supplies are things like paper and pencils and whatnot—things that we simply use as we run our operations.

Now, what you see here on the slide (Slide 7) is not an all inclusive list. 1) Cash, 2) Accounts Receivable, 3) Inventory, and 4) Supplies, while very good examples of Current Assets; are not the only Current Assets that exist.

As we move through the course, we will add to this list. We will learn additional Current Assets.

For now, those are the four (4) that you will want to be comfortable with. Those are the four (4) that you will want to know are considered Current.

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Slide 8

Chapter 2 Module 1: Assets

Long-Term Assets - Assets that are expected to be used in business operations for longer than one year

2 Categories of Long-Term Assets

- 1. Property-Plant-Equipment (P-P-E)**
- 2. Intangibles**

So, we have our Current Assets—those assets that we either are going to use up or convert into cash within a year.

Then, we have our Long-Term Assets. It is kind of an easy definition once you hear the Current Asset one.

Long-Term Assets are ones that we expect to own for longer than one year. They are assets that we expect to use in operations for more than a one-year period.

Now, these Long-Term Assets really can be divided into two (2) different categories—all long-term—but two different types of Long-Term Assets.

We have what is called P P & E—it stands for Property, Plant, and Equipment (P-P-E).

And, we have our Intangible Assets.

We will talk about each one individually.

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Slide 9

Chapter 2 Module 1: Assets

Property-Plant-Equipment - long-term assets that have a physical substance (i.e., you can touch, feel, and see these assets)

Examples of P-P-E:

- 1. Land**
- 2. Buildings**
- 3. Equipment**

Note: The item accumulated depreciation is shown on the balance sheet as a **DECREASE** of P-P-E (see page 26 in the text)

P-P-E—Property Plant and Equipment:

These represent Long-Term Assets that have a physical substance. These are assets that we expect to own for longer than a year that has a physical substance meaning: I can go up; I can see it; I can touch it; I can put my hands on it; I feel the asset. It has some sort of substance.

Common examples of P-P-E—we will list three (3) of them—are 1) Land, or Property; 2) the Buildings or Plant; and the “E,” of course, is the Equipment or machinery, or furniture. or all of those sort of roll into the idea of Equipment.

Land-Buildings-Equipment: all good examples of Long-Term Assets that have a physical substance.

One point to note:

It is not something we are going to deal a lot with here in this chapter, but in the next chapter and in the following chapter, we will see it in depth.

But, it is worth noting, now, that there is this item referred to as: Accumulated Depreciation.

And, you will find this Accumulated Depreciation right there on the Balance Sheet as a Decrease of Property-Plant-Equipment (P-P-E).

So, when you are going through the Chapter and you are looking at the Balance Sheets that they provide for you, do not be shocked to see that.

It is not something we will deal with in this chapter that much. But, we will most certainly hit it and hit it pretty hard over the next couple of chapters.

But, recognize that you will see it as a Decrease to the P-P-E on the Balance Sheet.

So, what you see here is the Long-Term Assets that have a physical substance.

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Slide 10

Chapter 2 Module 1: Assets

Intangible Assets - long-term assets that lack a physical substance (i.e., you can not touch, feel, and see these assets)

Examples of Intangibles:

1. Trademark
2. Patent
3. Copyright

And, let's talk about the Intangible Assets.

These are also Long-Term Assets. These are also assets we expect to own for longer than a year—except these ones lack a physical substance. These ones we cannot touch or see or feel. But, it does not mean they do not exist. It does not mean they are not assets. You just cannot see or touch them.

Common examples of Intangibles:

What do you think?

I am going to give you the first one. And then, usually, once people see the first one they are able to come up with a couple of others.

One real good example of an Intangible Asset is: 1) a trademark.

What is another good example?

What do you think?

2) A patent!

Finally, a third good example of an Intangible Asset is: 3) a copyright.

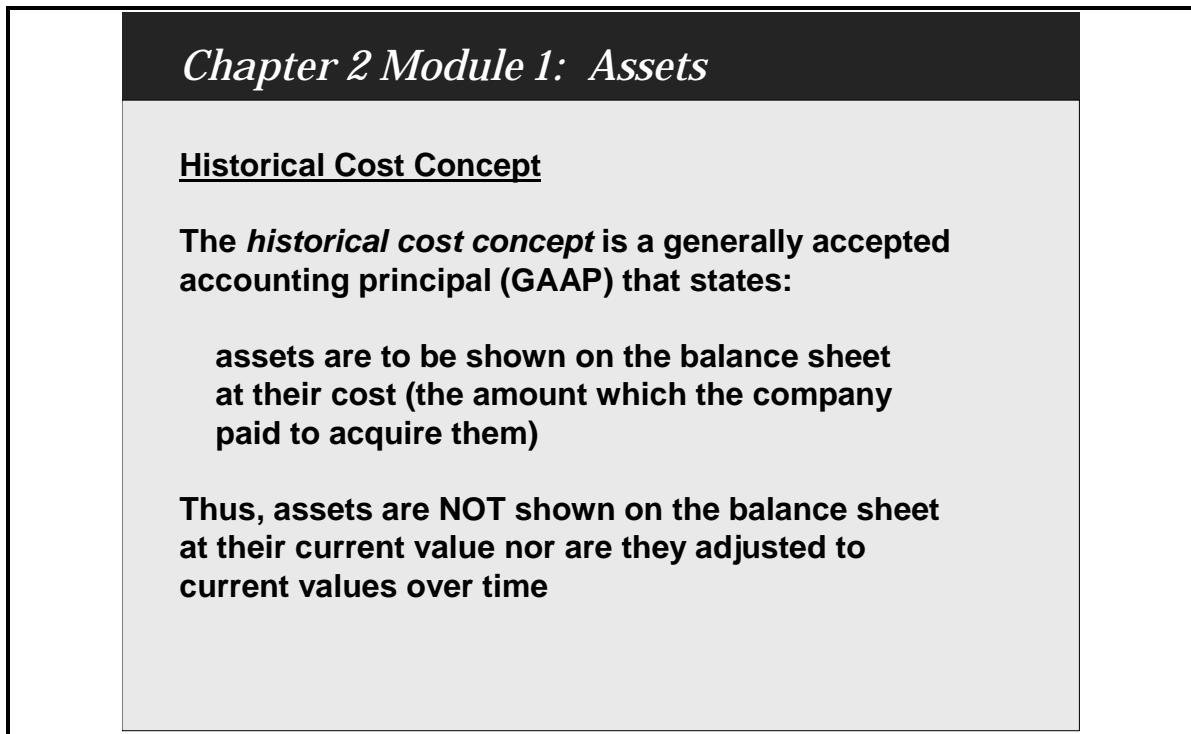
So, those are all good examples of Long-Term Assets that do not have physical substance.

So, the Total Assets of the company consist of those that are Current (i.e., those that will be converted into cash or used up within a year) and those that are Long-Term.

Those that are Long-Term are then sub-divided into those with physical substance (P-P-E) and those that lack physical substance (Intangible Assets).

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Slide 11

A rectangular box with a black border containing text about the historical cost concept. The top part of the box has a dark grey header with the text 'Chapter 2 Module 1: Assets' in white. Below this, the text is on a light grey background. It starts with the underlined heading 'Historical Cost Concept', followed by a paragraph defining the concept as a GAAP principle. This is followed by a list of two points: 'assets are to be shown on the balance sheet at their cost (the amount which the company paid to acquire them)' and 'Thus, assets are NOT shown on the balance sheet at their current value nor are they adjusted to current values over time'.

Chapter 2 Module 1: Assets

Historical Cost Concept

The *historical cost concept* is a generally accepted accounting principal (GAAP) that states:

- assets are to be shown on the balance sheet at their cost (the amount which the company paid to acquire them)**
- Thus, assets are NOT shown on the balance sheet at their current value nor are they adjusted to current values over time**

One other key point about Assets:

Remember when we talked about Generally Accepted Accounting Principles (GAAP)—the rules that we had to follow when preparing financial statements?

Here is the first one we are going to talk about.

It is called: the Historical Cost Concept.

And the Historical Cost Concept states:

All assets must be shown on the Balance Sheet at their Cost (i.e. the amount that we paid to acquire them). The cost concept requires assets be shown on the Balance Sheet at their Cost.

Assets are NOT SHOWN at—the alternative, of course, being—Market Value.

We do not show assets on the Balance Sheet at what they are worth. We do not make adjustments to those assets when their value goes up or down.

None of that is important in terms of Accounting and the Balance Sheet.

The Balance Sheet shows Assets at their Cost.

That is an objective number—one that we can prove. And, that is: the Historical Cost Concept.

That is the first Generally Accepted Accounting Principle (GAAP)—the first of many—that we will talk about this quarter.