Congress created the (SEC) and gave it broad powers to determine measurement rules for financial statements for publicly traded companies. 🡺SEC work with accountants and others to work out the detailed rules that become GAAP principles. 🡺 (FASB) set up and formulate GAAP. The FASB relies on a conceptual framework to provide a structure for developing specific accounting standards. 🡺Public Company Accounting Oversight Board: Sets auditing standards for independent auditors (CPAs)

SEC and FRAud: SEC Created Financial Reporting and Audit Task Force (FRAud), FRAud detecting fraud and prosecuting for violating financial statements and disclosures. EPS Initiative uses risk-based data analytics to uncover earnings management practices designed to hide week performance.

High Quality = Relevant + Faithful Representation

**Responsibility and the Need for Controls**:

1. system of internal controls. 2. Hire external independent auditors to audit the fairness of the financial statements. 3. Form a committee of the board of directors to oversee the integrity of these other safeguards.

**Company Internal Structure:** 1) The board of directors (selected by shareholders) oversees the CEO and senior management. 2) Audit Committee of the Board of Director: maintaining the integrity of the accounting and financial statement, responsible for hiring independent auditors, and meet separately with the auditors to discuss management’s compliance.3) Auditor: Follow PCAOB to verify the financial statements and the control systems to give unqualified(clean) option if correct.

**Information Intermediaries**: 1) Companies file their SEC forms electronically using the EDGAR. Each fact in the report is tagged using XBRL.2) Web 3) Analyst Report.

**Fair Disclosure:** no insider information, press release, conference call.

Disclosure Process: public (10K-annual,10Q-quarter, audited, include business description, financial statements, management’s Discussion and analysis, etc. Also 8-K if any material event happens like auditor changed, mergers)

**IASB VS GAAP VS IRC:** 1. IFRS issued by the International Accounting Standards Board (IASB). 2. US SEC allows foreign companies to use IFRS. 3. GAAP BS Order: Current then non-current, IFRS opposite. 4. U.S. GAAP allows FIFO, LIFO, and average cost inventory methods, IFRS prohibit LIFO. 5.GAAP also allows different inventory accounting methods to be used for different types of inventory items, while IFRS requires the same method be used for all inventory items that have a similar nature and use. 6. (IRC)Country’s tax laws determine the acceptability of different inventory methods for tax purposes. 7. GAAP defines probable >70%, IFRS >50%Balance Sheet: Assumptions: 1. Separate entity assumption, 2. Going concern assumption (continuity assumption). 3. Monetary unit assumption. Measurement Concept: Historical cost. *Some events are not reflected in the financial statements.*

**Operating expense:** inventory cost, **does not include overhead costs**(sales, marketing, advertisement), service companies may not report COGS. Supplies Expense, Wages Expense (not included costs like training), Insurance Expense, Utilities Expense, Repair Expense (exclude capitalized case), rent expense, admin expense(overhead,advertisement,training,executive salaries,renting headquarters facilities), Gain/Loss on Disposal, depreciation expense, R&D(while IFRS capitalizes it), **other items(interest revenue, dividend revenue, interest expense, loss/gain on sale of investments).**

GAAP does not allow cash-basis accounting.

**Accrual Basis**: Revenue is recognized (1) when the company transfers promised goods or services to customers (2) in the amount it expects to be entitled to receive. (when title and risks of ownership transfer (delivered)🡺 FOB Destination or FOB shipping point) Expenses are recognized when the cost is incurred, Salaries and wages to employees who worked during the period. Utilities for the electricity used during the period. Supplies used during the period. Facilities rented during the period. Equipment used during the period. regardless of when cash is received or paid.

**Adjustment Process:Cash was never adjusted**

Cost of goods sold related to the returned items would also be reduced.

**Accounting for bad debts**: Beginning:estimation(Db:bad debt expense,Cr:Allowance for bad debt(+XA,-A))

Write off: (Db:allowance(-XA,+A), Cr:account receivable) 🡺 Does not affect Income statement and net book value of accounts receivable.

If LIFO is used to compute taxable income, it must also be used to calculate inventory and cost of goods sold for financial statements. This is called the LIFO Conformity Rule. Accounting rules require companies to apply their accounting methods on a consistent basis over time

**NRV in ending inventory falls below cost**, must be assigned to their net realizable value, particularly important for :1) High-technology companies 2) Companies that sell seasonal goods 🡺Db: COGS, Cr: Invetory

building cost= materials+labor+overhead cost+interest on debt (capitalized)

Impairments: Step1: signs of impairment of assets: 1) Significant pattern of decline of market price of the assets 2) Lower demand 3) Change in economic or legal factors 3) damage to the asset 4) Asset is held for disposal or is part of a restructuring. Step2: Test the recoverability of the long-lived assets: impaired if not recoverable when NBV>FCF. Step3: Measure the Impairment: NBV- FV = impairment loss. Step4:Db:Loss due to impairment, Cr:Assets. Disposal of Long-lived asset: (Db:Cash, Accumulated Depreciation, (loss), Cr: that asset, (gain)) Intangible assets: Definite life(amortized, straight-line, usually no residual value). Indefinite life (not amortized, view for impairment 🡺 carrying value=market value)

Goodwill: Purchase price- Fair value (CA – Liabilities), Trademark: Only recorded if purchase. copyrights:70 years, Patents:20 years (if internally developed, only registration fees and legal costs are capitalized), R&D not capitalized 🡺go to IS expense. Franchises, Licenses,etc.

Depletion: capitalized. Dr. Inventory, Cr.Natural Resources

Liabilities: Notes Payable: Private Placement (banks, insurance, pension plans), bonds 🡺publicly trader.

Lessor: owns the assets. Lessee: pays interest for the right to use. Finance Lesse V.S. Opearating Lesse

Record Long-term: Db: Lesse (+A), Cr:Lease Liability(+L), Short-term:Db:Lease expense,Cr:Cash

Contingent Liabilities: only record liabilities that amount can be estimated and probable. Ow. Resonably possible🡺footnote, else 🡺X disclosure.

**Bonds:** Advantage: stockholders maintain control, interest expense is tax deductible, the return to shareholders can be positive. Disadvantage:Risk of bankruptcy increase.

Issurance Process: indenture specifies all the details of the bond offering. Prospectus is a regulatory document that is filed with the SEC. Covenants designed to protect the bondholders. Trustee to represent bondholders.

Record at present Value: Db:Cash, (Bond Discount) Cr: Bond Payable, (Bond Premium).

During the Period: Db: Interest Expense, (Bond Premium) Cr: cash, (Bond Discount)

GAAP requires that effective-interest method to amortize bond discounts and bond premiums. GAAP permits straight-line amortization when results do not materially differ.

Call Bond: Db: Bond Payable, (bond premium), (Loss) Cr: Cash,(bond discount),(gain)

**Authorized shares** (max shares can issue) =outstanding + Tresury + Unissued

Reacquire share: Db:Tresury , Cr:Cash

Reissue: Db:Cash, CR:Tresury+Additional Paid-in(:=issuePrice-selling)

Large Stock dividend (>0.2):Db:RE, Cr:Common Stock.

Small Stock dividend:Db:RE, Cr: Common Stock + Additional Paid-in

Stock Split: Par Value =Par Value/2

**Operating Activities**=Customers,dividends, (Purchase of services,goods for resale, salaries and wages, income taxes, interest on liabilities)

Interest is Operating in GAAP, but in IFRS 🡺 Opearting/ Investing(receive)/ Financing(paid)

**Formula:**

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Description automatically generated1.ROE=NI/E=ROA\*Leverage

=ProfitMargin(NI/NetSales)\*AssetTurnover(NetSales/AverageAsset)\*Leverage(AverageAsset/E)

2.Gross Profit Percentage=Gross Profit/NetSales

4. AR Turnovers:Net credit sales/ average net AR

5.Gross AR-Allowance for bad debt=Net AR

6.2/10,n/30, Amount Saved/Amount Paid=Interest rate for (30-10) days. EIR= 365/(30-10)\*interest rate\_(30-10)days

7.Sales Revenue-Discounts-Return&Allowance=Net Sales

8. Inventory Cost= Invocie Price+Freight-ins+inspection costs+preparation costs- return&allowances-discount. Note:Cost related to selling 🡺admin

9. COGS: Goods Available for sales (:== Beginning Inventory+purchase)-ending invetory

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Description automatically generated10.LIFO Reserve= excess FIFO over LIFO ,which is a contra-asset

11.Net Inventories (reported in BS)= Invertory at lower of FIFO cost or net realizable cost – LIFO Reserve

12. NRV= sales price-costs to sells

13. Invetory Turnovers=COGS/average inventory, Average days to selss inventory=365/inventory Turnover

14. Acquistion cost=pruchase price+sales taxes+legal fees+transportation+installation/preparation fees

15. building cost= materials+labor+overhead cost+interest on debt (capitalized)

16. Cost-accumulated Depreciation=book value

17.(Cost-Residual)/Useful life=depreciation expense per year

18.(Cost-Residual)/total produciton units=depreciation per units

19.(Cost-Accumulated Depreciation)\*2/Useful Life =Depreciation Expense

20.Asset intangibility= 1- fixded asset/ total asset

21. Fixed Asset Turnover=net sales/ average net fixed assets

22. Net payroll= gross payroll- tax

23. Working Capital= Current Assets- Current Liabilities

24. Current ratio= Current Assets/ Current Liabilities

25. AP Tunrover= cost of goods sold/ average AP

26. Coupon= annual rate/frequency

27. Times interest earned=(NI + Interest expense + Income tax expense)/Interest Expense

28. Debt-To-Equity=Debt/Equity

30. Authorized shares (max shares can issue)=outstanding + Tresury + Unissued

31.Dividend Yield= Dividend per share/market price

32. Quality of Income Ratio= Cash flow from operating/Net Income

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Description automatically generated with medium confidence33.Capital acquisition Ratio= Cash flow from Opearting/ cash paid for property, Plant, Equipment

34.Free Cash flow= Cash flow from operating – Dividends- Capital Expenditures

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