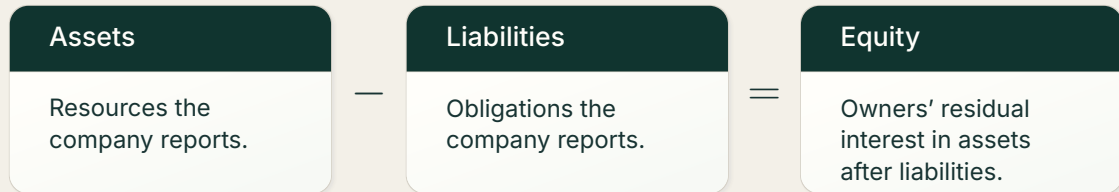


ACC 300 • SESSION 10

Understanding the balance sheet

💡 Financial position at a date

A balance sheet reports a company's financial position **at a specific date**.



What do the reported amounts represent?

How are they classified?



Major types of assets

ASSET TYPE	RESOURCE REPORTED
Cash	Available funds, subject to any restrictions
Receivables	Amounts owed by customers or others
Inventory and prepayments	Goods held for sale and benefits paid for in advance
Investments	Financial interests held by the company
Property and equipment	Resources used repeatedly in operations
Intangible and other assets	Nonphysical rights and other recognized resources

Later accounting topics determine when each resource is recognized and how it is measured.



Major types of liabilities

Liabilities represent obligations the company still has to settle.

LIABILITY TYPE	OBLIGATION REPORTED
Payables and accruals	Amounts owed to suppliers, employees, governments, and others
Customer advances	Cash received before promised goods or services are provided
Borrowings	Principal the company must repay to lenders
Warranty and similar obligations	Expected future performance arising from past activity
Other long-term obligations	Obligations expected to be settled in later periods

The account identifies the obligation; classification identifies the expected settlement period.

Why classify assets and liabilities?

Classification separates nearer-term resources and obligations from those associated with later periods.

CURRENT

Resources expected to be available, sold, collected, or consumed, and obligations expected to be settled, within the current-classification period.

NONCURRENT

Resources retained for longer-term use and obligations expected to be settled later.

Cash available for operations	\$100,000
Equipment used for five years	\$100,000

Both are assets, but separating them helps a reader see their different roles. Classification changes presentation, not the total amount reported.

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Classifying assets



Asset classification and expected use

Expected use

What is the company expected to do with the asset?

Operating cycle

- The company expects to sell, collect, or consume the asset.
- Timing and the operating cycle matter.

Continuing use

- The company uses the asset over multiple periods.
- These assets are generally noncurrent.

Restrictions

- Availability depends on the restriction's purpose.
- The restriction may affect classification.



Assets in the ordinary operating process

Different business models use different resources in their ordinary operating processes.

Riverton Bicycles, Inc.

Manufactures and sells bicycles.

Northfield Systems Support, Inc.

Provides recurring building-systems support services.

Sell

- **Riverton:** bicycle components and completed bicycles held for sale

Collect

- **Both companies:** receivables from customers

Consume

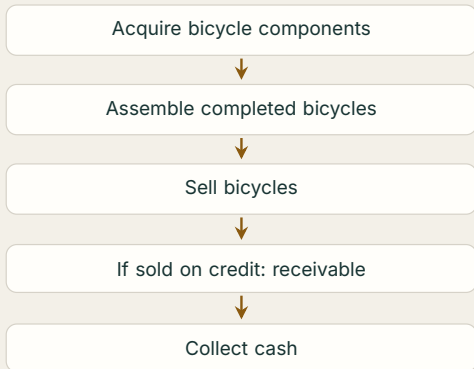
- **Northfield:** diagnostic supplies used while providing services
- **Both companies:** prepaid services such as insurance



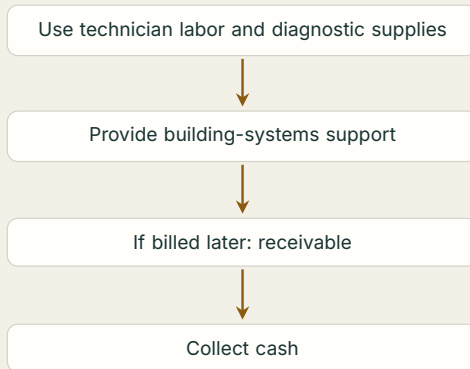
The operating cycle

The ordinary operating process runs through collection from the customer.

Riverton Bicycles



Northfield Systems Support



What is "current"?

12 months or the normal operating cycle, whichever is longer

Cycle shorter than 12 months

Use 12 months.

Cycle longer than 12 months

Use the longer operating cycle.

Why the rule exists

Current classification needs a time horizon. With a 20-month normal operating cycle, inventory completing sale and collection in 17 months can still be current.



What about assets outside the operating cycle?

Do not ask

"Where is this in the operating cycle?"



Instead ask

"Is the company retaining the asset for continuing use?"

**Manufacturing
equipment**

Supports production.

**Delivery
vehicles**

Supports delivery.

**Office
buildings**

Supports operations.

**Land used
in operations**

Supports operations.

These assets support the operating cycle without passing through the sale-and-collection process.

**Assets retained for continuing use are generally
noncurrent.**

Use identifies the classification

Riverton Bicycles, Inc. manufactures bicycles from purchased components. It holds some tangible resources for sale to customers and uses others repeatedly in production and delivery.

INVENTORY

Components and completed bicycles

- Held for sale to customers
- Move through Riverton's ordinary operating process

PROPERTY AND EQUIPMENT

Bicycle assembly equipment and delivery vehicles

- Used repeatedly in operations
- Not held for sale to customers

💡 Restrictions can affect cash classification

Cash is normally current when it is available for current operations.

- 1 **Is the cash restricted?** If no, apply the normal current-asset rules.
- 2 **What is the restriction for?** If restricted, consider the purpose before classifying the cash.

CURRENT PURPOSE

Restricted cash may still be current. For example, it may be restricted to settle a current obligation.

NONCURRENT PURPOSE

Restricted cash is generally noncurrent. Riverton reserves cash for a 2028 bicycle assembly-line replacement.

The expected spending date alone does not determine classification.

? iClicker check, asset classification

? iClicker · Question 1 of 5

Which item is most likely a current asset at December 31, 2026?

- ☐ A Riverton's bicycle assembly equipment, used for several years
- ☐ B Northfield's diagnostic supplies, expected to be consumed during the next 3 months
- ☐ C Riverton's cash restricted for a 2028 assembly-line replacement
- ☐ D Northfield's service vehicles, used repeatedly in operations

✓ Asset classification: answer

Which item is most likely a current asset at December 31, 2026?

✓ iClicker · Answer 1 of 5

- A** Riverton's bicycle assembly equipment, used for several years. The equipment is used over multiple periods, so it is noncurrent.
- B** Northfield's diagnostic supplies, expected to be consumed during the next 3 months
Northfield consumes these supplies within 3 months, so they are current.
- C** Riverton's cash restricted for a 2028 assembly-line replacement. The 2028 restriction is for a noncurrent purpose.
- D** Northfield's service vehicles, used repeatedly in operations. The vehicles are used over multiple periods, so they are noncurrent.



Classify Northfield's assets

Northfield Systems Support, Inc. provides scheduled building-systems support under recurring service contracts. Its normal operating cycle is **1 month**.

Take 5 minutes to work on your own or with those around you. Classify each reported asset amount as current or noncurrent. Keep each contra account with the asset it reduces.

ACCOUNT	AMOUNT	RELEVANT INFORMATION
Restricted Vehicle Cash	\$20,000	Restricted for vehicle purchases planned for 2028.
Trade Receivables	\$73,000	Expected to be collected within 30 days.
Equipment and Vehicles	\$290,000	Service vans and testing equipment support repeated service periods.
Operating Cash	\$45,000	Available for normal operations at December 31, 2026.
Accumulated Depreciation	(\$60,000)	Contra account related to equipment and vehicles.
Prepaid Insurance	\$15,000	Coverage extends through June 30, 2027.
Diagnostic Supplies	\$20,000	Expected to be consumed while providing service during the next 3 months.
Allowance for Credit Losses	(\$3,000)	Contra account related to trade receivables.

✓ Northfield's asset classifications

Northfield's 1-month operating cycle is shorter than 12 months, so it uses a **12-month classification period**.

ACCOUNT	AMOUNT	CLASSIFICATION	REASON
Restricted Vehicle Cash	\$20,000	Noncurrent	Restricted for vehicle purchases planned for 2028.
Trade Receivables	\$73,000	Current	Expected to be collected within 30 days.
Equipment and Vehicles	\$290,000	Noncurrent	Used repeatedly in service operations.
Operating Cash	\$45,000	Current	Available for normal operations.
Accumulated Depreciation	(\$60,000)	Noncurrent	Contra account presented with the related noncurrent equipment and vehicles.
Prepaid Insurance	\$15,000	Current	Coverage extends through June 30, 2027.
Diagnostic Supplies	\$20,000	Current	Expected to be consumed while providing services during the next 3 months.
Allowance for Credit Losses	(\$3,000)	Current	Contra account presented with the related current receivables.

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Classifying liabilities



How do we classify a liability?

- 1 **Identify what the company still owes.** Cash, goods or services, or other performance?
- 2 **Determine the expected settlement period.** Use 12 months or the normal operating cycle, whichever is longer.
- 3 **Classify the obligation.** Expected settlement within that period is current; expected settlement after that period is noncurrent.

Special classification rules

Certain borrowing arrangements may require additional analysis.



Settlement does not always mean paying cash

OBLIGATION	SETTLEMENT
Accounts payable	Cash to supplier
Wages payable	Cash to employees
Riverton customer advance	Deliver bicycles
Northfield customer advance	Provide support services
Riverton warranty liability	Repair or replace bicycle

The form of settlement does **not**, by itself, determine whether the liability is current.



Customer advances remain liabilities

Cash received before performance is a liability, not revenue.

RIVERTON'S ADVANCE

Riverton collected **\$50,000** for bicycles it has not yet delivered.

ACCOUNT	DEBIT	CREDIT
Cash	50,000	
Customer Advances		50,000

Current liability

Riverton expects to deliver the bicycles by March 31, 2027. Expected settlement within the 12-month period makes the advance current.

Connection to revenue recognition

If ASC 606's contract criteria are met, payment before performance is a contract liability. Before those criteria are met, record a liability, often called a customer deposit or advance, until the recognition conditions are met. The company does not record revenue merely because it receives cash.

ASC 606-10-25-8 and 606-10-45-2.



One loan can have two classifications

At December 31, 2026, Riverton owes **\$460,000** of loan principal. Ignore interest.

PRINCIPAL DUE	AMOUNT
March 31, 2027	\$25,000
June 30, 2027	25,000
September 30, 2027	25,000
December 31, 2027	25,000
Due after 2027	360,000

CURRENT PORTION

$\$25,000 \times 4 \text{ payments} =$

CURRENT

\$100,000

NONCURRENT PORTION

$\$460,000 - \$100,000 =$

NONCURRENT

\$360,000

Which Northfield liabilities are current?

Northfield Systems Support, Inc. has a 1-month normal operating cycle. Work through the list with those around you and determine which obligations, or portions of obligations, are current at December 31, 2026.

OBLIGATION	AMOUNT	RELEVANT INFORMATION
Customer Advances	\$15,000	Related services are expected to be provided during the next 2 months.
Accounts Payable	\$20,000	Supplier balances are due within 30 days.
Vacation Payable	\$6,000	Expected to be settled through paid leave or payment during 2027.
Utilities Payable	\$4,000	Due in January 2027.
Wages Payable	\$15,000	Payable on the next regular payroll in January 2027.
Loan Principal	\$138,000	\$8,000 is due during 2027, \$8,000 is due during 2028, and \$122,000 is due after 2028.
Payroll Liabilities	\$2,000	Required remittances are due in January 2027.

✓ Northfield's liability classifications

OBLIGATION	AMOUNT	CLASSIFICATION	REASON
Customer Advances	\$15,000	Current	Related services are expected to be provided during the next 2 months.
Accounts Payable	\$20,000	Current	Supplier balances are due within 30 days.
Vacation Payable	\$6,000	Current	Expected to be settled through paid leave or payment during 2027.
Utilities Payable	\$4,000	Current	Due in January 2027.
Wages Payable	\$15,000	Current	Payable on the next regular payroll in January 2027.
Loan Principal, due during 2027	\$8,000	Current	Due within 12 months.
Loan Principal, due during 2028	\$8,000	Noncurrent	Due after the 12-month classification period.
Loan Principal, due after 2028	\$122,000	Noncurrent	Due after the 12-month classification period.
Payroll Liabilities	\$2,000	Current	Required remittances are due in January 2027.

? iClicker check, liability classification

? iClicker · Question 2 of 5

Northfield receives cash in December for support services it will provide during the next 2 months. **At December 31, how should the unearned amount be classified?**

- ☐ A Revenue, because cash has already been collected
- ☐ B A current liability, because Northfield still owes near-term service
- ☐ C A noncurrent liability, because settlement will not require cash
- ☐ D Equity, because the customer has already financed the company

✓ Customer advances: answer

At December 31, how should the unearned amount be classified?

Northfield receives cash in December for support services it will provide during the next 2 months.

✓ iClicker · Answer 2 of 5

A

Revenue, because cash has already been collected. Cash collection does not create revenue when Northfield still owes the service.

B

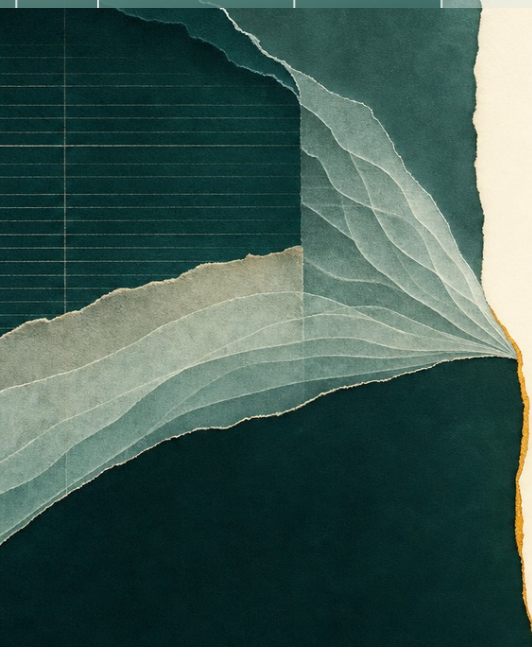
A current liability, because Northfield still owes near-term service
Northfield still owes service during the next 2 months, so the advance is a current liability.

C

A noncurrent liability, because settlement will not require cash. A current liability can be settled through service rather than cash.

D

Equity, because the customer has already financed the company. Customer financing does not create shareholders' equity.



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Equity and the classified balance sheet

💡 Equity as a residual interest

Residual interest means the amount of reported assets remaining after reported liabilities are deducted.

$$\text{Reported equity} = \text{Reported assets} - \text{Reported liabilities}$$

RIVERTON'S REPORTED AMOUNTS

BALANCE SHEET EXCERPT

Reported assets	\$1,200,000
Reported liabilities	(760,000)
REPORTED EQUITY	

\$440,000

WHAT EQUITY REPRESENTS

Equity is not a separate resource the company can spend.

Equity accounts describe interests in net assets. They do not identify where the company's resources are held.

Measurement and classification

MEASUREMENT

What amount is reported?

Accounting measurement rules determine the dollar amount shown for an asset or liability.

CLASSIFICATION

Where is that reported amount presented?

Classification places the reported amount in the appropriate current or noncurrent group.

Changing an item's classification changes its presentation, not the measured amount itself.

Build Riverton's classified balance sheet

Riverton Bicycles, Inc. manufactures bicycles. Normal operating cycle: 4 months.

Take 5-7 minutes to prepare its classified balance sheet at December 31, 2026. Present valuation accounts with their assets and calculate subtotals.

ADJUSTED ACCOUNT	USD	RELEVANT FACTS
Warranty Liability	12,000	Repairs or replacements expected in the next 9 months.
Property and Equipment	660,000	Assembly equipment and delivery vehicles used repeatedly.
Operating Cash	120,000	Available for normal operations.
Retained Earnings	240,000	Adjusted account balance.
Customer Advances	50,000	Bicycles expected to be delivered by March 31, 2027.
Inventory	320,000	Normal 4-month sale-and-collection cycle.
Loan principal due after 2027	360,000	Contractually due after 2027.
Trade Receivables	157,000	Collection expected within 3 months.
Utilities Payable	10,000	Due in January 2027.
Restricted Construction Cash	80,000	Reserved for assembly-line replacement in 2028.
Common Stock	200,000	Adjusted account balance.
Allowance for Credit Losses	(7,000)	Valuation allowance for trade receivables.
Accounts Payable	190,000	Due within 60 days.
Prepaid Insurance	30,000	Coverage through September 30, 2027.
Loan principal due during 2027	100,000	Contractually due during 2027.
Accumulated Depreciation	(160,000)	Related to property and equipment.
Payroll Liabilities	8,000	Required remittances due in January 2027.
Wages Payable	30,000	Next regular payroll in January 2027.

✓ Classified balance sheet: assets

ASSETS	AMOUNT	REASON / PRESENTATION
Operating Cash	\$120,000	Available for normal operations.
Trade Receivables, net	\$150,000	\$157,000 less \$7,000 allowance; expected collection within 3 months.
Inventory	\$320,000	Moves through Riverton's 4-month operating cycle.
Prepaid Insurance	\$30,000	Coverage extends through September 30, 2027.
Total current assets	\$620,000	
Restricted Construction Cash	\$80,000	Restricted for a 2028 long-lived asset replacement.
Property and Equipment, net	\$500,000	\$660,000 cost less \$160,000 accumulated depreciation.
Total noncurrent assets	\$580,000	
Total assets	\$1,200,000	

✓ Classified liabilities and equity

LIABILITIES AND EQUITY	AMOUNT	REASON / PRESENTATION
Accounts Payable	\$190,000	Due within 60 days.
Wages Payable	\$30,000	Due in January 2027.
Payroll Liabilities	\$8,000	Due in January 2027.
Customer Advances	\$50,000	Bicycles expected to be delivered by March 31, 2027.
Warranty Liability	\$12,000	Expected settlement during the next 9 months.
Utilities Payable	\$10,000	Due in January 2027.
Loan principal due during 2027	\$100,000	Contractually due during 2027.
Total current liabilities	\$400,000	
Loan principal due after 2027	\$360,000	Contractually due after 2027.
Total liabilities	\$760,000	
Common Stock	\$200,000	Reported within shareholders' equity.
Retained Earnings	\$240,000	
Total shareholders' equity	\$440,000	
Total liabilities and shareholders' equity	\$1,200,000	



Riverton Bicycles classified balance sheet

Riverton Bicycles, Inc. · December 31, 2026

ASSETS	USD	LIABILITIES AND EQUITY	USD
Current assets		Current liabilities	
Operating Cash	120,000	Accounts Payable	190,000
Trade Receivables, net	150,000	Wages Payable	30,000
Inventory	320,000	Payroll Liabilities	8,000
Prepaid Insurance	30,000	Customer Advances	50,000
Total current assets	620,000	Warranty Liability	12,000
Noncurrent assets		Utilities Payable	10,000
Restricted Construction Cash	80,000	Current portion of loan	100,000
Property and Equipment, net	500,000	Total current liabilities	400,000
Total noncurrent assets	580,000	Long-term Loan Principal	360,000
Total assets	1,200,000	Total liabilities	760,000
		Common Stock	200,000
		Retained Earnings	240,000
		Total shareholders' equity	440,000
		Total liabilities and equity	1,200,000

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Interpreting reported amounts





Recognition, measurement, interpretation

Before interpreting a balance-sheet amount, separate three questions:

Recognition

Should the item appear in the financial statements?

ASC structure:
XXX-XX-25-X

Measurement

What dollar amount should be reported?

Initial: XXX-XX-30-X

Subsequent:
XXX-XX-35-X

Interpretation

What does the reported amount tell us, and what does it not tell us?



Economic value and asset recognition

Economic usefulness

Economic usefulness alone does not create a separately recognized asset.

Recognition rules

Recognition depends on the applicable accounting requirements and how the resource was obtained or developed.

Brand example

An internally developed brand, for example, may support future sales without appearing as a separate asset.

Different measurement processes

A **carrying amount** is the amount reported after applying the relevant measurement requirements and adjustments.

PROPERTY AND EQUIPMENT

Riverton reports historical cost reduced by accumulated depreciation.

RIVERTON · USD

Cost	660,000
Accumulated depreciation	(160,000)

REPORTED AMOUNT

\$500,000

TRADE RECEIVABLES

Riverton reports customer balances reduced by expected credit losses.

RIVERTON · USD

Trade receivables	157,000
Allowance	(7,000)

REPORTED AMOUNT

\$150,000

Different measurement processes produce the amounts combined in total assets.

Reported equity is not business value

Claim to evaluate

"Riverton reports \$440,000 of equity, so the shareholders' interest must be worth \$440,000."

Why doesn't that conclusion follow from the balance sheet alone?

- Some **economically valuable** resources may not be separately recognized.
- Carrying amounts are not necessarily **current market** values.
- A buyer also considers expected **future performance and risk**.



The notes are part of the balance-sheet story

The face of the balance sheet summarizes reported amounts. The notes provide detail needed to understand many of those amounts.

THE BALANCE SHEET MAY SHOW...

- Property and equipment, net
- Other assets
- Long-term debt
- Restricted cash

THE NOTES MAY EXPLAIN...

- What the line contains
- Important measurement policies
- Debt maturities and terms
- Restrictions and other relevant facts

? Interpreting reported amounts

? iClicker · Question 3 of 5

A company reports equipment at \$420,000 cost less \$150,000 accumulated depreciation. Its valuable internally developed customer list is not separately recognized. **Which conclusion is best supported?**

- ☐ A Total assets equal the current market value of all controlled resources.
- ☐ B The \$270,000 is what the company would receive for the equipment.
- ☐ C The balance sheet can omit valuable resources and use amounts other than current market value.
- ☐ D Management should record the customer list at its estimated value.

✓ Reported amounts: answer

Which conclusion is best supported?

A company reports equipment at \$420,000 cost less \$150,000 accumulated depreciation. Its valuable internally developed customer list is not separately recognized.

✓ iClicker · Answer 3 of 5

A

Total assets equal the current market value of all controlled resources. Accounting rules can exclude resources and use other measures.

B

The \$270,000 is what the company would receive for the equipment. Cost less accumulated depreciation does not estimate sale proceeds.

C

The balance sheet can omit valuable resources and use amounts other than current market value.

The customer list is unrecognized, and equipment is reported at cost less accumulated depreciation.

D

Management should record the customer list at its estimated value. Economic value alone does not permit recognizing this internally developed list.

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Liquidity



Liquidity and near-term obligations

Liquidity concerns the company's ability to meet **near-term obligations** as they come due, using resources that are currently available or expected to become available in the near term.

Liquidity differs from solvency. Solvency concerns the company's ability to meet obligations over longer horizons.

- Current assets are resources expected to be sold, collected, consumed, or otherwise available within the current-classification period.
- Current liabilities are obligations expected to be settled within that period.

Comparing those groups gives a starting view of near-term payment capacity, but it does not show whether particular resources will become cash before particular obligations are due.



Working capital and the current ratio

WORKING CAPITAL

Current assets — Current liabilities

The dollar difference shows how much current resources exceed or fall short of current obligations.

CURRENT RATIO

Current assets ÷ Current liabilities

The ratio shows current resources for each \$1 of current liabilities. It can help compare companies of different sizes.

Limits

Neither measure shows the timing or convertibility of each individual asset or liability. Both provide a starting point for evaluating liquidity.

Calculate Riverton's liquidity measures

Riverton Bicycles, Inc. · December 31, 2026

Take a couple minutes to calculate working capital and the current ratio. Work on your own or with those around you.

ASSETS	USD
Current assets	
Operating Cash	120,000
Trade Receivables, net	150,000
Inventory	320,000
Prepaid Insurance	30,000
Total current assets	620,000
Noncurrent assets	
Restricted Construction Cash	80,000
Property and Equipment, net	500,000
Total noncurrent assets	580,000
Total assets	1,200,000

LIABILITIES AND EQUITY	USD
Current liabilities	
Accounts Payable	190,000
Wages Payable	30,000
Payroll Liabilities	8,000
Customer Advances	50,000
Warranty Liability	12,000
Utilities Payable	10,000
Current portion of loan	100,000
Total current liabilities	400,000
Long-term Loan Principal	360,000
Total liabilities	760,000
Common Stock	200,000
Retained Earnings	240,000
Total shareholders' equity	440,000
Total liabilities and equity	1,200,000

✓ Working capital and current ratio: answer

RIVERTON · DECEMBER 31, 2026

CURRENT ASSET	USD
Operating Cash	120,000
Trade Receivables, net	150,000
Inventory	320,000
Prepaid Insurance	30,000
Current assets	620,000
Current liabilities	400,000

Excluded noncurrent balances:

- Restricted cash: \$80,000.
- Net equipment: \$500,000.
- Loan: \$360,000.

Equity is \$440,000.

WORKING CAPITAL

Current assets – Current liabilities

$$\$620,000 - \$400,000 =$$

WORKING CAPITAL

\$220,000

CURRENT RATIO

Current assets ÷ Current liabilities

$$\$620,000 \div \$400,000 =$$

CURRENT RATIO

1.55

A current ratio is not a cash ratio

Riverton's **\$620,000** of current assets includes:

CURRENT ASSET	AMOUNT
Operating cash	\$120,000
Trade receivables, net	150,000
Inventory	320,000
Prepaid insurance	30,000

INVENTORY AND PAYMENT CAPACITY

Inventory must first be sold and, for a credit sale, collected before it becomes cash available for payment.

More inventory can raise the current ratio. Riverton's 1.55 ratio does not mean it has \$1.55 of cash for each \$1 owed.

Same ratio, different composition

Starting from Riverton's December 31 balances, Riverton purchases **\$60,000 of materials for cash**. No other balance changes.

Selected accounts and totals only.

MEASURE	BEFORE PURCHASE	AFTER PURCHASE
Operating cash (included in current assets)	\$120,000	?
Inventory (included in current assets)	\$320,000	?
Total current assets	\$620,000	?
Total current liabilities	\$400,000	?
Current ratio	1.55	?

Discussion

Has Riverton's immediate access to cash changed?

✓ Same ratio, different composition: answer

Riverton buys \$60,000 of materials for cash. No other balance changes.

Selected accounts and totals only.

MEASURE	BEFORE PURCHASE	AFTER PURCHASE
Operating cash (included in current assets)	\$120,000	\$60,000
Inventory (included in current assets)	\$320,000	\$380,000
Total current assets	\$620,000	\$620,000
Total current liabilities	\$400,000	\$400,000
Current ratio	1.55	1.55

The current ratio stayed at 1.55, but Riverton now has \$60,000 less cash available for immediate use.



Paying a current liability

Start again from Riverton's December 31 balances. Riverton pays **\$60,000 of accounts payable with operating cash**. No other balance changes.

Selected accounts and totals only.

MEASURE	BEFORE PAYMENT	AFTER PAYMENT
Operating cash (included in current assets)	\$120,000	?
Accounts payable (included in current liabilities)	\$190,000	?
Total current assets	\$620,000	?
Total current liabilities	\$400,000	?
Working capital	\$220,000	?
Current ratio	1.55	?

After calculating the changes, what can you conclude about liquidity?

✓ Paying a current liability: answer

Riverton pays \$60,000 of accounts payable with operating cash.

MEASURE	BEFORE PAYMENT	AFTER PAYMENT
Operating cash	\$120,000	\$60,000
Current assets	\$620,000	\$560,000
Current liabilities	\$400,000	\$340,000
Working capital	\$220,000	\$220,000
Current ratio	1.55	1.65

- Current assets and current liabilities both decreased by **\$60,000**, so working capital remained unchanged.
- Because current liabilities started lower than current assets, the same \$60,000 payment removed a larger percentage of liabilities than of assets. The current ratio therefore increased from **1.55 to 1.65** ($\$560,000 \div \$340,000 = 1.65$).
- Riverton now has less cash but also fewer unpaid obligations. The higher ratio alone does not establish that its ability to make the next payment improved.

? iClicker check, liquidity measures

? iClicker · Question 4 of 5

A company begins with current assets of \$300,000 and current liabilities of \$200,000. It pays \$40,000 of wages payable with cash. Which result is correct?

- ☐ A Working capital falls to \$60,000; current ratio stays 1.50
- ☐ B Working capital stays \$100,000; current ratio rises to 1.63
- ☐ C Working capital stays \$100,000; current ratio falls to 1.30
- ☐ D Working capital rises to \$140,000; current ratio rises to 1.63

✓ Liquidity measures: answer

Which result is correct?

The company has \$300,000 of current assets and \$200,000 of current liabilities. It pays \$40,000 of wages payable in cash.

✓ iClicker · Answer 4 of 5

A Working capital falls to \$60,000; current ratio stays 1.50. Equal reductions in both balances leave working capital unchanged.

B Working capital stays \$100,000; current ratio rises to 1.63
After the \$40,000 payment, current assets are \$260,000 and current liabilities are \$160,000.
Working capital: $\$260,000 - \$160,000 = \$100,000$.
Current ratio: $\$260,000 \div \$160,000 = 1.625 \approx 1.63$.

C Working capital stays \$100,000; current ratio falls to 1.30. The ratio rises because \$40,000 is a larger share of the smaller liability balance.

D Working capital rises to \$140,000; current ratio rises to 1.63. Both balances fall equally, so working capital does not increase.

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Comparing reported amounts



Before comparing reported amounts

Before comparing periods, companies, or balances, make sure the inputs are comparable.

UNDERLYING ITEMS

Do the amounts include the same kinds of accounts or components?

GROUPING

Are components combined, separated, or netted in the same way?

MEASUREMENT

Are accounting policies and estimates sufficiently comparable for the question?

Choose the comparison

Then choose the comparison that answers your question.



A comparability problem

An analyst is comparing Riverton's cash-related balances across years.

- Riverton's **2025 standalone filing** reported a single "Cash and restricted cash" caption of \$200,000.
- Riverton's **2026 filing** separately reports \$120,000 of operating cash and \$80,000 of restricted construction cash.
- The 2026 filing also presents comparative 2025 information using the newer presentation.

The analyst copies the \$200,000 amount from the old 2025 filing and compares it directly with 2026 operating cash of \$120,000.

What should the analyst do before interpreting the apparent \$80,000 decrease?

✓ Use comparable presentation

The analyst should use amounts presented on the **same basis**, preferably the comparative amounts in the 2026 filing, which reflect the company's current presentation for both years.

- Do not compare a combined 2025 caption with only one component of the 2026 presentation.
- Compare operating cash with operating cash, or reconstruct total cash-related balances for both years if that is the question.
- If the necessary breakdown is not available, state the limitation rather than treating unlike amounts as equivalent.



Horizontal analysis

Horizontal analysis compares the **same reported amount across periods**. It applies to consistently measured accounts, subtotals, totals, or other financial-statement amounts.

DOLLAR CHANGE

$$\text{Later dollar amount} - \text{Earlier dollar amount}$$

PERCENTAGE CHANGE

$$\text{Dollar change} \div \text{Earlier dollar amount}$$

A zero starting amount

Percentage change is undefined when the earlier amount is zero. Report and describe the dollar change instead.

Riverton's changes across years

Compare inventory and total assets across 2025 and 2026.

YEAR-END BALANCE	2025 · USD	2026 · USD
Inventory	260,000	320,000
Total assets	1,100,000	1,200,000

Inventory

Dollar change

$$\$320,000 - \$260,000 = \$60,000.$$

Percentage change

$$\frac{\$60,000}{\$260,000} = 23.08\%.$$

Total assets

Dollar change

$$\$1,200,000 - \$1,100,000 = \$100,000.$$

Percentage change

$$\frac{\$100,000}{\$1,100,000} = 9.09\%.$$

Inventory grew more than twice as fast as total assets. The difference identifies inventory as an amount to investigate.



Common-size analysis

Common-size analysis expresses reported amounts relative to a common base so composition can be compared across periods or companies of different sizes.

- **Balance sheet:** each amount is commonly expressed as a percentage of total assets at the same date.
- **Income statement:** amounts are commonly expressed as a percentage of revenue.

Relationship

$$\text{Balance-sheet common-size percentage} = \frac{\text{Balance-sheet amount}}{\text{Total assets}}$$

A change between two common-size percentages is expressed in **percentage points**.



Riverton's inventory share

Question: Has inventory become a larger or smaller part of Riverton's reported asset base?

	2025	2026
Inventory	\$260,000	\$320,000
Total assets	\$1,100,000	\$1,200,000
Inventory ÷ total assets	23.64%	26.67%

Relationship

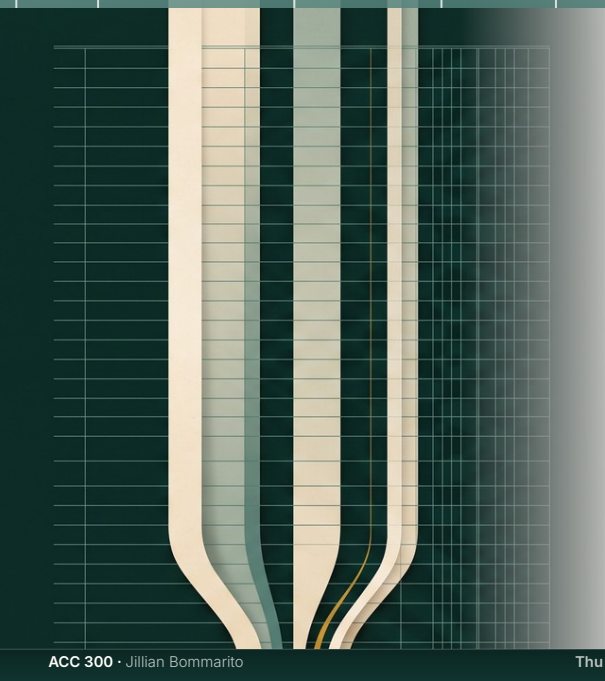
Change in inventory share = $26.67\% - 23.64\% = 3.03$ percentage points

Conclusion: Inventory became a larger part of Riverton's reported resources. Its share of total assets increased from 23.64% to 26.67%.

From a signal to the next question

- 1 **Dollar change.** Riverton's inventory increased by \$60,000.
- 2 **Growth relative to total assets.** Inventory increased 23.08%, while total assets increased 9.09%.
- 3 **Share of total assets.** Inventory increased from 23.64% to 26.67% of total assets.
- 4 **Current-ratio limit.** The 1.55 ratio includes inventory but does not show whether the inventory is selling.
- 5 **Next analysis.** Inventory turnover, introduced in Unit 5, will help evaluate whether inventory is selling.

These calculations do not establish the cause. Riverton may be preparing for higher sales or accumulating bicycles customers do not want. Additional facts are needed.



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Balances and period activity

A balance sheet is a snapshot

BALANCE SHEET

Reports resources and obligations **at a date.**

INCOME STATEMENT

Reports activity **over a period.**

RELATING ACTIVITY TO RESOURCES

A single ending balance may not represent the amount held throughout the period.

When analysis relates period activity to resources used during that period, consider whether an average balance is more representative.

Why use an average balance?

An average balance uses observations from the period to estimate a representative amount.

Relationship

$$\text{Average balance} = \frac{\text{Sum of observed balances}}{\text{Number of observations}}$$

- Beginning-and-ending balances are a common approximation when only annual statements are available.
- More frequent, regularly spaced observations may better capture variation during the year.
- The result is still an approximation, it is not automatically a daily average.
- Use an average only when the question calls for a balance representative of a period.



Average-balance example

RIVERTON'S INVENTORY OBSERVATIONS

DATE	INVENTORY
2025-12-31	\$260,000
2026-03-31	300,000
2026-06-30	350,000
2026-09-30	370,000
2026-12-31	320,000

BEGINNING-AND-ENDING AVERAGE

$$(\$260,000 + \$320,000) \div 2 =$$

AVERAGE

\$290,000

2026 QUARTER-END AVERAGE

$$(\$300,000 + \$350,000 + \$370,000 + \$320,000) \div 4 =$$

AVERAGE

\$335,000

The observations suggest different representative balances. Neither calculation establishes inventory held on every day of the year.

Which comparison fits the question?

Choose the method that best fits each question.

QUESTION	METHOD?
Did trade receivables increase compared with last year?	?
Does property and equipment make up a larger share of total assets than last year?	?
What receivables balance best represents the resources outstanding while annual credit sales were generated?	?
What is the relationship between current assets and current liabilities at December 31?	?

✓ Choosing the comparison: answer

QUESTION	BEST METHOD	WHY
Did trade receivables increase compared with last year?	Horizontal analysis	The question compares the same account across periods.
Does property and equipment make up a larger share of total assets than last year?	Common-size analysis	The question asks about the account's share of the asset base.
What receivables balance best represents the resources outstanding while annual credit sales were generated?	Average balance	Period activity is being related to a balance-sheet amount held during the period.
What is the relationship between current assets and current liabilities at December 31?	Point-in-time current ratio	Both amounts are being compared at one reporting date.

? iClicker check, choosing an analysis

? iClicker · Question 5 of 5

A company's property and equipment increased from \$240 million to \$300 million. Over the same period, total assets increased from \$800 million to \$1.2 billion. Which analysis measures property and equipment as a share of total assets?

- ☐ A Horizontal percentage change in property and equipment only
- ☐ B Working capital
- ☐ C Common-size analysis using total assets as the base
- ☐ D Average property and equipment balance

✓ Choosing an analysis: answer

Which analysis measures property and equipment as a share of total assets?

A company's property and equipment increased from \$240 million to \$300 million. Over the same period, total assets increased from \$800 million to \$1.2 billion.

✓ iClicker · Answer 5 of 5

A

Horizontal percentage change in property and equipment only. Horizontal analysis measures the change in that account, not its share of total assets.

B

Working capital. Working capital compares current assets with current liabilities, not asset composition.

C

Common-size analysis using total assets as the base

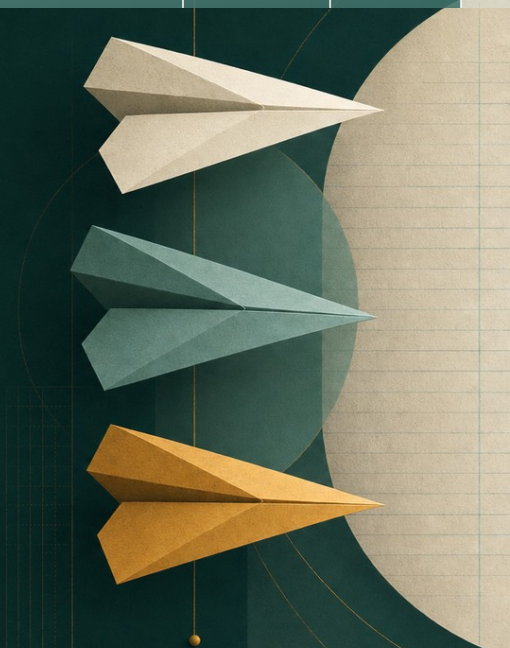
Common-size analysis expresses property and equipment as a percentage of total assets at each date, directly answering the question.

D

Average property and equipment balance. An average measures the balance over a period, not its share of total assets.

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Course project and AI





Company project placeholder

Placeholder slide. Final content requires the separate instructions for this section.



Company project placeholder

Placeholder slide. Final content requires the separate instructions for this section.

NEXT CLASS · TUESDAY, OCTOBER 6

Account for current obligations

Record payables and accruals. Classify debt using maturities, refinancing agreements, covenants, and waivers. Determine the treatment of loss contingencies and warranties.