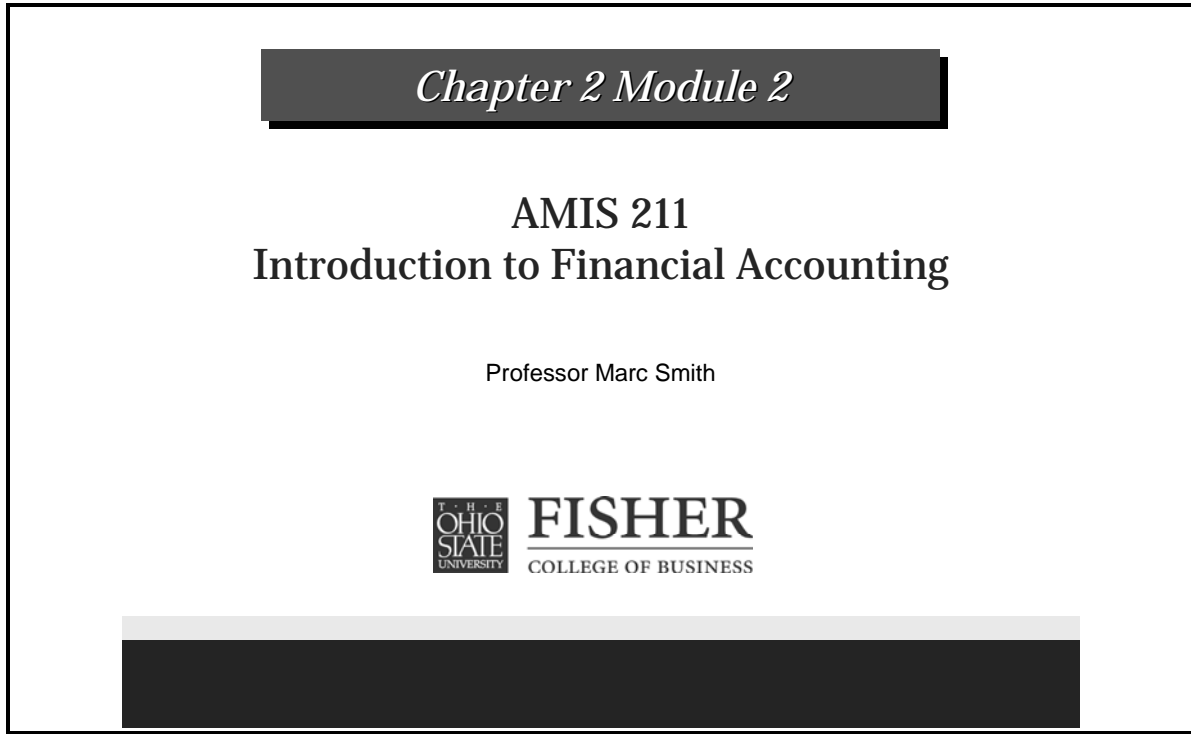


Chapter 2, Module 2 – Financial Statements


Slide 1

A rectangular box with a black border containing the slide content. At the top is a dark grey bar with the text 'Chapter 2 Module 2' in white italicized font. Below this is the text 'AMIS 211 Introduction to Financial Accounting' in a bold serif font. Underneath is 'Professor Marc Smith' in a smaller serif font. At the bottom center is the logo for Fisher College of Business at Ohio State University, featuring a square with 'T H B OHIO STATE UNIVERSITY' and the word 'FISHER' in large letters above 'COLLEGE OF BUSINESS'. At the very bottom of the box is a dark grey bar with a light grey bar above it.

Chapter 2 Module 2

AMIS 211
Introduction to Financial Accounting

Professor Marc Smith

 **FISHER**
COLLEGE OF BUSINESS

Hi everyone. Welcome back.

Where we left off last time was dealing with the Balance Sheet.

And, we have gotten through a portion of the Balance Sheet. We have talked about Assets.

Let's go ahead and look at what else we find on the Balance Sheet.

Go to the next slide with me.

Slide 2

Chapter 2 Module 2: Liabilities

LIABILITIES

- **debts owed by the business**
- **represent creditor claims against the company's assets**

There are two major categories of liabilities:

- 1) Current Liabilities**
- 2) Long-Term Liabilities**

As we learned previously, the Balance Sheet shows the Assets, the Liabilities, and the Equity of the company at a specific point in time.

Now, we have already talked about Assets.

And, we know Assets fall into two major categories: Current Assets and Long-Term Assets. And then, Long-Term Assets are then subdivided into Intangibles and P-P-E.

Let's look at the Liabilities (i.e. debts) of the organization.

We know that Liabilities represent the debts that are owed by the business. We also know that they represent the Creditors' claims against the Assets of the business. The Liabilities are what is owed to the Creditors and what should be paid out of our Assets to the Creditors.

Now, these Liabilities can be categorized into two (2) major categories that should sound somewhat familiar to you.

We have 1) Current Liabilities and we have 2) Long-Term Liabilities.

Go to the next slide...

Slide 3

Chapter 2 Module 2: Liabilities

Current Liabilities:

Liabilities expected to be paid within one year

Examples of Current Liabilities:

- 1. Accounts Payable**
- 2. Short-Term Notes Payable**
- 3. Salaries Payable**
- 4. Income Taxes Payable**
- 5. Utilities Payable**

NOTE: #3, #4, and #5 above are examples of what is called an *accrued liability*

And, let's start talking about the Current Liabilities.

What do you think they are?

Do not give me any examples yet. Give me a definition.

What do you think a Current Liability represents?

If a Current Asset is one that is going to be converted into cash within a year; Current Liabilities are debts that we expect to pay within one year—debts that we think will be paid off within one year of the Balance Sheet date.

Some different examples of Current Liabilities consist of: 1) Accounts Payable (A/P).

Remember when we had an Account Receivable (A/R)—money that was owed to us—a Current Asset?

An Account Payable (A/P) is when we owe the money.

If we buy something and we do not pay for it right away, that is an Account Payable. It is a liability; typically classified as a Current Liability.

Another Current Liability is: 2) Short-Term Notes Payable.

This represents going to the bank and borrowing money and the bank saying: “Hey, you will have to pay us back. Here, sign a note that says you will pay me back within ten (10) months.”

So, a Note that covers a less than the twelve-month period is considered short-term and thus: Current.

Another example of a Current Liability is: 3) Salaries Payable—what we owe our employees. They are not going to be willing to wait longer than a year.

Another example includes 4) Income Taxes Payable. This is what we owe the Government. They are certainly not going to wait more than a year to collect their money.

Another example is: 5) Utilities Payable. The Utility Company won't wait longer than a year to be paid.

Note: #3, #4, and #5—the Salaries Payable, Income Taxes Payable, and Utilities Payable—are all examples of what we call an Accrued Liability.

That will become a very important term a little bit later into the course.

But, you might want to note now those sorts of things are referred to as Accrued Liabilities.

You also might want to note that: while these are very good examples of Current Liabilities, they are not the only examples. Just like the prior lists of Assets that we put together. As we move throughout the course we will

continually learn new accounts and we will continually learn new items to add to our lists.

So, you will want to recognize: it is a good starting list. It is not an all-inclusive list.

All debts to be paid within one year are these Current Liabilities.

Let's go to the next slide.

Slide 4

Chapter 2 Module 2: Liabilities

Long-Term Liabilities
debts that will be paid in longer than one year

Examples of Long-Term Liabilities:

- 1. Long-Term Notes Payable**
- 2. Mortgage Payable**
- 3. Bonds Payable**

Long-Term Liabilities, then, are debts that will be paid in longer than one year.

Some good examples include, as you can see there on the screen (Slide 4):

1) Long-Term Notes Payable.

It is the same idea as a Short-Term Notes Payable.

You go to the bank. The bank says: “Hey, look, you have to sign a note that says that you will pay us back.” But, instead of signing a 10-month Note, you sign a two-year Note—one that says you will owe them the money in two years. This is classified as a Long-Term Liability.

2) A Mortgage Payable is a good example of a Long-Term Debt.

Just curious: How many of you actually own your own home? Or, if you are like me, you own the doorknob on your home. Probably, I am sure many of you do.

When you signed your mortgage and you got the money from your bank. Did you sign an eight-month mortgage or a nine month mortgage?

Or, like me, a twenty-year or thirty-year mortgage? These things are very long in term.

Another good example to note for Long-Term Liabilities is: 3) a Bond Payable.

Let’s go to the next slide.

Slide 5

Chapter 2 Module 2: Equity

EQUITY (STOCKHOLDERS' EQUITY):

There are two types of equity:

- 1) Contributed Capital**
- 2) Retained Earnings**

Contributed Capital represents investments made by owners into the business

Those were the Liabilities.

Let's talk about the final item we find on the Balance Sheet: Equity or Stockholders' Equity.

Remember: it is the Owners' investment within the company.

There are two (2) different sources of Equity.

One is referred to as 1) Contributed Capital. The other is referred to as 2) Retained Earnings.

There are two (2) different types of Equity: 1) Contributed Capital and 2) Retained Earnings.

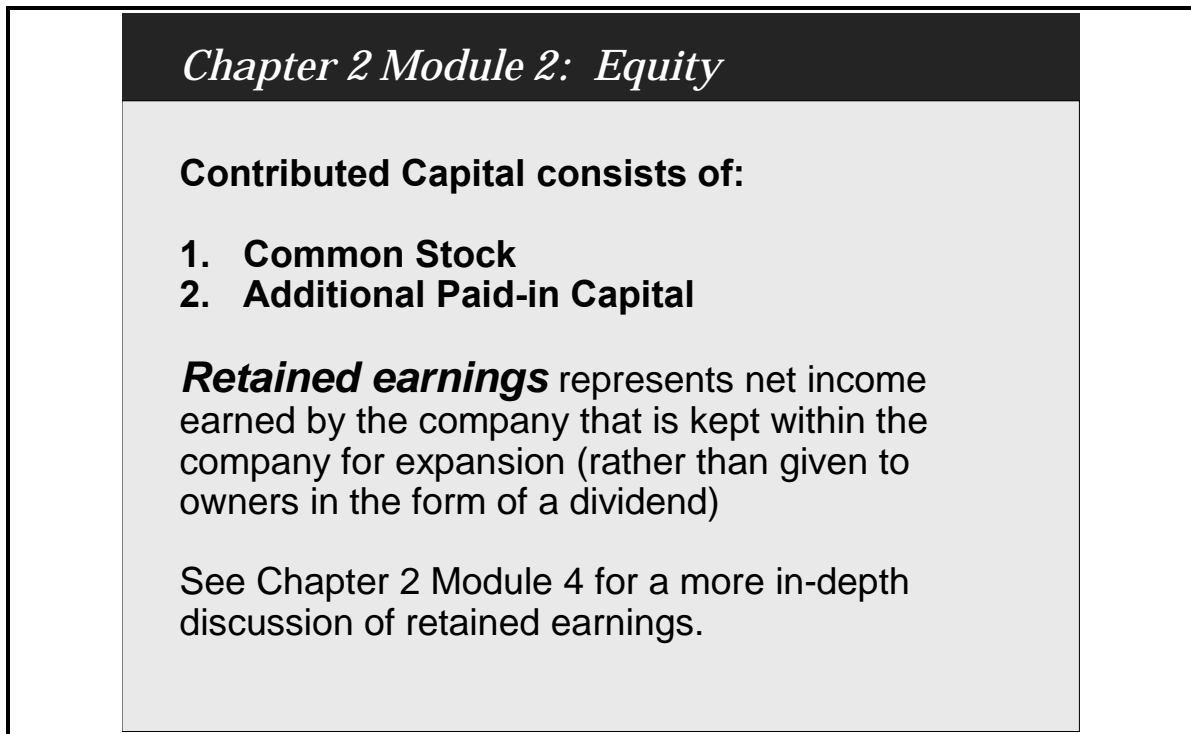
Contributed Capital—which is probably what we can all relate to a little better—that simply represents investments made into the business by Owners, typically, through the sale of stock.

The company sells stock. The Owner gives the company cash in order to be an Owner and own that stock.

So, the Contributed Capital simply represents investments made by Owners into the company.

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Slide 6

A rectangular box with a black border containing text. The top part of the box has a dark grey background with the text 'Chapter 2 Module 2: Equity' in white. Below this, on a light grey background, is the text 'Contributed Capital consists of:' followed by a numbered list: '1. Common Stock' and '2. Additional Paid-in Capital'. Below the list, the text reads: '**Retained earnings** represents net income earned by the company that is kept within the company for expansion (rather than given to owners in the form of a dividend)'. At the bottom of the box, it says: 'See Chapter 2 Module 4 for a more in-depth discussion of retained earnings.'

Chapter 2 Module 2: Equity

Contributed Capital consists of:

- 1. Common Stock**
- 2. Additional Paid-in Capital**

Retained earnings represents net income earned by the company that is kept within the company for expansion (rather than given to owners in the form of a dividend)

See Chapter 2 Module 4 for a more in-depth discussion of retained earnings.

Now, this Contributed Capital actually consists of two (2) items: 1) the actual Common Stock—the stock that is sold to the Owners; as well as something called 2) APIC. It stands for Additional Paid-In Capital.

So, do not be shocked when you see both of those. They both relate to the actual sale of the stock. So, the distinction is not that important.

What we would like you to get right now is: they are both part of the Contributed Capital.

They are both part of Equity—both part of the Equity that is received when Owners make investments into the company.

So, that is the Contributed Capital.

What about the Retained Earnings?

This is one you are probably not as familiar with.

Retained Earnings represents the income, or profit, earned by the company that the company then re-invests back into itself rather than paying that profit out to the Owners as dividends.

Let's just sort of go through that again because Retained Earnings is an important idea.

It represents the profit that the company earns and then re-invests back into the company. Rather than saying: "Hey, Owners! This is really yours. Let's give it back to you in the form of a dividend."

When we talk about the Statement of Owners' Equity a little bit later, we will talk a lot more in depth about Retained Earnings.

Please go to the next slide with me.

Slide 7

Chapter 2 Module 2: Balance Sheet

IMPORTANT:

Fundamental Accounting Equation

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

A final thing now that we have wrapped up our discussion of the Balance Sheet in the past couple of modules.

We talked about the Assets and all of the different types of Assets—all resources owned by the business.

We have talked about the Liabilities—the debts that are owed (i.e. the Creditors claims against Assets).

And, we have just talked about Equity—the two (2) different sources; the actual investment by Owners into the business: 1) Contributed Capital and then the income that is earned and re-invested rather than given immediately to Owners—2) Retained Earnings. They make up the Equity.

We want to wrap up this discussion with that fundamental accounting equation.

How do those things relate to each other?

What is that all important formula that we must know?

Assets or resources always equal (=) the debts or Liabilities plus (+) the Owners' investment referred to as Equity. ($A = L + E$).