



Generally Accepted Accounting Principles, Historical Cost, Accrual Basis vs. Cash Basis Accounting, and Current Assets and Liabilities vs. Non- Current Items



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Part I.

Generally Accepted Accounting Principles (GAAP) are a set of accounting standards which are used in the United States by the government, publicly traded companies, and private companies. These standards have been designed to provide a common standard to so that the financial evaluation of organizations is on a level playing field in terms of transparency and overall fairness. GAAP financial statements must be comparable, consistent, reliable, and relevant.

A big part of accounting is the representation of assets and expenses. Typically they are represented via their historical cost representing the value of money spent at the time of purchase of expense. Over time, historical cost for assets is amended with depreciation or appreciation depending on whether the item in question has acquired or lost value since it was last recorded.

Cash-basis accounting is an accounting method which does not fall under GAAP. It does not recognize accounts payable or receivable. The most important metric for determining a firm's financial state is cash flow and cash position. Revenue is recognized once payments are received and expenses are recognized after payments are made.

Accrual-basis accounting records events in terms of how they will affect net-worth. Differently from cash-basis accounting this method takes into consideration accounts payable and receivable. Although cash-basis accounting is not GAAP compliant it is still more conservative than accrual-basis accounting because it assesses a firm's financial status based on cash on hand as opposed to future cash projections.

Current assets are normally considered as anything that can be converted fairly quickly into cash such as cash, inventory, securities, bonds, and receivables. Non-current assets are items which cannot be easily converted into cash.

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Part II.

A balance sheet is a statement which lists an organizations assets and liabilities. The term balance implies that all assets must equal liabilities plus shareholder equity. A balance sheet is representative of a moment in time and not an accounting period such as most accounting statements.

An income statement or profit and loss statement (P&L) is probably the most toward understanding whether or not a company is making money or not. It calculates net revenue which consists of all sales of profits and services prior to expenses being taken out. It is then transformed into net income once the expenses are subtracted.

A cash flow is a statement that shows incoming and outgoing money during a monthly, quarterly, or yearly period. It lists accounts payable and receivable as well as detailing the status of all corporate holdings that may be transformed into cash. It is a very important tool because it analyzes a company's ability to meet expenses necessary to doing business.

“Our Automotive sector's revenue, income and cash are generated primarily from sales of vehicles to our dealers and distributors (i.e., our customers). Vehicles we produce generally are subject to firm orders from our customers and generally are deemed sold (with the proceeds from such sale recognized in revenue) immediately after they are produced and shipped to our customers. This is not the case, however, with respect to vehicles produced for sale to daily rental car companies that are subject to a guaranteed repurchase option or vehicles produced for use in our own fleet (including management evaluation vehicles). Vehicles sold to daily rental car companies that are subject to a guaranteed repurchase option are accounted for as operating leases, with lease revenue and profits recognized over the term of the lease. When we sell the vehicle at auction, we recognize a gain or loss on the difference, if any, between actual auction value and the projected auction value. Therefore, except for the impact of the daily rental units sold subject to a guaranteed repurchase option and those units placed into our own fleet, vehicle production is closely linked with unit sales and revenue from such sales.” (Ford Motor Company)

Ford is going through some tough times. Their income statement shows very poor performance. They only generated \$495M off of overall revenues of \$138B. Their 304B in assets are dangerously close to their level of liabilities currently at \$292B. What is most preoccupying is their ability to maintain sufficient cash flow. Despite \$20B in net cash from activities their statements they showed a (\$5B) deficit in available cash. Ford must restructure itself into a more efficient car manufacturer at the expense of market share and revenues if it is to survive long-term.

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“We believe that over the last few years we have laid a foundation for long-term growth by delivering innovative new products, creating opportunity for partners, improving customer satisfaction with key audiences, putting some of our most significant legal cases behind us, and improving our internal business processes. Our focus in fiscal year 2006 is building on this foundation and executing well in key areas, including continuing to innovate on our integrated software platform, delivering compelling value propositions to customers, responding effectively to customer and partner needs, and continuing to focus internally on product excellence, business efficacy, and accountability across the company..” (Microsoft Corporation)

Microsoft has the healthiest financial indicators of the three corporations. The income statement showing a \$12B net income off of \$44B in revenues is the strongest among the three in terms of profit margin percentage. We can see that these extraordinary indicators carry through into the balance sheet where they have an incredible \$70B in assets with only \$22B in liabilities. Cash flow for Microsoft has not been a problem. Last year they invested \$8B from the overall \$14B net cash flow thus keeping \$6B on hand. Barring any unfortunate anti-trust legal entanglements Microsoft has a very rosy future ahead of it indeed.

“Exxon Mobil Corporation or ExxonMobil (NYSE: XOM), headquartered in Irving, Texas, a suburb of Dallas, USA, is the largest publicly traded integrated oil and gas company in the world, formed on November 30, 1999, by the merger of Exxon and Mobil. As of 2007, it is the largest company in the world (in market value) and seventh largest publicly traded company in the world as ranked by the Forbes Global 2000; at \$410.7 billion and the second largest company in the world (by revenue), after Wal-Mart Stores as ranked by the Fortune Global 500. It is the largest of the six oil "supermajors" with daily production of 6.5m boe (barrels of oil equivalent), contributing 3% of the world's oil and 2% of the world's energy. Among all oil companies, both private and state-owned, ExxonMobil ranks 14th in the world in proven oil and gas reserves. Although the largest among privately owned oil companies, ExxonMobil is still dwarfed in size by the largest state petroleum producers.” (Exxon Mobil Corporation)

Similarly to Microsoft, Exxon-Mobil is a very well managed company. The balance sheet stands out with an impressive \$152B in assets and a mere \$78B in liabilities. The company's ability to turn a profit is not in question with a healthy \$20B income off of \$246B overall revenues. The company's cash flow is not a problem either given that they are keeping \$10B on hand. Exxon-Mobile finances are impeccable and barring any unforeseen industry strategic inflection points they will maintain healthy margins long into the future.



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