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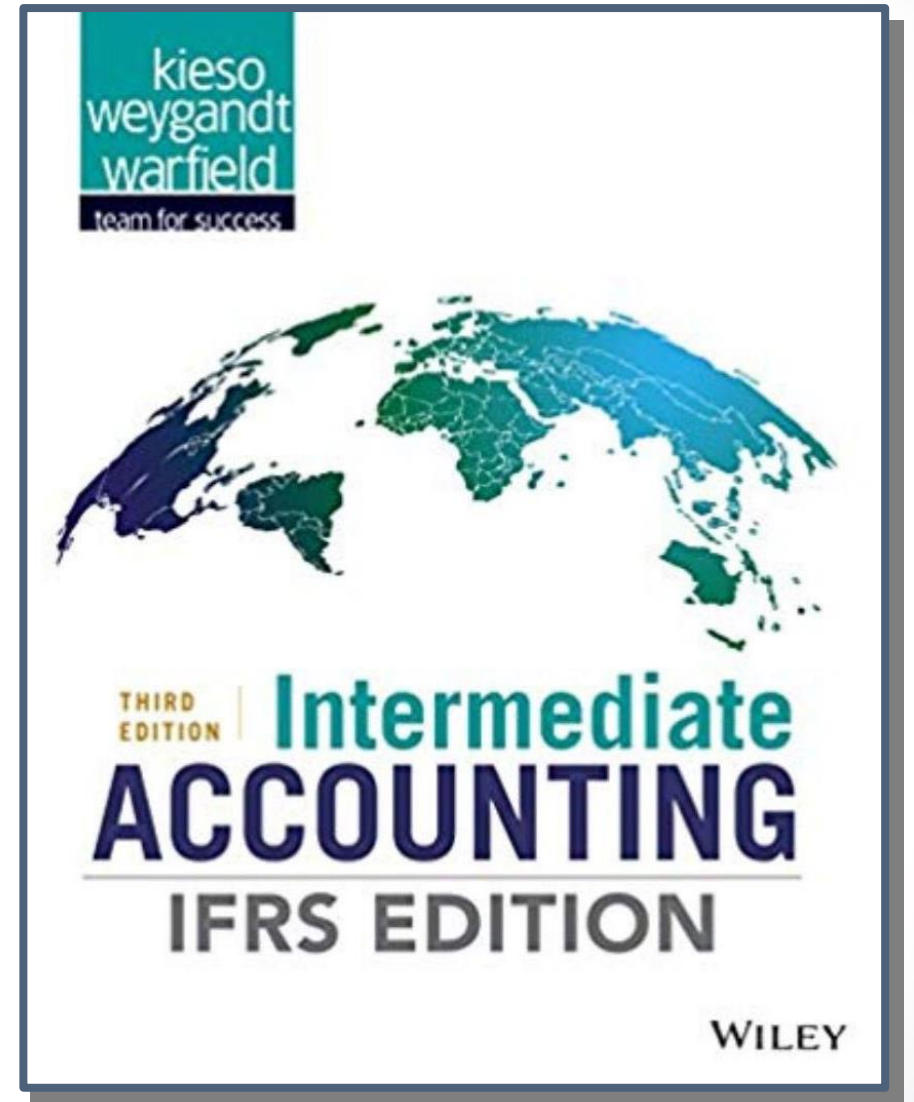
American University Of The Middle East

Intermediate Accounting I

CHAPTER 5 (Part 1)

Statement of Financial Position

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Learning Objectives (Part 1)

LEARNING OBJECTIVES

After studying the first part of Chapter 5, you should be able to:

1. Explain the **uses, limitations, and content** of the **statement of financial position**.
2. Identify the major **classifications** of the **statement of financial position**
3. **Prepare** a classified **statement of financial position**.

What is a Statement of Financial Position?

Statement of financial position, also referred to as the **balance sheet**:

- ▶ Reports **assets**, **liabilities**, and **equity at a specific date**.

It provides information about resources, obligations to creditors, and interest on net resources, and helps in predicting amounts, timing, and uncertainty of future cash flows.

Statement of financial position, is **used to**:

- ▶ Computing **rates of return**.
- ▶ Evaluating the **capital structure**.
- ▶ Assess **risk** and **future cash flows**.
- ▶ Assess the company's:
 - **Liquidity** (the ability of a company to convert assets into cash and pay **current debt**)
 - **Solvency** (the ability of a company to pay for all its debt, current and non-current)
 - **Financial flexibility** (the ability of a company to change the amounts and timing of cash flows so it can respond to unexpected needs and opportunities)

What are the limitations of a Statement of Financial Position?

A Statement of financial position has the following limitations:

- ▶ **Most assets and liabilities are reported at historical cost.** As a result, the information provided in the statement of financial position does not represent the true value of items.
- ▶ Companies **use judgments and estimates** to determine many of the items reported in the statement of financial position. This affects the reliability of the information to some extent.
- ▶ **Many items of financial value are omitted**, just because the company cannot measure them reliably.

What is reported in a Statement of Financial Position?

Elements of the Statement of Financial Position

ASSETS

- ▶ Resource controlled by the entity.
- ▶ Result of past events.
- ▶ Future economic benefits are expected to flow to the entity.

LIABILITIES

- ▶ Present obligation of the entity.
- ▶ Arising from past events.
- ▶ Settlement is expected to result in an outflow of resources embodying economic benefits.

EQUITY

- ▶ Residual interest in the assets of the entity after deducting all its liabilities.

Classification in the Statement of Financial Position

Statement of financial position accounts are **classified**. This means that a statement of financial position groups together similar items to arrive at significant subtotals. Furthermore, the material is arranged so that important relationships are shown.

The Statement of Financial Position Classification

Companies further divide **assets**, **liabilities** and **equity** into several **sub-classifications**. Below you will find a general format of statement of financial position

ASSETS

Non-current Assets

- Investments
- Property, Plant & Equipment
- Intangible assets
- Other assets

Current Assets

Inventories
Prepaid Expenses
Receivables
Short-term investments
Cash & Cash equivalents

EQUITY + LIABILITIES

- Share Capital
- Share Premium
- Retained Earnings
- Accumulated other Comprehensive Income
- Non-Controlling Interest

LIABILITIES

Non-current Liabilities

Bonds
Non-Current Payables
Long-term provisions

Current Liabilities

Accounts Payable
Unearned Revenue
Salaries Payable
Interest Payable
Notes Payable
Dividends Payable

Non-Current Assets

Non-current assets are defined as all assets that do not meet the criteria to be classified as current assets.

4 types of non-current assets

Long-term Investments

- ▶ **Securities** (bonds, ordinary shares, or long-term notes).
- ▶ **Tangible assets not currently used in operations** (land held for speculation).
- ▶ **Special funds** (sinking fund, pension fund, or plant expansion fund).
- ▶ Non-consolidated **subsidiaries** or **associated companies**

Property, Plant, and Equipment

- ▶ **Tangible long-lived assets** used in the regular operations of the business.
- ▶ **Physical property** such as land, buildings, machinery, furniture, tools, and wasting resources (minerals).

Intangibles Assets

- ▶ Assets that **lack physical substance** and are not financial instruments.
- ▶ **Patents, copyrights, franchises, goodwill, trademarks, trade names, and customer lists**

Other Assets

- ▶ **Long-term prepaid expenses**
- ▶ **Non-current receivables**
- ▶ **Property held for sale**
- ▶ **Restricted cash or securities**

Current Assets

Cash and other assets a company **expects to convert into cash, sell, or consume** either **in one year or in the operating cycle**, whichever is longer

Items included in current assets:

- ▶ Inventories
- ▶ Prepaid Expenses
- ▶ Receivables
- ▶ Short-term investments
- ▶ Cash & Cash equivalents

Equity

Equity is defined as the residual interest in the assets of an entity after deducting all of its liabilities.

Items included in Equity Section:

- ▶ **Share Capital.** The par or stated value of shares issued, both ordinary and preference.
- ▶ **Share Premium.** The excess of amounts paid-in over the par or stated value.
- ▶ **Retained Earnings.** The company's undistributed earnings.
- ▶ **Accumulated Other Comprehensive Income.** The aggregate amount of the other comprehensive income items.
- ▶ **Treasury Shares.** Generally, the amount of ordinary shares repurchased.
- ▶ **Non-Controlling Interest (Minority Interest).** A portion of the equity of subsidiaries not owned by the reporting entity.

Non-Current Liabilities

They represent obligations that a company does **not** reasonably **expect to liquidate within** the longer of **one year** or the normal **operating cycle**.

THREE TYPES

Obligations arising from
specific financing
situations

For Example:

- ▶ Long-term Bonds
- ▶ Long-term Lease contracts
- ▶ Long-term Notes

Obligations arising from
the ordinary **operations**

For Example:

- ▶ Non-Current Payables
- ▶ Pension Obligations
- ▶ Deferred Tax Liabilities

Obligations that **depend on**
the **occurrence of** one or
more **future events**

For Example:

- ▶ Product warranties
 - ▶ Environmental liabilities
- often called **provisions**

Current Liabilities

Obligations that a company generally **expects to settle in its normal operating cycle** or **one year**, whichever is longer.

Include:

- ▶ Payables resulting **from the acquisition of goods and services**. (Current Payables)
- ▶ **Collections received in advance** for the delivery of goods or performance of services. (Unearned Revenues)
- ▶ **Other liabilities** whose liquidation will take place **within the operating cycle** or one year. (Salaries Payable, Interest Payable, Notes Payable, Dividends Payable, etc.)

Preparation of a Statement of Financial Position

Companies in general use **two formats** for Statement of Financial Position presentation

- ▶ **Report form:** The **report form** lists the sections (assets, liabilities & equity) one above the other.
- ▶ **Account form:** The **account form** lists assets on the left side, and equity and liabilities on the right side.

IFRS do not prescribe any particular order of presenting the items in the statement of financial position.

Typically **assets** are presented **current then non-current, or vice versa**, and **liabilities** and **equity** can be presented **current then non-current then equity, or vice versa**.