Today’s Content

- The Balance Sheet
  - Long term assets
  - Liabilities
  - Stockholder’s equity
  - Some issues
Assets & Liabilities

- Assets & Liabilities on a Balance sheet
  - Presented in order of liquidity … from most to least “liquid” (essentially a measure of the “ability to convert to cash” rapidly)
  - Subdivided into “current” & “long term”
    - Current assets (& liabilities) are those that are expected to be used up & replenished on an on-going basis during the accounting period
    - Long term assets (& liabilities) are expected to last more than the accounting period

Long Term Assets

- Long term assets (Non-current assets)
  - Assets that will be used in the business to generate revenue over periods more than one year or accounting period
  - Property, plant & equipment, net
    - Fixed assets … Tangible assets
  - Equity and other investments
  - Goodwill, net
  - Other non-current assets

Property, Plant & Equipment, net

- Property, plant & equipment, net
  - Usually a major item on the balance sheet as it represents physical items that are used in doing business … land, buildings, trucks, etc.
  - All fixed assets, except for land, are depreciated over their estimated useful lives
  - Usually simply shown at “book value” or “net”
    - Original cost + any expenses necessary to make it productive + improvements - salvage value - accumulated depreciation
Property, Plant, & Equipment, net
(IT examples)
• Dell … uses straight-line depreciation
  – Assumes 10 to 30 years for buildings
  – Assumes 2 to 5 years for all other assets
• Intel … uses straight-line depreciation
  – Assumes 4 to 40 years for buildings
  – Assumes 2 to 5 years for machinery & equip.
• Microsoft … uses straight-line depreciation
  – Assumes 1 to 15 years for property & equip.
  – Assumes 1 to 3 years for software

Asset Depreciation
• Straight-line depreciation allocates an asset’s cost to expense on an even basis over its useful life
• Management has tremendous flexibility in its choices of depreciation methods
  – Accelerated depreciation allocates more cost to expense over the early years of its life and less in the later years

Equity & Other Investments
• Equity & other investments
  – Are investments classified as “available for sale”
  – Valued at “fair market value”
  – Companies usually use a “specific identification method”
Goodwill, net

- Goodwill ...an “intangible asset”
  - Goodwill is recorded on a balance sheet when one company acquires another and pays more than the fair value of the net tangible & intangible assets acquired
  - Amortized using a straight-line method
  - Microsoft (2001 balance sheet):
    - Amortization of goodwill & other acquisition-related intangibles ... $2.3 billion

Other Non-current Assets

- Other non-current assets
  - Is a catch-all category that includes items such as:
    - Property held for sale
    - Start up costs for a new line of business
    - Cash surrender value of life insurance policies

The Other Side

- Liabilities
  - The claims against the asset side of the balance sheet
  - Listed in order of their liquidity
    - Meaning “how soon cash will be needed to pay them off”
    - Current liabilities are claims that will be satisfied in less than one year or operating cycle
Current Liabilities

- Current liabilities on the balance sheet
  - Accounts payable
    - Credit extended to the company that will be paid off in the normal course of business
  - Notes payable
    - Short-term obligations such as promissory notes and lines-of-credit from a bank or supplier or a business partner
  - Accrued liabilities
    - Short-term obligations such as accrued compensation & maturing debts

Long-term Liabilities

- Long-term liabilities
  - Obligations that will not be satisfied in less than one year or operating cycle
    - Long-term debt
    - Deferred income taxes
    - Commitments & contingencies

Stockholder’s Equity

- Stockholder’s equity … the ownership interest in a company
  - Anything that is left of the assets after the liabilities are satisfied
  - Accounts are listed in “the order of their priority” … meaning priority of claim against the assets
Preferred & Common Stock

- Preferred stock
  - Stock that has a fixed, stated dividend rate
  - Non-voting stock
- Common stock
  - Stock that receives a dividend only when voted by the board
- “par value” + “additional paid-in capital”
  - Par value is a stated amount at time of issue
  - Additional paid-in capital is the amount paid over par value when issued for sale

Retained Earnings

- Retained earnings
  - Represents the total amount that a company has earned, minus any payments in cash or stock made to shareholders
  - The amount that has been reinvested in the business

The Balance Sheet

*(some issues)*

- The balance sheet balances!
  - What about “stock options” given to executives as remuneration?
    - Not yet an equity item! A commitment? (Expense?)
    - June 30, 2001: 331 million vested shares & 550 million shares available with an average price of $49.54 (Microsoft footnote)
  - What is “off balance sheet financing?”
    - Set up a subsidiary & have it borrow money for you
    - Debt that does not appear on your balance sheet!
Summary

- Long term assets
- Liabilities
  - Current liabilities
  - Long term liabilities
- Stockholder’s equity
  - Preferred & common stock
  - Retained earnings
- Some balance sheet issues
  - Stock options & off balance sheet financing