

2024-2025 Edition
CMA
Preparatory Program

Part 1
Volume 1: Sections A – C

**Financial Planning,
Performance, and Analytics**

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Editorial Notes

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Introduction to CMA Part 1

The CMA Part 1 Exam has six sections in the ICMA's *Learning Outcome Statements*:¹

- A. External Financial Reporting Decisions: 15%
- B. Planning, Budgeting and Forecasting: 20%
- C. Performance Management: 20%
- D. Cost Management: 15%
- E. Internal Controls: 15%
- F. Technology and Analytics: 15%

The *Learning Outcome Statements* (LOS) for both exam parts are available to download on the IMA's website at www.imanet.org.

The questions on the exams focus on understanding, in-depth thinking on business strategy, and problem-solving ability, not just number crunching. To be able to think through the questions on the exam, candidates will need to understand the concepts and be able to apply the concepts to new situations. These study materials provide the tools for understanding the concepts, but they cannot teach in-depth thinking and problem solving. Your ability to put the knowledge you gain into practice to pass the CMA exam will depend on you and the effort you put into preparing for the exam.

Note: The ICMA's Content Specification Outlines state the following (on page 2) with respect to background that candidates for the CMA certification need before beginning to study for the CMA exams:

"5. With regard to U.S. federal income taxation issues, candidates will be expected to understand the impact of income taxes when reporting and analyzing financial results. In addition, the tax code provisions that impact decisions (e.g., depreciation, interest, etc.) will be tested."

Comment: The HOCK CMA study materials include brief descriptions of relevant U.S. federal income tax laws, but if candidates need additional information, they are encouraged to consult the U.S. Internal Revenue Code or other reliable resources.

"6. Candidates for the CMA designation are assumed to have knowledge of the following: preparation of financial statements, business economics, time value of money concepts, statistics, and probability."

Comment: Candidates are assumed to have the specified knowledge before beginning to study for the CMA exams. The HOCK CMA study materials cover specific topics listed in the ICMA's Learning Outcome Statements, but they do not cover the complete assumed knowledge material that is the background for the study materials. Candidates without that knowledge should plan to gain it by either taking university-level courses or consulting relevant textbooks.

Section A, *External Financial Reporting Decisions*, represents 15% of the exam. Section A covers external financial reporting from the perspective of its use in decision-making only, which is what is tested on the Part 1 exam. A knowledge of external financial reporting is assumed as a prerequisite to preparing for the CMA exams.

Section B, *Planning, Budgeting and Forecasting*, represents 20% of the exam and includes strategic planning, budgeting, forecasting, and top-level planning and analysis.

Section C, *Performance Management*, is 20% of the exam. Section C covers variance analysis and responsibility accounting as well as financial performance measures. For variances, it is important to be able to calculate the variances and interpret the information provided by variance analysis. Therefore, in addition

¹ The *Learning Outcome Statements* are published by the Institute of Certified Management Accountants (ICMA), the examining body for the CMA exams. The *Learning Outcome Statements* provide in detail the information candidates need to know and things they need to be able to do to pass the CMA exams.

to memorizing the variance formulas, candidates will need to be able to understand and interpret the results of each variance calculation.

Section D, *Cost Management*, is 15% of the exam. Section D focuses on costing systems and covers several methods of allocating costs and overheads. It also covers supply chain management and business process improvement.

Section E, *Internal Controls*, represents 15% of the exam. The technicalities of internal controls are important to know, especially the relevant laws businesses are subject to and the related guidance that has been published. The Sarbanes-Oxley Act has had far-reaching effects and candidates should be familiar with its requirements.

Section F, *Technology and Analytics*, is 15% of the exam and covers information systems including accounting information systems, data governance, technology, and data analytics.

The exam will consist of 100 multiple-choice questions and 2 essay scenarios, each with several questions. The multiple-choice questions will **not** be presented in order according to sections. Thus, an exam might begin with a sales variance question, then follow that with an inventory question, and so forth.

Only candidates who score a minimum of 50% correct on the multiple-choice portion of the exam will be eligible to take the essay section of the exam.

Section A – External Financial Reporting Decisions

Study Unit 1: A.1. The Financial Statements, the Balance Sheet

Note: References to the relevant sections of the FASB's *Accounting Standards Codification*[®] and to other publications of the FASB are provided throughout Section A. The references are supplied for candidates who wish to do further research on the topics. Candidates are **not** expected to memorize the relevant reference numbers.

The objective of financial reporting is to provide financial information about a company that is useful for making decisions about providing resources to the company.²

Differences Between IFRS and U.S. GAAP

IFRS stands for "**International Financial Reporting Standards**," a widely accepted set of accounting principles used in many countries around the world. **IFRS** is primarily a **principles-based** set of accounting standards with few practical examples and limited interpretative guidance. Neither acting as a tax standard nor applying to government organizations, IFRS is intended for multiple countries with different cultural, legal, and commercial standards.

IFRS's main objective is to be more open and flexible; therefore, the standard-setters leave interpretation to companies and their auditors, resulting in greater flexibility. As a result, companies and their auditors can interpret IFRS differently. The significance of these differences in interpretation will vary from company to company, depending on factors such as the nature of the company's operations, the industry in which it operates, and the accounting policies it chooses.

U.S. GAAP, on the other hand, is largely a **rules-based** body of standards with extensive interpretive guidance for individual industries and specific examples for auditors and practitioners. It applies to United States-based companies and foreign companies that participate in the U.S. financial markets. In addition, the standard-setters actively interpret the standards. This active participation often results in a proscriptive approach in U.S. GAAP that reflects the strong regulatory environment in the United States.

Because many of the countries in the world have adopted IFRS, think of IFRS as "International" GAAP compared to "U.S." GAAP. Despite their differences, the **general** principles, conceptual framework, and accounting results between U.S. GAAP and IFRS are often very similar, if not the same, because the two standards are more alike than different for most **common** transactions.

For the exam, candidates need to know what IFRS is and some specific differences between U.S. GAAP and IFRS. **These specific differences appear in orange boxes following the related U.S. GAAP coverage of the topic.**

² Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 1, *The Objective of General Purpose Financial Reporting*, September 2010 Amended December 2021, paragraph OB2 p. 1.

Users of Financial Information

Users of financial information include existing and potential investors, lenders, and other creditors; and the decisions they are making relate to buying, selling, or holding debt or equity instruments and providing credit. Users need information to help them assess their expectations about returns—such as dividends, principal payments, interest payments, or market price increases—and the amount, timing, and uncertainty of (that is, prospects for) future net cash inflows to the company.³

In addition to making decisions about investing and lending, financial statements are used to assess areas of strength and weakness in the company, evaluate management performance, and determine whether the company is complying with regulatory requirements, among other things. Therefore, other users who may not be providing capital to the company—such as management, employees, financial analysts, and regulators—may find financial statements useful as well.

It is not possible for accounting information to provide all the information that all users need to make their decisions. Users need to access information from other sources as well, such as economic forecasts, the political climate, and industry outlooks.⁴ However, the financial statements do attempt to provide as much useful information as possible.

Users of financial information can be classified according to whether they are direct or indirect users and whether they are internal or external users.

Direct and Indirect Users. Direct users are directly affected by the results of a company. Direct users include investors and potential investors, employees, management, suppliers, and creditors. Direct users stand to lose money if the company has financial problems.

Indirect users are people or groups who represent direct users. They include financial analysts and advisors, stock markets, and regulatory bodies.

Internal and External Users. Internal users such as managers make decisions from within the company regarding its operation. External users include investors and lenders who make decisions from outside the company about whether to begin a relationship, continue a relationship, or change their relationship with the company. External users also include investment advisers and financial analysts who advise current and potential investors; regulators who are responsible for protecting the interests of investors; and bond rating agencies that rate the quality of new bond issues and update the issuers' overall ratings with respect to all their outstanding debt. The rating agencies rate an issue in terms of the probability that the issuer will default on the debt, and their ratings are used by current and potential investors as well as by those who advise them.

Note: Financial reports are prepared for users who have a **reasonable knowledge** of business and economic activities and who review and analyze the information diligently.⁵ That means that, in the preparation of financial statements, a **reasonable level** of competence on the part of users can be assumed. Someone who has a "reasonable understanding" of business, accounting, and economic activities should be able to read the financial information and understand it.

³ Ibid., paragraph OB2-OB3, pp. 1-2.

⁴ Ibid., paragraph OB6, p. 2.

⁵ Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 3, *Qualitative Characteristics of Useful Financial Information*, as amended August 2018, paragraph QC32, p. 6.

The Financial Statements Are Interrelated

Financial statements articulate with each other, meaning they are interrelated. The different financial statements reflect different aspects of the same transactions or other events and circumstances.

- The amount of change in retained earnings on the balance sheet during the period is equal to net income on the income statement minus dividends declared (adjusted for retrospective adjustments made to retained earnings, if any).
- Many balance sheet accounts are used to calculate income statement amounts. For example, fixed assets are used to calculate depreciation expense.
- The change in cash on the balance sheet from the beginning of the period to the end of the period is equal to the net increase (decrease) in cash during the period reported on the statement of cash flows.

No one financial statement provides all the financial information that is useful for making an assessment or a decision. Resource providers need a variety of information, including information about assets, liabilities, and equity at the end of a period; comprehensive income during the period, including revenues, expenses, gains, and losses; cash flows during the period, and investments by and distributions to owners. A full set of financial statements is intended to present that information.⁶

Elements of Financial Statements

Elements of financial statements are the building blocks of the financial statements. Elements of financial statements are **assets, liabilities, equity** (or for a not-for-profit company, net assets), **comprehensive income and its components, investments** by owners, and **distributions** to owners.

Comprehensive income is equal to the change in assets and liabilities (that is, net assets) other than those resulting from investments by owners and distributions to owners. The components of comprehensive income include **revenues, expenses, gains, and losses**.⁷

Note: A **full set of financial statements** presents the **elements** of financial statements (assets, liabilities, equity, comprehensive income, and investments by and distributions to owners).⁸ Most revenues, expenses, gains, and losses are reported on the income statement, but a few of them are classified as other comprehensive income and are reported as increases or decreases to the accumulated other comprehensive income account in the equity section of the balance sheet. Comprehensive income is explained in Study Unit 3 of this section, *The Statement of Comprehensive Income*.

General purpose financial reporting includes a full set of financial statements plus the notes to financial statements and required supplemental information.⁹ The notes amplify or complement information about items in financial statements.¹⁰

The **notes** to financial statements are not considered a part of a full set of financial statements, but notes and supplementary information are a required part of **general purpose financial reporting**.¹¹

⁶ Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 7, *Presentation*, December 2021, paragraphs PR14, PR20, pp. 4-5.

⁷ *Elements of Financial Statements*, paragraph E78, p. 18.

⁸ *Ibid.*, paragraph PR20, p. 5.

⁹ *Ibid.*, paragraph PR20, p. 5.

¹⁰ Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 4, *Elements of Financial Statements*, December 2021, paragraph E6, p. 2.

¹¹ *Presentation*, paragraph PR20, p. 5. The statement that the notes are not a part of a full set of financial statements is a departure from previous guidance, which stated that notes have "long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles." That statement is now replaced with the statement that notes and supplementary information are a required part of general purpose financial **reporting**.

The financial statements used by businesses under U.S. Generally Accepted Accounting Principles (GAAP) are:

- 1) Balance sheet (also called the statement of financial position)
- 2) Statement of comprehensive income/Income statement
- 3) Statement of changes in stockholders' equity
- 4) Statement of cash flows

Recognition of Financial Statement Items

For an item to be recognized in the financial statements, it must:

- 1) Meet the definition of an element of financial statements
- 2) Be measurable
- 3) Be able to be depicted and measured with faithful representation.
- 4) Be representationally faithful, verifiable, and neutral.

When an item no longer meets any one of the recognition criteria, it should be derecognized, that is, removed from the financial statements as an asset, a liability, or equity.¹²

Measurement and Valuation of Financial Statement Items

Items reported in the financial statements are measured and valued according to various methods:

- **Historical cost or historical proceeds:** Property, plant, and equipment and most inventories are reported at the amount paid to acquire them, adjusted after acquisition for amortization or other allocations. Liabilities such as those involving the obligation to provide goods or services to customers are reported at historical proceeds, or the value received when the obligation was incurred, adjusted for amortization or other allocations.
- **Current replacement cost:** Some inventories are reported at their current replacement cost.
- **Current market value:** Certain investments in marketable securities are reported at their current market values. Current market value is also used for assets expected to be sold at prices that are lower than previous carrying amounts, which results in the reporting of a loss. Some liabilities such as for writers of options or short sellers of common shares are reported at current market values.
- **Net realizable or settlement value:** Short-term receivables and some inventories are reported at their net realizable values. Net realizable value is the undiscounted amount that an asset is expected to be converted into less direct costs necessary to make the conversion. Trade payables are reported at their net settlement values, that is, the amount expected to be paid to liquidate the obligation including direct costs necessary to make the payment.
- **Present (discounted) value of future cash flows:** Long-term receivables are reported at the present value of future cash inflows the asset is expected to be converted into, less the present values of cash outflows necessary to obtain the inflows. Long-term payables are reported at the present values of the future cash outflows expected to be required to satisfy them, discounted at the implicit or historical rate.¹³

¹² Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 5, *Recognition and Derecognition*, August 2023, paragraphs RD5, RD13, pp. 1-3.

¹³ Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises* as amended December 2021, paragraph 67, p. 3. The Statement with respect to recognition has been superseded by Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter

Note: An explanation of time value of money concepts, including present value of future cash flows, is available to download at:

https://www.hockinternational.com/download/Time_Value_of_Money.pdf.

Time value of money factor tables are available for download from:

https://www.hockinternational.com/download/PV_FV_Tables.xlsx.

- **Liquidation values** of assets (but not of liabilities) are used when a company is no longer a going concern and liquidation is imminent.

1) The Balance Sheet (Statement of Financial Position)

Note: Guidance in the *Accounting Standards Codification*[®] on presentation of the balance sheet is in ASC 210. Information from the FASB's Statements of Financial Accounting Concepts as amended December 2021 is also used in this topic.

The balance sheet, also called a **statement of financial position**, provides information about a company's assets, liabilities, and owners' equity **at a point in time** (usually the end of a reporting period). The balance sheet shows the company's resource structure—its assets—and its financing structure—its liabilities and equity. The balance sheet provides a basis for computing rates of return,¹⁴ evaluating the capital structure of the business, and predicting a company's future cash flows. It helps users to assess the company's liquidity, financial flexibility, net resources available, its capability of generating future net cash flows, exposures to risk, and its ability to meet its long-term financial obligations.¹⁵

- **Liquidity** refers to the time expected to elapse until an asset is converted into cash or until a liability needs to be paid. The greater a company's liquidity is, the lower will be its risk of failure.
- **Financial flexibility** is the ability of a business to take effective actions to alter the amounts and timing of its cash flows to enable the business to respond to unexpected needs and take advantage of opportunities.¹⁶
- **Solvency** refers to the company's ability to pay its long-term obligations when they are due. A company with a high level of long-term debt relative to its assets has lower solvency than a company with a lower level of long-term debt.
- **Risk** refers to the unpredictability of future events, transactions and circumstances that can affect the company's cash flows and financial results.

The statement of financial position can also be used in financial statement analysis to assess a company's ability to distribute cash to its investors to provide them an adequate rate of return.

Information provided in a balance sheet about a company's assets, liabilities, and equity does not indicate the value of a business. However, along with other financial information, it provides insight that may enable resource providers to make their own estimates of the business's value.¹⁷

Balance sheet accounts are **permanent accounts**. Balance sheet accounts are not closed out at the end of each accounting period as income statement accounts are, but rather their balances are cumulative. They keep accumulating transactions and changing with each transaction, year after year.

⁵, *Recognition and Derecognition*, August 2023; but the Statement with respect to measurement attributes has not been superseded as of this writing. The chapter on measurement is in initial deliberations by the FASB as of this writing.

¹⁴ A rate of return is an income amount divided by an asset amount. Thus, though the balance sheet does not present income information, it provides a **basis for computing rates of return** because it presents the asset amounts that are used in the computation of the rate of return.

¹⁵ *Presentation*, paragraph PR23, p. 5.

¹⁶ *Ibid.*, footnote 8 to paragraph PR23, p. 5.

¹⁷ *Ibid.*, paragraph PR24, pp. 5-6.

Elements of the Balance Sheet

Elements of the balance sheet include assets, liabilities, stockholders' (or owners') equity, investments by owners, and distributions to owners.

Definitions of the elements of financial statements are in Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*—Chapter 4, *Elements of Financial Statements* (issued December 2021). According to the Concepts Statement:

- **Assets are rights to economic benefits** that exist at the financial statement date, meaning they have arisen from past transactions or other past events or circumstances.
- **Liabilities are obligations to provide or to be ready to provide economic benefits to others** that exist at the financial statement date, meaning they have arisen from past transactions or events.
- **Equity** is the company's net assets, or the difference between its assets and its liabilities. For a business, equity is the **ownership interest**. Equity is increased or decreased by increases and decreases in net assets from nonowner sources (that is, net income or loss and other comprehensive income or loss) as well as by investments by owners and distributions to owners.¹⁸
- **Investments by owners** are increases in equity resulting from transfers made to the company to obtain or increase ownership interests in the company. Investments by owners are usually in the form of assets, but they may also be in the form of services provided to the company or of satisfaction or conversion of the company's liabilities.
- **Distributions to owners** are decreases in equity that result from transferring assets, rendering services, or incurring liabilities to owners. Distributions to owners decrease ownership interest in the business.¹⁹ Distributions to owners include dividends.

Classifications of Assets and Liabilities

On the balance sheet, assets and liabilities are classified as either **current** or **non-current**. Generally, current assets and liabilities are short-term and non-current assets and liabilities are long-term, but the more correct terminology is "current" and "non-current" for both assets and liabilities. Whether an asset or liability is classified as current or non-current depends on the time frame in which the company expects an asset to be converted into cash or a liability to be settled.

Current Assets

Current assets are cash and other assets or resources that are expected to be realized in cash or sold or consumed during the normal **operating cycle** of the business.

Note: The **operating cycle** is defined in the Master Glossary in the FASB's *Accounting Standards Codification*[®] as the average time between the acquisition of materials or services and their final cash realization.

If a company has several operating cycles within a year, one year is to be used as the period for classifying assets as current. However, if a company's operating cycle is greater than twelve months, the longer period is used for classifying assets as current. If a company has no clearly defined operating cycle, the one-year rule governs.²⁰

¹⁸ Ibid., paragraphs E61-E70, pp. 14-16.

¹⁹ Ibid., paragraphs E71-E72, p. 17.

²⁰ Per ASC 210-10-45-3.

Current assets include:

- **Cash** available for current operations, including coins, currency, undeposited checks (checks that have been received but have not yet been deposited in the bank), money orders and drafts, and demand deposits.
- **Cash equivalents.** Short-term, highly liquid investments that are convertible to known amounts of cash without a significant loss in value and have maturities of 3 months or less from the date of purchase.
- **Marketable securities classified as current assets.** Marketable debt and equity securities that represent the investment of cash available for current operations.²¹ Marketable equity securities may or may not be classified as current assets, depending on management's intention.
- **Receivables.** Trade accounts receivable, notes receivable, and acceptances receivable. Receivables from officers, employees, affiliates, and others are also current assets if they are collectible in the ordinary course of business within one year or the company's operating cycle.
- **Contract assets classified as current assets.** Under the FASB's revenue recognition standard, ASC 606, contract assets represent a company's right to consideration for goods or services the company has transferred to a customer when that right depends on something other than the passage of time—for example, the company's future performance—before the company can invoice the customer. Contract assets may be current assets or non-current assets or both, depending on the circumstances, such as when receipt of payment is expected according to the agreement with the customer. Contract assets are explained in Study Unit 26 in this section, *Revenue Recognition*.
- **Short-term notes receivable** if they conform generally to normal trade practices and terms within the business.
- **Inventories.** Merchandise on hand and available for sale and, for a manufacturer, raw materials and work-in-process as well as finished goods. Operating supplies and ordinary maintenance material and parts are also inventories.
- **Prepaid expenses.** Amounts paid in advance for the use of assets such as rent paid at the beginning of a rental period or amounts paid for services to be received at a future date. Prepaid expenses are not convertible to cash, but they are classified as current assets because they would have required the use of current assets during the coming operating cycle if the expenses had not been prepaid.
- **Funds that are restricted for current purposes.** If cash or cash equivalents are being held for a current purpose, such as for payment of current obligations due within a year or the operating cycle, whichever is longer, or as a compensating balance to support short-term borrowing, the cash should be reported on a separate line in the current assets section of the balance sheet.

Non-Current Assets

Non-current assets are assets or resources **other than** those that are expected to be realized in cash or sold or consumed during the normal operating cycle of the business.

Non-current assets include:

- Cash and claims to cash that are restricted as to withdrawal or use for other than current operations, for example to acquire non-current assets or to liquidate long-term debt. The restricted cash should be reported on a separate line in the investments or other assets section as non-current assets.
- Marketable securities, including stocks, bonds, and long-term notes receivable that do not represent the investment of cash available for current operations. Even though a security may be readily

²¹ Per ASC 210-10-45-1f.

marketable, if management does not intend to convert it to cash within one year or the company's operating cycle, whichever is longer, it should be classified as a non-current asset.

- Long-term investments or advances, whether marketable or not, made for the purpose of obtaining control, for affiliation, or other continuing business advantage.
- Property, plant, and equipment.
- Right-of-use assets obtained under lease agreements.
- Intangible long-term assets, such as a patent.
- Contract assets under ASC 606 that are not expected to be converted to cash within one year or the operating cycle, whichever is longer.
- Net deferred tax assets.
- The cash surrender value of life insurance policies on the lives of key employees.
- Other non-current assets not included in other categories, such as non-current receivables, long-term prepayments, and restricted cash or securities or assets in special funds.

Property, Plant, and Equipment (Fixed Assets)

Property, plant, and equipment (PP&E) are tangible assets used in operations that will continue to be used beyond the end of the current period. When the fixed assets are purchased, they are recorded at their cost, including shipping-in and installation costs needed to bring the asset to usable condition. The cost is then expensed over the life of the asset through depreciation, amortization, or depletion (except for land, which is not depreciated).

Examples of property, plant, and equipment include:

- Land, buildings, machinery, furniture, equipment, and vehicles that are owned
- Natural resources, such as gas, minerals, or timberland that are owned

Natural resources other than land are depleted; property, plant, and equipment other than land are depreciated. Land is not depreciated or depleted because land is not used up and does not wear out.

Intangible Long-term Assets

Intangible assets do not have physical substance, but they provide benefit to the company. Intangible assets may be either purchased or developed internally. However, because an asset recorded on the balance sheet comes about only by means of a prior transaction, internally generated intangible assets are not recorded on the balance sheet.²²

Examples of intangible assets are copyrights, patents, goodwill, trademarks, and franchises. Leasehold improvements, which are improvements made to leased property at the lessee's expense and that cannot be removed by the lessee when the lease period is over, are also intangible assets, as is the right of use of an asset obtained under lease agreement.

The cost of an intangible asset with a limited life is amortized over its useful life. An intangible asset with an indefinite life, such as goodwill, is assessed periodically for impairment.

Current Liabilities

Current liabilities are obligations that will be settled by using current assets or by creating other current liabilities.

²² For an internally developed patent, the costs of registration fees and legal fees for filing the patent (only) may be capitalized and amortized because the costs of research and development are expensed as they are incurred.

Examples of current liabilities include:

- Accounts payable and trade notes payable due to suppliers for purchases of goods and services.
- Cash dividends payable.
- Contract liabilities that represent the company's obligation to transfer goods or services to a customer because the company has received consideration from the customer such as a prepayment. Contract liabilities may be current liabilities or non-current liabilities or both, depending on the circumstances such as when the company expects to satisfy its performance obligations.
- Other deposits received from customers such as a security deposit on a lease.
- Agency collections such as employee tax withholdings and sales taxes, where the company acts as agent for another party (the government) and is obligated to remit the payments.
- Obligations due on demand according to their terms, such as demand notes.
- Short-term (30-, 60-, 90-day) notes.
- Current portions of long-term debt and lease liabilities (the portions of the principal due within the operating cycle, usually twelve months).
- Taxes payable, wages payable, and other accruals.
- Long-term obligations callable at the balance sheet date due to some violation by the company such as a violation of a loan covenant.²³
- Assurance-type warranties²⁴ for which the term of the warranty extends only into the next accounting period or, if the warranty is longer term, the portion of the warranty period that extends only into the next period.

Current liabilities **do not include**:

- Debts to be paid by funds in accounts classified as non-current.
- The portion of a short-term obligation intended to be refinanced by a long-term obligation, subject to fulfilling requirements as noted below.

Note: If the company can demonstrate that it has the **intent and the ability to refinance an obligation** that is coming due in the next twelve months, it may **reclassify that obligation on the balance sheet as a non-current liability**. Having a commitment from a bank for long-term financing of the obligation is an example of a way to demonstrate the intent and ability to refinance it.

For example, when a company can show that it has the intent and the ability to refinance an obligation that is due in nine months, the company can show the obligation on its balance sheet as a non-current liability because management knows it will use the funds received from the future long-term financing to settle the existing debt. The company is replacing one kind of debt with another kind of debt.

Bank Overdrafts: An Item That Could Be Reported by Netting Against the Current Asset “Cash” or by Adding to the Current Liability “Accounts Payable”

Bank overdrafts are amounts by which a company's checking account is in a negative position due to checks written that exceed the amount in the account. The management of the bank has discretion over whether a non-sufficient funds check will be honored, allowing the overdraft, or whether the non-sufficient funds

²³ A covenant is a condition or a requirement in a loan agreement or in a bond indenture. (A bond indenture is the legal, binding contract between a bond issuer, the borrower, and the bondholders, who are the lenders.) Covenants may restrict the actions of the borrower or require that the borrower meet certain requirements such as maintaining certain financial statement ratios. If the borrower fails to meet the requirements of the loan agreement, the loan becomes in default, just as if the borrower had failed to make scheduled loan payments, and the full principal and any accrued interest becomes immediately due and payable.

²⁴ An assurance-type warranty is a manufacturer's warranty given along with the sale of the product that provides assurance only that the product meets agreed-upon specifications in the contract at the time it is sold, without any additional payment being required from the customer.

check will be returned to the payee unpaid. If the bank honors the check and allows the overdraft in the payor's account, the overdraft amount should be added to the payor's accounts payable and reported as a current liability, **unless the payor has cash in an amount greater than the overdraft in another account in the same bank**. If enough cash is present in another account **in the same bank**, the net amount of cash available (the positive balance minus the negative balance) in that bank should be reported as part of cash, a current asset.

Non-current Liabilities

Non-current liabilities are liabilities that will **not** be settled within one year or the operating cycle if the operating cycle is longer than one year.

Examples of non-current liabilities are:

- Contract liabilities classified as non-current.
- Long-term notes or bonds payable.
- The long-term portions of long-term debt and lease liabilities (the portions of the principal due after the operating cycle (usually twelve months)).
- Pension obligations.
- Net deferred tax liabilities.
- The non-current portion of assurance-type warranties for which the term of the warranty extends beyond the next accounting period.

Note: Most long-term debt is subject to various covenants and restrictions, requiring a great deal of disclosure in the financial statements.

Equity

Equity is the ownership interest in a business. Equity is the portion of the company's assets owned by and owed to the owners. It is the difference between the company's assets and its liabilities and is the residual interest of the company. If the company were to be liquidated, equity represents the amount that would theoretically be distributable to the owners.

Equity is increased by increases in net assets from nonowner sources such as net income and other comprehensive income and reduced by decreases in net assets from nonowner sources such as net losses and other comprehensive losses. Equity is also increased by investments by owners and reduced by distributions to owners.

All business enterprises have owners' equity, but the types of accounts in owners' equity will differ depending on the type of business. The following discussion focuses on corporations, so the elements of owners' equity discussed here are the elements of a corporation's equity.

Owners' equity for corporations is split into six different categories:

- **Capital stock** - The par or stated value of the shares issued.
- **Additional paid-in capital** - The excess of amounts contributed by owners from the sale of shares over and above the par or stated value of the shares issued.
- **Retained earnings** - Net income of the company that has not been distributed as dividends.
- **Accumulated other comprehensive income items** - Specific items that are not included in the income statement but are included in equity and adjust the balance of equity, even though they do not flow to equity by means of the income statement as retained earnings do.

- **Noncontrolling interest** - A portion of the equity of subsidiaries partially but not wholly owned.²⁵
- **Treasury stock** - a contra-equity account that represents shares that have been repurchased by the corporation. The balance in the treasury stock account is either the amount paid for shares that have been repurchased or the par value of shares that have been repurchased, depending on the method used by the company to account for treasury stock.²⁶

Note: When a corporation repurchases shares of its own stock from the market, the repurchased shares are called **treasury shares** or **treasury stock**. Treasury shares purchased **reduce** owners' equity because those shares are no longer outstanding.

Benefits of the Balance Sheet

- Because the balance sheet provides information on assets, liabilities, and stockholders' equity, it provides a basis for computing rates of return, evaluating the capital structure of the business, and predicting a company's future cash flows.
- The balance sheet helps users to assess the company's liquidity, financial flexibility, net resources available, its capability of generating future net cash flows, exposures to risk, and its ability to meet its long-term financial obligations (its solvency). The statement of financial position can also be used in financial statement analysis to assess a company's ability to distribute cash to its investors to provide them an adequate rate of return.

Limitations of the Balance Sheet

- A balance sheet reports a company's financial position at one point in time, but it does not report the company's true value, for the following reasons:
 - **Many assets are not reported on the balance sheet**, even though they have value and will generate future cash flows, such as employees, other human resources, internally generated intangible assets, processes and procedures, and competitive advantages.
 - **Values of certain assets are measured at historical cost**, or the price the company paid to acquire the asset—not the asset's market value, replacement cost, or value to the company. For example, property, plant, and equipment (PP&E) are reported on the balance sheet at historical cost minus accumulated depreciation, although the assets' value in use may be significantly greater.
 - **Judgments and estimates are used to determine the value of many items reported in the balance sheet.** For example, estimates of the balance of receivables the company will collect are used to value accounts receivable; the expected useful life of fixed assets is used to determine the amount of depreciation; and the company's liability for future warranty claims is estimated by projecting the number and the cost of the future claims.
 - **Most liabilities are valued at the present value of cash flows discounted at the rate that was current when the liability was incurred**, not at the present value of cash flows discounted at the current market interest rate. If market interest rates increase, a liability with a fixed interest rate that is below the market rate increases in its value to the company. If market rates decrease, a liability with a fixed interest rate that is higher than the market interest rate sustains a loss in value. Neither of these changes in values is recognized on the balance sheet.

²⁵ Noncontrolling interest is explained in the topic *Business Combinations and Consolidations* in this volume.

²⁶ Treasury stock can be accounted for under the cost method, the par value method, or the constructive retirement method. Under the cost method, the full amount paid to repurchase the treasury stock is debited to the treasury stock account. Under the par value method, the par value of the repurchased shares is debited to the treasury stock account and the remaining purchase price is debited to the additional paid-in capital account. Under the constructive retirement method, the par value of the repurchased shares is debited directly to the common stock account and the remaining purchase price is debited to the additional paid-in capital account. The methods of accounting for treasury stock are covered in more detail in any accounting textbook.

Note: Fair value is used to measure many items presented on the balance sheet. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

For marketable securities and other assets with active markets, the fair value is the current market value. For assets without active markets, fair value may be the price for a similar item in an active market or in an inactive market, such as a valuation multiple based on the sale price of comparable assets or, for a building, the price per square foot received in sales of comparable buildings. If markets do not exist or are not liquid, a company's internal assumptions such as forecasts of future cash flows may be used to determine the fair value of an asset or liability.

Companies have an option to measure most financial assets and liabilities at fair value.

Study Unit 2: A.1. Comprehensive Income and the Income Statement

2) Comprehensive Income and the Income Statement

Guidance in the *Accounting Standards Codification*[®] on presentation of the income statement is in ASC 225. Information from the FASB's Statements of Financial Accounting Concepts as amended December 2021 is also used in this topic.

Comprehensive income is defined by the FASB as the change in equity (net assets) of a company during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income includes net income and all the items of other comprehensive income²⁷ recorded during the period in the accumulated other comprehensive income account.

The components of comprehensive income include revenues, expenses, gains, and losses during a period.²⁸ The aggregation of most of the components of comprehensive income results in net income, which is reported on the **income statement**. However, certain revenues, expenses, gains, and losses are included in comprehensive income but are excluded from net income. Comprehensive income is discussed in more detail in the next study unit, Study Unit 3.

Information about revenues, expenses, gains, and losses provide the details about how much and in what ways the equity (net assets) of a company increased or decreased during the period other than from investments by or distributions to owners.²⁹

The income statement is created using the accrual method of accounting as applied to historical transactions. The income statement gives the results of operations for a **period** and is like a movie, recording the monetary effect of business transactions for that period. The income statement is different from the balance sheet because the balance sheet provides information specific to **one moment in time, like a photograph**.

The income statement accounts used to record revenues, expenses, gains, and losses are **temporary accounts**. They are **closed to retained earnings, a permanent account on the balance sheet** at the end of each fiscal year. At the beginning of each fiscal year, the balances in the income statement accounts are zero.

Certain types of events are classified and reported separately on the income statement. The standard **multiple-step** income statement format includes the following sections:

²⁷ Accounting Standards Codification Master Glossary, www.fasb.org.

²⁸ *Presentation*, paragraph PR18, p. 4.

²⁹ *Ibid.*, paragraph PR25, p. 6.

Revenues	\$XXXXXX	
Cost of goods sold	<u>XXXX</u>	
Gross profit	\$XXXXXX	
Selling, general, and administrative expenses	<u>XXX</u>	
Operating income	\$XXXXXX	
Interest and dividend income	XXX	
Interest expense	XXX	
Non-operating gains/(losses)	<u>XXXX</u>	
Income from continuing operations before income taxes	\$XXXXXX	
Provision for income taxes on continuing operations	<u>XXXX</u>	
Income from continuing operations		\$ XXXX
Discontinued operations:		
Gain/(loss) from operations of discontinued Component X (including gain/[loss] on disposal of \$XXX)	\$ XXXX	
Income tax benefit or (income tax expense)	<u>XXX</u>	
Income (loss) on discontinued operations		\$ <u>XXXX</u>
Net Income		\$ <u>XXXX</u>

Note: In addition to income information, information regarding **Earnings per Share (EPS)** must also be presented on the face of the income statement.

Note: “Income from continuing operations” on a multi-step income statement is **not** the same as “operating income.”

Operating income includes revenues and expenses generated by the company’s core business. Operating income does **not** include financial income (interest and dividend income) or financial expense (interest expense), nor does it include non-operating gains and losses or the provision for income taxes on continuing operations.

Income from continuing operations, on the other hand, **does** include financial income, financial expense, non-operating gains and losses, and income taxes on continuing operations, in addition to revenues and expenses generated by the company’s core business.

Income from continuing operations refers to gain or loss that the company generated on all its activities that are expected to continue in the future. It is called income from **continuing** operations to distinguish it from gains and losses on **discontinued** operations. Income from continuing operations does **not** include income from discontinued operations because income from discontinued operations represents income or loss that is not expected to continue in the future. The potential buyer of a company should look at income from continuing operations instead of net income because income from continuing operations will continue in the future.

The line “Income from continuing operations” appears on an income statement only if the company is reporting results of discontinued operations.

A **single-step** income statement that has only two groupings, revenues and expenses, may also be used. Total expenses are subtracted from total revenues to determine the net income or loss. The single-step form of income statement is simpler and eliminates potential classification problems.

Elements of Comprehensive Income

Elements of comprehensive income include revenues, expenses, gains, and losses.

- **Revenues** are inflows or other enhancements of assets or settlements of liabilities³⁰ (or a combination of both) that result from delivering or producing goods, rendering services, or other activities.³¹

Note: The **revenue recognition principle** requires revenues to be recognized in the accounting period in which the performance obligation is satisfied.

- **Expenses** are outflows or other using-up of assets or the incurrence of liabilities (or a combination of both) that result from delivering or producing goods, providing services, or carrying out other activities.³²

Note: The **expense recognition principle**, or the **matching principle**, states that recognition of expenses is related to net changes in assets and the earning of revenues. Expenses should be recognized when the work or product contributes to revenue.

- **Gains** are increases in equity (that is, net assets) resulting from transactions and other events and circumstances affecting the company other than those resulting from revenues or investments by owners.³³
- **Losses** are decreases in equity (net assets) that result from transactions and other events and circumstances affecting the company other than those resulting from expenses or distributions to owners.³⁴

The difference between revenues/expenses and gains/losses is:

- Revenues and expenses result from delivering or producing goods or providing services. Revenues and expenses can also result from activities that permit others to use the company's resources and that result in interest, rent, royalties, and fees.³⁵
- Gains and losses result from exchange transactions such as sales of assets used in a productive capacity; holding gains and losses; and loss events such as natural catastrophes.³⁶
- However, if gains and losses are an ordinary part of a company's activities, they may be presented with revenues and expenses. An example is gains and losses from trading activities of a company whose primary business is trading securities or commodities.³⁷

³⁰ Settlement of a liability creates revenue, for example, when the company has received a deposit from a customer for an order to be delivered in the future. The deposit is a contract liability when received. When the performance obligation in the contract has been satisfied, the contract liability is debited to reduce it by the amount of the deposit, and the amount of the deposit is credited to revenue.

³¹ *Elements of Financial Statements*, paragraph E80, p. 19.

³² *Ibid.*, paragraph E81, p. 19.

³³ *Ibid.*, paragraph E82, p. 19.

³⁴ *Ibid.*, paragraph E83, p. 19.

³⁵ *Ibid.*, paragraph E84, p. 19.

³⁶ *Ibid.*, paragraph E85, p. 19.

³⁷ *Ibid.*, paragraph E89, p. 20.

Other Income Statement Items

Unusual Gains and Losses

Unusual gains and losses are gains and losses the company considers to be of an unusual nature or of a type that indicates infrequency of occurrence or both. Some examples of unusual losses are losses on inventory or other assets damaged in a fire and restructuring charges.

Unusual gains and losses are part of income from continuing operations (in contrast to discontinued operations). Unusual gains and losses are generally reported as **non-operating gains and losses** within income from continuing operations. Unusual gains or losses that are similar and are not material individually should be combined on one line. Unusual gains or losses that are material should be reported on a separate line or disclosed in the notes to financial statements.³⁸

Discontinued Operations

Guidance in the *Accounting Standards Codification*[®] on presentation of discontinued operations in financial statements is in ASC 205-20.

A discontinued operation is defined as a component³⁹ or a group of components of a company that is either held for sale or has been disposed of by sale or otherwise that represents a **strategic shift** that has or will have a major effect on the company’s operations and financial results. A strategic shift that has or will have a major effect on operations and financial results could include disposing of operations in a major geographical area or disposing of a major line of business, a major equity investment, or other major parts of the business.

All gains or losses incurred by the discontinued component, including both gain or loss on operations of a component that is held for sale and gain or loss on the disposal of a component, are **reported net of tax in the period in which the gain or loss occurred**. The gain or loss from operations of the discontinued component and the gain or loss from the disposal, when the disposal takes place, are combined and reported on one line, followed by the income tax effect on the next line, either a tax benefit (for a loss) or a tax expense (for a gain), followed by the after-tax income or loss on discontinued operations. The gain/loss, the tax expense or tax benefit associated with the gain or loss of the discontinued component, and the net income or loss on discontinued operations should be reported below income from continuing operations, as follows.⁴⁰

Income from continuing operations before income taxes	\$ XXXXX	
Provision for income taxes on continuing operations	<u>XXXX</u>	
Income from continuing operations		\$ XXXX
Discontinued operations:		
Gain/(loss) from operations of discontinued Component X (including gain/[loss] on disposal of \$XXX)	\$ XXXX	
Income tax benefit or (income tax expense)	<u>XXX</u>	
Income (loss) on discontinued operations		\$ XXXX
Net Income		\$ XXXX

³⁸ Per ASC 220-20-45-1.

³⁹ A **component** is defined as operations and cash flows that can be clearly distinguished from the rest of the company both operationally and for financial reporting purposes.

⁴⁰ ASC 205-20-45-3A.

A gain or loss on the disposal or a loss recognized on classification as held for sale may also be disclosed in the notes to financial statements.⁴¹

Disposal of a component or a group of components that represents a strategic shift must be reported as discontinued operations when **any** of the following three items occurs:

- 1) The component or group of components meets the criteria in ASC 205-20-45-1E to be classified as **held for sale**. ASC 205-20-45-1E requires the held-for-sale classification in the period in which **all** the following criteria are met:
 - Management commits to a plan to sell the component or group of components.
 - The component(s) are available for immediate sale.
 - An active program to locate a buyer or buyers and other actions required to complete the sale have been initiated.
 - The sale is probable⁴² within one year, unless events beyond the company's control occur.
 - The component(s) are being actively marketed at a reasonable price in relation to their fair value.
 - Actions required to complete the plan to sell the component(s) make it unlikely that the plan will be withdrawn or significantly changed.
- 2) The component or group of components is sold.
- 3) The component or group of components is disposed of in a manner other than by sale, such as by abandonment or by distribution to owners in a spinoff.⁴³

In addition to reporting the discontinued component's results of operations separately in the current period, the company should also reclassify to discontinued operations the net income or loss from the discontinued operations in the **prior period** income statements presented as comparisons. Reclassification of prior period operating results is done so that the prior period financial statements are comparable to the current period financial statements.

In other words, all gains and losses from the component to be discontinued should be removed from income from continuing operations so users of the financial statements can see what income from continuing operations is without the operations of the component disposed of or to be disposed of.

Companies use the line "**Income from continuing operations**" on the income statement only when gains or losses on discontinued operations occur.

Intra-period Tax Allocation

The income tax effect of discontinued operations needs to be reported on the income statement separately from income taxes applicable to continuing operations, and discontinued operations are reported on the income statement net of their applicable taxes. Therefore, **taxes must be allocated on the income statement between income from continuing operations and income from discontinued operations**.

In addition, any items reported on the balance sheet in accumulated other comprehensive income are to be reported net of tax. Allocation of tax among income from continuing operations, discontinued operations, and accumulated other comprehensive income is called **intra-period tax allocation** (allocation within one period).

⁴¹ Per ASC 205-20-45-3B.

⁴² According to the FASB's Accounting Standards Codification Glossary, "probable" means "the future event or events are likely to occur." www.fasb.org.

⁴³ A spinoff is a form of corporate divestiture. It results in a subsidiary or a division of the company becoming an independent company. Usually, shares in the new company are distributed to the shareholders of the parent company on a pro-rata basis.

The income tax due should be allocated first to income from continuing operations. The remaining tax due should be allocated to gains/losses from discontinued operations and items reported in accumulated other comprehensive income according to each one's proportion of the total other taxable items.

Benefits of the Income Statement

The income statement helps to predict future cash flows, as follows:

- It helps users to evaluate the company's past performance and to compare it to the performance of its competitors.
- It provides a basis for predicting future performance.
- It helps users assess the risk or uncertainty of achieving future cash flows.

Limitations of the Income Statement

Most of the limitations of the income statement are caused by the periodic nature of the income statement. At any given financial statement date, buying and selling will be in process and some transactions will be incomplete. Therefore, net income for a period necessarily involves estimates that affect the company's performance for the period.

Limitations that reduce the usefulness of the income statement for predicting amounts, timing, and uncertainty of cash flows include:

- Net income is an estimate that reflects several assumptions.
- Income numbers are affected by the accounting methods used. For example, differences in methods of depreciation can cause differences in the amount of depreciation expense during each year of an asset's life. A lack of comparability between and among companies results from these differences in accounting methods.
- Income measurement requires judgment. For example, the amount of depreciation expense recognized during a period is dependent on estimates regarding the useful lives of the assets being depreciated.
- Items that cannot be measured reliably are not reported in the income statement. For instance, increases in value due to brand recognition, customer service, and product quality are not reflected in net income.
- The income statement is limited to reporting events that produce reportable revenues and expenses. Some transactions are not reported immediately on the income statement.

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Study Unit 3: A.1. The Statement of Comprehensive Income**3) Statement of Comprehensive Income**

Guidance in the *Accounting Standards Codification*[®] on presentation of the statement of comprehensive income is in ASC 220.

Comprehensive income is the change in equity (net assets) of a company that occurs during a period from transactions and other events **other than** those resulting from investments by owners such as sale of newly issued stock and distributions to owners such as distribution of dividends or repurchase of shares.⁴⁴

Comprehensive income includes everything on the income statement **plus** some other specific items that do not appear on the income statement. The other items are called "other comprehensive income" and are reported directly in equity. Therefore, comprehensive income is more inclusive than net income. In other words, although net income is a big part of comprehensive income, it is not the same as comprehensive income.

Net income flows to retained earnings in equity when the year-end close is performed, so net income ends up in equity. The other comprehensive income items that are not presented on the income statement go directly to equity by means of the **accumulated other comprehensive income** account. Accumulated other comprehensive income is a line in the equity section of the balance sheet that includes the items that are comprehensive income but are not reflected on the income statement.

The word "other" in "accumulated other comprehensive income" refers to the specific items that are other than income statement transactions and that flow to equity by means of the accumulated other comprehensive income account. Even though those items are not on the income statement, those items, along with net income, are also comprehensive income. Those items are called **other comprehensive income** items because they are reported not in net income (and remember, net income is a part of comprehensive income) but directly in equity. They are **other** comprehensive income.

Of these specific items, the ones that would increase net income if they were reported on the income statement are **credited** to accumulated other comprehensive income, and the ones that would decrease net income if they were reported on the income statement are **debited** to accumulated other comprehensive income.

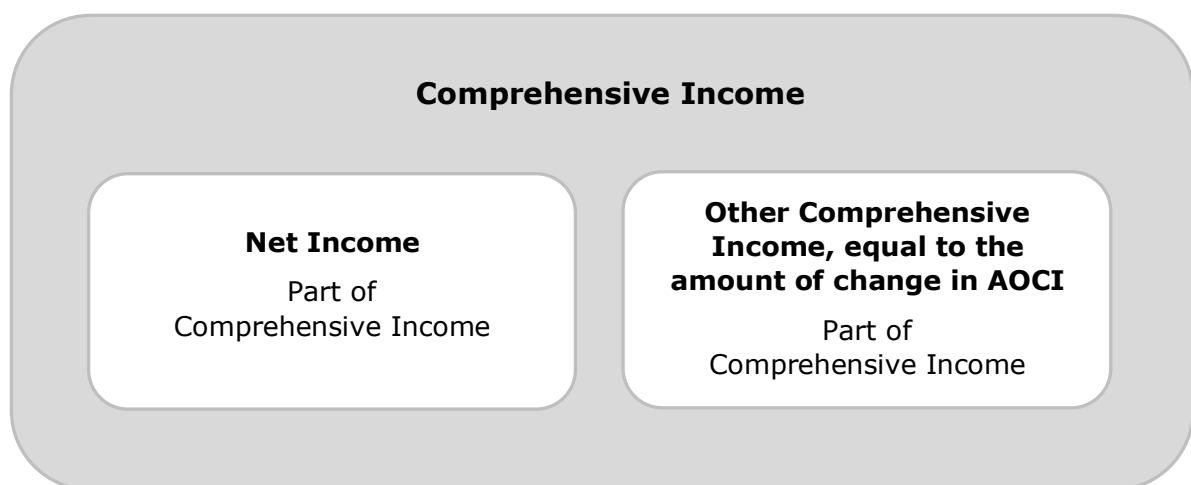
The word "accumulated" in "accumulated other comprehensive income" means that the balance in the account keeps accumulating. Since accumulated other comprehensive income is a balance sheet account, it is a permanent account. It is never closed out, and the balance in it keeps accumulating just like any other balance sheet account. The accumulated other comprehensive income account may be referred to as **AOCI**.

The **amount of change** in the AOCI account from the beginning of the year to the end of the year is the net amount of other comprehensive income items that were recorded during the year. The amount of change in the AOCI account during a period is called simply "**other comprehensive income**," or **OCI**.

"Total comprehensive income" or just "comprehensive income" for a period includes net income for the period **plus** other comprehensive income for the period.

Note: Comprehensive income for a period is the period's net income plus or minus the amount of change during the period in the accumulated other comprehensive income account.

⁴⁴ *Presentation*, paragraph PR31, p. 7.



Note: Definitions to know and understand:

- **Accumulated Other Comprehensive Income (AOCI)** is the name of the balance sheet account in the equity section of the balance sheet where certain items of revenues, expenses, gains, and losses that are not reported in net income are recorded. The balance in the AOCI account accumulates and is never closed out because it is a permanent account.
- **Other comprehensive income (OCI)** is revenues, expenses, gains, and losses that are included in comprehensive income but are excluded from net income. Other comprehensive income is the **amount of change** in the Accumulated Other Comprehensive Income account during a period. Other comprehensive income is also the net of all the debit and credit transactions in the AOCI account during the period.
- **Comprehensive Income** is all changes in the equity of a business during a period except for those resulting from investments by owners and distributions to owners. It is the **total** of net income for the period **plus** other comprehensive income for the same period.
- The **Statement of Comprehensive Income** reports both net income **and** other comprehensive income.

The Statement of Comprehensive Income

According to ASC 220-10-45-1, a company has the option to report comprehensive income, including net income **and** other comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements.

- If the company chooses to present a single continuous financial statement, it must present it in two sections: net income and other comprehensive income. It must present:
 - Total net income along with the components that make up net income; and
 - A total amount for the other comprehensive income along with the components that make up other comprehensive income.
- If the company chooses to present two separate but consecutive financial statements, it must present:
 - Total net income and the components of net income in the statement of net income; and
 - Total other comprehensive income and the components of other comprehensive income in a statement of comprehensive income that immediately follows the statement of net income. The statement of comprehensive income must begin with net income.

The items that are considered other comprehensive income items are not reported on the income statement but instead are reported as a component of equity in the accumulated other comprehensive income account. They are expressly stated in the standards (ASC 220-10-45-10A). The items currently in this group include:

- 1) Foreign currency translation adjustments that result from converting the financial statements of a foreign subsidiary from its functional currency into U.S. dollars for consolidated reporting.⁴⁵
- 2) Gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date.
- 3) Gains and losses on intra-entity foreign currency transactions that are of a long-term investment nature, meaning settlement is not planned or anticipated in the foreseeable future, when the parties to the transaction are consolidated, combined, or accounted for by the equity method in the reporting company's financial statements.
- 4) Gains and losses on derivative instruments that are designated as, and qualify as, cash flow hedges.
- 5) For derivatives that are designated in qualifying hedging relationships, the difference between changes in fair value of the excluded components and the initial value of the excluded components recognized in earnings under a systematic and rational method.
- 6) Unrealized holding gains and losses on available-for-sale debt securities.
- 7) Unrealized holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category.
- 8) Gains or losses associated with pension or other postretirement benefits that are not recognized immediately as a component of net periodic benefit cost.
- 9) Prior service costs or credits associated with pension or other postretirement benefits.
- 10) Transition assets or obligations associated with pension or other postretirement benefits that are not recognized immediately as a component of net periodic benefit cost.
- 11) Changes in fair value attributable to instrument-specific credit risk of liabilities for which the fair value option is elected.
- 12) The effect of changes in the discount rates used to measure traditional and limited-payment long-duration insurance contracts
- 13) The effect of changes in the fair value of a market risk benefit⁴⁶ attributable to a change in the instrument-specific credit risk

The items above may each be shown as either net of tax or before related tax effects with one amount shown for the aggregate income tax expense or benefit related to the total of other comprehensive income.

If a company has no items of other comprehensive income in any period presented, it is not required to report other comprehensive income or comprehensive income.⁴⁷

A company must report the accumulated balance of the items of other comprehensive income **on the balance sheet as an element of owners' equity**. Accumulated other comprehensive income should be reported separately from stock, additional paid-in capital (APIC) and retained earnings.

⁴⁵ Foreign currency translation is covered on the CMA Part 2 exam and is explained in the study materials for that exam.

⁴⁶ According to the FASB's glossary, a "market risk benefit" is an insurance term. It is a contract or contract feature in a long-duration contract issued by an insurance company that both protects the contract holder and exposes the insurance company to other-than nominal capital market risk.

⁴⁷ Per ASC 220-10-15-3.