Chapter 3

Balance Sheet

The principal financial statements are the balance sheet, income statement, and statement of cash flows. This chapter will review the balance sheet in detail. Other titles used for the balance sheet are statement of financial position and statement of financial condition. The title *balance sheet* is the predominant title used.[1]

Another statement, called the statement of stockholders' equity, reconciles the changes in stockholders' equity, a section of the balance sheet. This statement will also be reviewed in this chapter. Many alternative titles are used for the statement of stockholders' equity. The title most frequently used is the statement of shareholders' equity.[2]

Basic Elements of the Balance Sheet

A **balance sheet** shows the financial condition of an accounting entity as of a particular date. The balance sheet consists of assets, the resources of the firm; liabilities, the debts of the firm; and stockholders' equity, the owners' interest in the firm.

The assets are derived from two sources, creditors and owners. At any point in time, the assets must equal the contribution of the creditors and owners. The accounting equation expresses this relationship:

Assets = Liabilities + Stockholders' Equity

On the balance sheet, the assets equal the liabilities plus the stockholders' equity. This may be presented side by side (account form) or with the assets at the top and the liabilities and stockholders' equity at the bottom (report form). Exhibit 3-1 presents a typical report form format, and Exhibit 3-2 presents a typical account form format.

Balance sheet formats differ across nations. For example, nations influenced by British financial reporting report the least liquid assets first and cash last. Nations influenced by the United States report a balance sheet emphasizing liquidity, as illustrated in this chapter.

Assets

Assets are probable future economic benefits obtained or controlled by an entity as a result of past transactions or events.[3] Assets may be *physical*, such as land, buildings, inventory of supplies, material, or finished products. Assets may also be *intangible*, such as patents and trademarks.

Exhibit 3-1 MILACRON INC. AND SUBSIDIARIES*

Consolidated Balance Sheets, Report Form

MILACRON INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
December 31, 2006 and 2005

	2006	2005
	(In millions, except par value)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 38.5	$ 45.7
Notes and accounts receivable, less allowances of $7.3 in 2006 and $9.0 in 2005	114.5	117.7
Inventories		
Raw materials	7.6	8.2
Work-in-process and finished parts	88.4	83.6
Finished products	74.7	69.3
Total inventories	170.7	161.1
Other current assets	41.9	44.3
Total current assets	365.6	368.8
Property, plant and equipment—net	114.3	114.2
Goodwill	87.3	83.7
Other noncurrent assets	83.3	104.9
Total assets	$ 650.5	$ 671.6
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current Liabilities		
Short-term borrowings	$ 25.5	$ 4.1
Long-term debt and capital lease obligations due within one year	2.2	2.6
Trade accounts payable	77.8	76.4
Advanced billings and deposits	24.4	22.6
Accrued and other current liabilities	82.6	76.3
Total current liabilities	212.5	182.0
Long-term accrued liabilities	226.5	261.4
Long-term debt	232.8	233.3
Total liabilities	671.8	676.7
Commitments and contingencies	—	—
Shareholders' deficit		
4% Cumulative Preferred Shares	6.0	6.0
6% Series B Convertible Preferred Stock, $.01 par value (outstanding: .5 in both 2006 and 2005)	116.1	112.9
Common shares, $.01 par value (outstanding: 52.3 in 2006 and 50.1 in 2005)	0.5	0.5
Capital in excess of par value	351.1	348.0
Contingent warrants	0.5	0.5
Accumulated deficit	(381.9)	(332.8)
Accumulated other comprehensive loss	(113.6)	(140.2)
Total shareholders' deficit	(21.3)	(5.1)
Total liabilities and shareholders' deficit	$ 650.5	$ 671.6

*"Milacron is a major solutions provider to the plastics-processing industries and a leading supplier of premium fluids to the networking industries." 10-K

Assets are normally divided into two major categories: current and noncurrent (long-term). **Current assets** are assets (1) in the form of cash, (2) that will normally be realized in cash, or (3) that conserve the use of cash during the operating cycle of a firm or for one year, whichever is longer. The *operating cycle* covers the time between the acquisition of inventory and the realization of cash from selling the inventory. **Noncurrent** or **long-term assets** take longer than a year or an operating cycle to be converted to cash or to conserve cash. Some industries, such as banking (financial institutions), insurance, and real estate, do not divide assets (or liabilities) into current and noncurrent. Chapter 12 reviews specialized industries.

Exhibit 3-2 CABOT CORPORATION*

Consolidated Balance Sheets, Account Form

CABOT CORPORATION
CONSOLIDATED BALANCE SHEETS

Assets	September 30, 2006	September 30, 2005
	(In millions, except share and per share amounts)	
Current Assets:		
Cash and cash equivalents	$ 189	$ 181
Short-term marketable securities investments	1	30
Accounts and notes receivable, net of reserve for doubtful accounts of $6 and $4	534	430
Inventories	420	493
Prepaid expenses and other current assets	75	80
Deferred income taxes	36	27
Assets held for sale	—	5
Total current assets	1,255	1,246
Investments:		
Equity affiliates	59	63
Long-term marketable securities and cost investments	3	6
Total investments	62	69
Property, plant and equipment	2,531	2,264
Accumulated depreciation and amortization	(1,567)	(1,430)
Net property, plant and equipment	964	834
Goodwill	31	25
Intangible assets, net of accumulated amortization of $10 and $9	5	6
Assets held for rent	40	37
Deferred income taxes	100	108
Other assets	77	49
Total assets	$ 2,534	$ 2,374

Liabilities and Stockholders' Equity	September 30, 2006	September 30, 2005
	(In millions, except share and per share amounts)	
Current Liabilities:		
Notes payable to banks	$ 58	$ 34
Accounts payable and accrued liabilities	384	321
Income taxes payable	27	30
Deferred income taxes	2	1
Current portion of long-term debt	34	47
Total current liabilities	505	433
Long-term debt	459	463
Deferred income taxes	20	15
Other liabilities	286	307
Commitments and contingencies (Note S)		
Minority interest	68	57
Stockholders' Equity:		
Preferred stock:		
Authorized: 2,000,000 shares of $1 par value		
Series B ESOP Convertible Preferred Stock 7.75% Cumulative:		
Authorized: 2,000,000 shares		
Issued and outstanding: 38,734 and 43,907 shares (aggregate redemption value of $39 and $44)	56	61
Less cost of 17,161 shares of preferred treasury stock	(38)	(38)
Common stock:		
Authorized: 200,000,000 shares of $1 par value		
Issued: 63,432,651 and 62,819,715 shares	64	63
Less cost of 146,389 and 152,121 shares of common treasury stock	(5)	(5)
Additional paid-in capital	7	32
Retained earnings	1,160	1,127
Unearned compensation	—	(41)
Deferred employee benefits	(38)	(42)
Notes receivable for restricted stock	(20)	(19)
Accumulated other comprehensive income (loss)	10	(39)
Total stockholders' equity	1,196	1,099
Total liabilities and stockholders' equity	$2,534	$2,374

*"Cabot is a global specialty chemicals and performance materials company headquartered in Boston, Massachusetts." 10-K

When a significant subsidiary is consolidated from an industry that does not use the concept of current and noncurrent, then the consolidated statements will not use the concept of current and noncurrent. These companies often present supplementary statements, handling the subsidiary as an investment (nonconsolidated).

For example, General Electric does not use the concept of current and noncurrent. General Electric Company's consolidated financial statements represent the combination of manufacturing and nonfinancial services businesses of General Electric Company (GE) and the accounts of General Electric Capital Services, Inc. (GECS).

Current Assets

Current assets are listed on the balance sheet in order of **liquidity** (the ability to be converted to cash). Current assets typically include cash, marketable securities, short-term receivables, inventories, and prepaids. In some cases, assets other than these may be classified as current. If so, management is indicating that it expects the asset to be converted into cash during the operating cycle or within a year, whichever is longer. An example is land held for immediate disposal. Exhibit 3-3 includes the items that the 2006 edition of *Accounting Trends & Techniques* reported as being disclosed as other current assets. The definition of current assets excludes restricted cash, investments for purposes of control, long-term receivables, the cash surrender value of life insurance, land and other natural resources, depreciable assets, and long-term prepayments.

Text not available due to copyright restrictions

Cash

Cash, the most liquid asset, includes negotiable checks and unrestricted balances in checking accounts, as well as cash on hand. Savings accounts are classified as cash even though the bank may not release the money for a specific period of time. Exhibit 3-4 illustrates the presentation of cash.

Marketable Securities

Marketable securities (also labeled short-term investments) are characterized by their marketability at a readily determinable market price. A firm holds marketable securities to earn a return on near-cash resources. Management must intend to convert these assets to cash during the current period for them to be classified as marketable securities.

The carrying basis of debt and equity marketable securities is fair value. Refer to Exhibit 3-4 for a presentation of marketable securities.

Accounts Receivable

Accounts receivable are monies due on accounts that arise from sales or services rendered to customers. Accounts receivable are shown net of allowances to reflect their realizable value.

Exhibit 3-4 SEACHANGE INTERNATIONAL, INC.*

Consolidated Balance Sheet (in Part)
Illustration of cash, marketable securities, and accounts receivable

SEACHANGE INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEET
(In thousands, except share and per share data)

ASSETS	**January 31, 2007**	**January 31, 2006**
Current Assets:		
Cash and cash equivalents	$31,179	$21,594
Restricted cash	—	500
Marketable securities	11,231	14,596
Accounts receivable, net of allowance for doubtful accounts of $466 at January 31, 2007 and $405 at January 31, 2006	28,854	30,109
Unbilled receivables	5,562	4,363
Inventories, net	19,350	19,299
Income taxes receivable	409	2,781
Prepaid expenses and other current assets	2,990	4,594
Total current assets	$99,575	$97,836

*"Seachange International, Inc. . . . a Delaware corporation founded on July 9, 1993, is a leading developer, manufacturer and marketer of digital video systems and services." 10-K

This amount is expected to be collected. The most typical allowances are for bad debts (uncollectible accounts). Other allowances may account for expected sales discounts, which are given for prompt payment or for sales returns. These types of allowances recognize expenses in the period of sale, at which time the allowance is established. In future periods, when the losses occur, they are charged to the allowance. All of the allowances are presented in one allowance account. Exhibit 3-4 presents the accounts receivable of Seachange International, Inc. (less allowances). At January 31, 2007, the firm expects to realize $28,854,000. The gross receivables can be reconciled as follows:

Receivables, net	$28,854,000
Plus: Allowances	466,000
Receivables, gross	$29,320,000

Other receivables may also be included in current assets. These receivables may result from tax refund claims, investees/affiliates, contracts, finance, retained interest in sold receivables, insurance claims, installment notes or accounts, asset disposals, and employees.[4]

Inventories

Inventories are the balance of goods on hand. In a manufacturing firm, they include raw materials, work in process, and finished goods. Inventories will be carried at cost, expressed in terms of lower-of-cost-or-market. (Cost methods and lower-of-cost-or-market are covered in Chapter 7.) Refer to Exhibit 3-5 for a presentation of inventory.

Raw Materials These are goods purchased for direct use in manufacturing a product, and they become part of the product. For example, in the manufacture of shirts, the fabric and buttons would be raw materials.

Work in Process Work in process represents goods started but not ready for sale. Work in process includes the cost of materials, labor costs for workers directly involved in the manufacture, and factory overhead. Factory overhead includes such cost items as rent, indirect wages, and maintenance.

Exhibit 3-5 STEEL DYNAMICS, INC.*

Consolidated Balance Sheets (in Part)
Illustration of Inventory

STEEL DYNAMICS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31,	
ASSETS	**2006**	**2005**
Current assets:		
Cash and equivalents	$ 29,373	$ 65,518
Accounts receivable, net of related allowances of $6,863 and $5,727 as of December 31, 2006 and 2005, respectively	355,011	214,670
Accounts receivable—related parties	53,365	38,830
Inventories	569,317	386,892
Deferred income taxes	13,964	6,516
Other current assets	15,167	13,307
Total current assets	$1,036,197	$725,733

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in Part)

Note 1. Description of the Business and Summary of Significant Accounting Policies (in Part)

Inventories. Inventories are stated at lower of cost or market. Cost is determined principally on a first-in, first-out, basis. Inventory consisted of the following at December 31 (in thousands):

	2006	**2005**
Raw materials	$243,770	$184,518
Supplies	130,373	97,627
Work in progress	54,555	38,221
Finished goods	140,619	66,526
	$569,317	$386,892

*"We are one of the largest steel producers in the United States based on an estimated annual steelmaking capability of approximately 5.2 million tons, with actual 2006 shipments from steel operations totaling 4.8 million tons." 10-K

Finished Goods Finished goods are inventory ready for sale. These inventory costs also include the cost of materials, labor costs for workers directly involved in the manufacture, and a portion of factory overhead.

Since retailing and wholesaling firms do not engage in the manufacture of a product but only in the sale, their only inventory item is merchandise. These firms do not have raw materials, work in process inventory, or finished goods.

Supplies In addition to goods on hand, the firm may have supplies. Supplies could include register tapes, pencils, or sewing machine needles for the shirt factory. Details relating to inventory are usually disclosed in a note.

Prepaids

A **prepaid** is an expenditure made in advance of the use of the service or goods. It represents future benefits that have resulted from past transactions. For example, if insurance is paid in advance for three years, at the end of the first year, two years' worth of the outlay will be prepaid. The entity retains the right to be covered by insurance for two more years.

Typical prepaids include advertising, taxes, insurance, promotion costs, and early payments on long-term contracts. Prepaids are often not disclosed separately. In Exhibit 3-1, the prepaid account is not disclosed separately. In Exhibit 3-2, prepaids are part of prepaid expenses and other current assets.

Long-Term Assets

Long-term assets are usually divided into four categories: tangible assets, investments, intangible assets, and other.

Tangible Assets

These are the physical facilities used in the operations of the business. The tangible assets of land, buildings, machinery, and construction in progress will now be reviewed. Accumulated depreciation related to buildings and machinery will also be reviewed.

Land Land is shown at acquisition cost and is not depreciated because land does not get used up. Land containing resources that will be used up, however, such as mineral deposits and timberlands, is subject to depletion. Depletion expense attempts to measure the wearing away of these resources. It is similar to depreciation except that depreciation deals with a tangible fixed asset and depletion deals with a natural resource.

Buildings Structures are presented at cost plus the cost of permanent improvements. Buildings are depreciated (expensed) over their estimated useful life.

Machinery Machinery is listed at historical cost, including delivery and installation, plus any material improvements that extend its life or increase the quantity or quality of service. Machinery is depreciated over its estimated useful life.

Construction in Progress Construction in progress represents cost incurred for projects under construction. These costs will be transferred to the proper tangible asset account upon completion of construction. The firm cannot use these assets while they are under construction. Some analysis is directed at how efficiently the company is using operating assets. This analysis can be distorted by construction in progress, since construction in progress is classified as part of tangible assets. To avoid this distortion, classify construction in progress under long-term assets, other.

Accumulated Depreciation Depreciation is the process of allocating the cost of buildings and machinery over the periods benefited. The depreciation expense taken each period is accumulated in a separate account (Accumulated Depreciation). Accumulated depreciation is subtracted from the cost of plant and equipment. The net amount is the **book value** of the asset. It does not represent the current market value of the asset.

There are a number of depreciation methods that a firm can use. Often, a firm depreciates an asset under one method for financial statements and another for income tax returns. A firm often wants to depreciate slowly for the financial statements because this results in the highest immediate income and highest asset balance. The same firm would want to depreciate faster for income tax returns because this results in the lowest immediate income and thus lower income taxes. Over the life of an asset, the total depreciation will be the same regardless of the depreciation method selected.

Three factors are usually considered when computing depreciation: (1) the asset cost, (2) length of the life of the asset, and (3) its salvage value when retired from service. The length of the asset's life and the salvage value must be estimated at the time that the asset is placed in service. These estimates may be later changed if warranted.

Exhibit 3-6 indicates the depreciation methods used for financial reporting purposes by the firms surveyed for the 2006 edition of *Accounting Trends & Techniques*. The most popular method was straight-line. Many firms use more than one depreciation method.

The following assumptions will be made to illustrate some depreciation methods:

1. Cost of asset—$10,000
2. Estimated life of asset—5 years
3. Estimated salvage (or residual) value—$2,000
4. Estimated total hours of use—16,000

Straight-Line Method The straight-line method recognizes depreciation in equal amounts over the estimated life of the asset. Compute depreciation using the straight-line method as follows:

$$\frac{\text{Cost} - \text{Salvage Value}}{\text{Estimated Life}} = \text{Annual Depreciation}$$

For the asset used for illustration, the annual depreciation would be computed as follows:

$$\frac{\$10{,}000 - \$2{,}000}{5 \text{ years}} = \$1{,}600$$

The $1,600 depreciation amount would be recognized each year of the five-year life of the asset. Do not depreciate the salvage value.

Declining-Balance Method The declining-balance method, an accelerated method, applies a multiple times the straight-line rate to the declining book value (cost minus accumulated depreciation) to achieve a declining depreciation charge over the estimated life of the asset. This book will use double the straight-line rate, which is the maximum rate that can be used. Compute depreciation using the declining-balance method as follows:

$$\frac{1}{\text{Estimated Life of Asset}} \times 2 \times \text{Book Amount at Beginning of the Year} = \text{Annual Depreciation}$$

For the asset used for illustration, the first year's depreciation would be computed as follows:

$$\frac{1}{5} \times 2 \times (\$10{,}000 - 0) = \$4{,}000$$

The declining-balance method results in the following depreciation amounts for each of the five years of the asset's life:

Year	Cost	Accumulated Depreciation at Beginning of Year	Book Amount at Beginning of Year	Depreciation for Year	Book Amount at End of Year
1	$10,000	—	$10,000	$4,000	$6,000
2	10,000	$4,000	6,000	2,400	3,600
3	10,000	6,400	3,600	1,440	2,160
4	10,000	7,840	2,160	160	2,000
5	10,000	8,000	2,000	—	2,000

Estimated salvage value is not considered in the formula, but the asset should not be depreciated below the estimated salvage value. For the sample asset, the formula produced a depreciation amount of $864 in the fourth year. Only $160 depreciation can be used in the fourth year because the $160 amount brings the book amount of the asset down to the salvage value. Once the book amount is equal to the salvage value, no additional depreciation may be taken.

Sum-of-the-Years'-Digits Method The sum-of-the-years'-digits method is an accelerated depreciation method. Thus, the depreciation expense declines steadily over the estimated life of the asset. This method takes a fraction each year times the cost less salvage value. The numerator of the fraction changes each year. It is the remaining number of years of the asset's life. The denominator of the fraction remains constant; it is the sum of the digits representing the years of the asset's life. Compute depreciation using the sum-of-the-years'-digits method as follows:

$$\frac{\text{Remaining Number of Years of Life}}{\text{Sum of the Digits Representing the Years of Life}} \times (\text{Cost} - \text{Salvage}) = \text{Annual Depreciation}$$

For the asset used for illustration, the first year's depreciation would be computed as follows:

$$\frac{5}{(5+4+3+2+1) \text{ or } 15} \times (\$10{,}000 - \$2{,}000) = \$2{,}666.67$$

The sum-of-the-years'-digits method results in the following depreciation amounts for each year of the five years of the asset's life:

Year	Cost Less Salvage Value	Fraction	Depreciation for Year	Accumulated Depreciation at End of Year	Book Amount at End of Year
1	$8,000	5/15	$2,666.67	$2,666.67	$7,333.33
2	8,000	4/15	2,133.33	4,800.00	5,200.00
3	8,000	3/15	1,600.00	6,400.00	3,600.00
4	8,000	2/15	1,066.67	7,466.67	2,533.33
5	8,000	1/15	533.33	8,000.00	2,000.00

Unit-of-Production Method The unit-of-production method relates depreciation to the output capacity of the asset, estimated for the life of the asset. The capacity is stated in terms most appropriate for the asset, such as units of production, hours of use, or miles. Hours of use will be used for the asset in our example. For the life of the asset, it is estimated that there will be 16,000 hours of use. The estimated output capacity is divided into the cost of the asset less the salvage value to determine the depreciation per unit of output. For the example asset, the depreciation per hour of use would be $0.50 [(cost of asset, $10,000 – salvage, $2,000) divided by 16,000 hours].

The depreciation for each year is then determined by multiplying the depreciation per unit of output by the output for that year. Assuming that the output was 2,000 hours during the first year, the depreciation for that year would be $1,000 ($0.50 × 2,000). Further depreciation cannot be taken when the accumulated depreciation equals the cost of the asset less the salvage value. For the example asset, this will be when accumulated depreciation equals $8,000.

In Exhibit 3-7, Lennox International, Inc., presents these assets as property, plant, and equipment at cost. Added detail information is disclosed in the notes.

Leases

Leases are classified as *operating* leases or *capital* leases. If the lease is in substance an ownership arrangement, it is a capital lease; otherwise, the lease is an operating lease. Assets leased under a capital lease are classified as long-term assets. They are shown net of amortization (depreciation) and listed with plant, property, and equipment. (The discounted value of the obligation, a liability, will be part current and part long term.) Chapter 7 covers the topic of leases in more length.

Exhibit 3-7 LENNOX INTERNATIONAL, INC., AND SUBSIDIARIES*

Consolidated Balance Sheets (in Part)
Properties and Depreciation

CONSOLIDATED BALANCE SHEETS
As of December 31, 2006 and 2005
(In millions, except share and per share data)

	As of December 31, 2006	2005
ASSETS		
Current assets:		
Cash and equivalents	$ 144.3	$ 213.5
Accounts and notes receivable, net	502.6	508.4
Inventories	305.5	242.4
Deferred income taxes	22.2	20.3
Other assets	43.8	62.6
Total current assets	1,018.4	1,047.2
Property, plant and equipment, net	288.2	255.7
Goodwill	239.8	223.9
Deferred income taxes	104.3	71.9
Other assets	69.1	138.9
Total assets	$1,719.8	$1,737.6

Notes to Consolidated Financial Statements (in Part)

2. Summary of Significant Accounting Policies (in Part)

Property, Plant and Equipment **(in Part)**

Property, plant and equipment are stated at cost, net of accumulated depreciation. Expenditures for renewals and betterments are capitalized and expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the following estimated useful lives:

Buildings and improvements	10 to 39 years
Machinery and equipment	3 to 10 years

5. Property, Plant and Equipment

	As of December 31, 2006	2005
Land	$ 32.7	$ 30.3
Buildings and improvements	181.6	177.1
Machinery and equipment	526.6	487.8
Construction in progress and equipment not yet in service	36.1	25.1
Total	777.0	720.3
Less—accumulated depreciation	(488.8)	(464.6)
Property, plant and equipment, net	$ 288.2	$ 255.7

*"Through our subsidiaries, we are a leading global provider of climate control solutions." 10-K

Investments

Long-term investments, usually stocks and bonds of other companies, are often held to maintain a business relationship or to exercise control. Long-term investments are different from marketable securities, where the intent is to hold for short-term profits and to achieve liquidity. (Financial reports often refer to marketable securities as investments.)

Debt securities under investments are to be classified as held-to-maturity securities or available-for-sale securities. *Held-to-maturity securities* are securities that the firm has the intent and ability to hold to maturity. Debt securities classified as held-to-maturity securities are carried at amortized cost. Debt securities classified as available-for-sale securities are carried at fair value.

Equity securities under investments are to be carried at fair value. An exception for fair value is used for common stock where there is significant influence. For these common stock investments, the investment is carried under the equity method. Under the equity method, the cost is adjusted for the proportionate share of the rise (fall) in retained profits of the subsidiary (investee). For example, a parent company owns 40% of a subsidiary company, purchased at a cost of $400,000. When the subsidiary company earns $100,000, the parent company increases the investment account by 40% of $100,000, or $40,000. When the subsidiary company declares dividends of $20,000, the parent company decreases the investment account by 40% of $20,000, or $8,000. This decrease occurs because the investment account changes in direct proportion to the retained earnings of the subsidiary.

Investments can also include tangible assets not currently used in operations, such as an idle plant, as well as monies set aside in special funds, such as pensions. The investments of Gentex Corporation are illustrated in Exhibit 3-8.

Intangibles

Intangibles are nonphysical assets, such as patents and copyrights. Intangibles are recorded at historical cost and amortized over their useful lives or their legal lives, whichever is shorter. Purchased goodwill resulting from an acquisition represents an exception to amortization. Research and development costs must be expensed as incurred. Thus, research and development costs in the United States represent an immediate expense, not an intangible. This requirement is not common in many other countries. The following are examples of intangibles that are recorded in the United States.

Exhibit 3-8 GENTEX CORPORATION*

Consolidated Balance Sheets (in Part)
As of December 31, 2006 and 2005
Investments

GENTEX CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 AND 2005

Assets	**2006**	**2005**
Current Assets:		
Cash and cash equivalents	$245,499,783	$439,681,693
Short-term investments	82,727,927	67,331,928
Accounts receivable	58,337,396	60,924,437
Inventories	48,805,398	39,836,822
Prepaid expenses and other	11,507,590	11,212,647
Total current assets	446,878,094	618,987,527
Plant and Equipment:		
Land, buildings and improvements	95,998,488	57,544,173
Machinery and equipment	231,526,281	196,878,770
Construction-in-process	12,393,019	40,858,633
	339,917,788	295,281,576
Less—accumulated depreciation and amortization	(155,783,415)	(131,251,235)
Other Assets:		
Long-term investments	146,215,929	132,524,966
Patents and other assets, net	7,800,004	7,102,968
	154,015,933	139,627,934
	$785,028,400	$922,645,802

*"Gentex Corporation . . . designs, develops, manufactures and markets proprietary products employing electro-optic technology: automatic-dimming rearview automotive mirrors and fire protected products." 10-K

(continued)

Exhibit 3-8 GENTEX CORPORATION (Continued)

Notes to Consolidated Financial Statements (in Part)

(1) Summary of Significant Accounting and Reporting Policies (in Part)

Investments

At December 31, 2006, investment securities are available for sale and are stated at fair value based on quoted market prices. Adjustments to the fair value of investments are recorded as increases or decreases, net of income taxes, within accumulated other comprehensive income (loss) in shareholders' investment.

The amortized cost, unrealized gains and losses, and market value of investment securities are shown as of December 31, 2006 and 2005:

2006	Cost	Unrealized Gains	Unrealized Losses	Market Value
Government Agency	$ 8,992,336	$ —	$ (3,796)	$ 8,988,540
Certificates of Deposit	71,200,000	—	—	71,200,000
Corporate Bonds	297,579	—	(4,926)	292,653
Other Fixed Income	2,539,387	—	—	2,539,387
Equity	110,150,262	36,173,199	(400,185)	145,923,276
	$193,179,564	$36,173,199	$ (408,907)	$228,943,856

2005	Cost	Gains	Losses	Market Value
U.S. Government	$ 5,000,000	$ —	$ —	$ 5,000,000
Government Agency	18,024,332	—	(33,462)	17,990,870
Certificates of Deposit	26,200,000	—	—	26,200,000
Corporate Bonds	17,288,250	—	(93,899)	17,194,351
Other Fixed Income	1,215,708	—	—	1,215,708
Equity	103,212,665	30,802,826	(1,759,526)	132,255,965
	$170,940,955	$30,802,826	$(1,886,887)	$199,856,894

Unrealized losses on investments as of December 31, 2006, are as follows:

	Aggregate Unrealized Losses	Aggregate Fair Value
Less than one year	$351,434	$ 7,451,508
Greater than one year	57,473	10,210,915

Management has reviewed the unrealized losses in the Company's fixed-income and equity securities as of December 31, 2006, and has determined that they are temporary in nature; accordingly, no losses have been recognized in income as of December 31, 2006.

Fixed income securities as of December 31, 2006, have contractual maturities as follows:

Due within one year	$82,731,723
Due between one and five years	297,579
Due over five years	—
	$83,029,302

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, investments, accounts receivable and accounts payable. The Company's estimate of the fair values of these financial instruments approximates their carrying amounts at December 31, 2006 and 2005.

Goodwill Goodwill arises from the acquisition of a business for a sum greater than the physical asset value, usually because the business has unusual earning power. It may result from good customer relations, a well-respected owner, and so on. Purchased goodwill is not amortized but is subject to annual impairment reviews.[5]

The global treatment of goodwill varies significantly. In some countries, goodwill is not recorded because it is charged to stockholders' equity. In this case, there is no influence to reported income. In some countries, goodwill is expensed in the year acquired. In many countries, goodwill is recorded and amortized.

Patents Patents, exclusive legal rights granted to an inventor for a period of 20 years, are valued at their acquisition cost. The cost of a patent should be amortized over its legal life or its useful life, whichever is shorter.

Trademarks Trademarks are distinctive names or symbols. Rights are granted indefinitely as long as the owner uses it in connection with the product or service and files the paperwork. Since a trademark has an indefinite life, it should not be amortized. Trademarks should be tested for impairment at least annually.

Franchises Franchises are the legal right to operate under a particular corporate name, providing trade-name products or services. The cost of a franchise with a limited life should be amortized over the life of the franchise.

Copyrights Copyrights are rights that authors, painters, musicians, sculptors, and other artists have in their creations and expressions. A copyright is granted for the life of the creator, plus 70 years. The costs of the copyright should be amortized over the period of expected benefit.

Exhibit 3-9 displays the 3M Company presentation of intangibles. It consists of goodwill and other intangibles.

Exhibit 3-9 3M COMPANY*

Balance Sheet
Intangibles

Consolidated Balance Sheet
3M Company and Subsidiaries
At December 31

(Dollars in millions, except per share amount)	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,447	$ 1,072
Marketable securities—current	471	—
Accounts receivable—net of allowance of $71 and $73	3,102	2,838
Inventories		
Finished goods	1,235	1,050
Work in progress	795	706
Raw materials and supplies	571	406
Total inventories	2,601	2,162
Other current assets	1,325	1,043
Total current assets	8,946	7,115
Marketable securities—noncurrent	166	—
Investments	314	272
Property, plant and equipment	17,017	16,127
Less: Accumulated depreciation	(11,110)	(10,534)
Property, plant and equipment—net	5,907	5,593
Goodwill	4,082	3,530
Intangible assets—net	708	486
Prepaid pension and postretirement benefits	395	2,905
Other assets	776	640
Total assets	$21,294	$20,541

*"3M is a diversified technology company with a global presence in the following businesses: industrial and transportation; health care; display and graphics; consumer and office; safety, security and protection services; and electro and communications." 10-K

(continued)

Exhibit 3-9 3M COMPANY (Continued)

Notes to Consolidated Financial Statements (in Part)

Note 1. Significant Accounting Policies (in Part)

Goodwill

Goodwill: Goodwill is the excess of cost of an acquired entity over the amounts assigned to assets acquired and liabilities assumed in a business combination. Goodwill is not amortized. Goodwill is tested for impairment annually, and will be tested for impairment between annual tests if an event occurs or circumstances change that would indicate the carrying amount may be impaired. Impairment testing for goodwill is done at a reporting unit level. Reporting units are one level below the business segment level, but can be combined when reporting units within the same segment have similar economic characteristics. The majority of goodwill relates to and is assigned directly to specific reporting units. An impairment loss generally would be recognized when the carrying amount of the reporting unit's net assets exceeds the estimated fair value of the reporting unit. The estimated fair value of a reporting unit is determined using earnings for the reporting unit multiplied by a price/earnings ratio for comparable industry groups, or by using a discounted cash flow analysis. The Company completed its annual goodwill impairment test in the fourth quarter of 2006 and determined that no goodwill was impaired.

Intangible asset: Intangible assets include patents, tradenames and other intangible assets acquired from an independent party. Intangible assets with an indefinite life, namely certain tradenames, are not amortized. Intangible assets with a definite life are amortized on a straight-line basis, with estimated useful lives ranging from one to 20 years. Indefinite-lived intangible assets are tested for impairment annually, and will be tested for impairment between annual tests if an event occurs or circumstances change that would indicate that the carrying amount may be impaired. Intangible assets with a definite life are tested for impairment whenever events or circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. An impairment loss is recognized when the carrying amount of an asset exceeds the estimated undiscounted cash flows used in determining the fair value of the asset. The amount of the impairment loss to be recorded is calculated by the excess of the asset's carrying value over its fair value. Fair value is generally determined using a discounted cash flow analysis. Costs related to internally developed intangible assets, such as patents, are expensed as incurred, primarily in "Research, development and related expenses."

Note 3. Goodwill and Intangible Assets

Purchased goodwill from acquisitions totaled $536 million in 2006, $41 million of which is deductible for tax purposes. Purchased goodwill in 2005 totaled $1.002 billion, primarily related to CUNO, none of which is deductible for tax purposes. The sale of 3M's global branded pharmaceuticals business (Health Care) resulted in the write-off of $54 million in goodwill, which is reflected in the translation and other column below. Changes in foreign currency exchange rates impacted both 2006 and 2005 goodwill balances. The goodwill balance by business segment follows:

Millions	Dec. 31, 2004 Balance	2005 Acquisition Activity	2005 Translation and Other	Dec. 31, 2005 Balance	2006 Acquisition Activity	2006 Translation and Other	Dec. 31, 2006 Balance
Industrial and Transportation	$ 375	$ 992	$ (27)	$1,340	$ 51	$ (7)	$1,384
Health Care	634	—	(75)	559	191	(37)	713
Display and Graphics	885	—	(14)	871	12	3	886
Consumer and Office	68	—	(5)	63	11	8	82
Safety, Security and Protection Services	193	—	(21)	172	239	26	437
Electro and Communications	566	10	(51)	525	32	23	580
Total Company	$2,721	$1,002	$(193)	$3,530	$536	$16	$4,082

Exhibit 3-9 3M COMPANY (Continued)

Acquired Intangible Assets

The carrying amount and accumulated amortization of acquired intangible assets as of December 31 follow:

Millions	2006	2005
Patents	$ 419	$378
Other amortizable intangible assets (primarily tradenames and customer-related intangibles)	641	369
Non-amortizable intangible assets (tradenames)	68	60
Total gross carrying amount	$1,128	$807
Accumulated amortization—patents	(266)	(205)
Accumulated amortization—other	(154)	(116)
Total accumulated amortization	(420)	(321)
Total intangible assets—net	$ 708	$486

Amortization expense for acquired intangible assets for the years ended December 31 follows:

Millions	2006	2005	2004
Amortization expense	$ 89	$ 48	$ 43

Expected amortization expense for acquired intangible assets recorded as of December 31, 2006, follows:

(Millions)	2007	2008	2009	2010	2011	After 2044
Amortization expense	$69	$67	$66	$57	$50	$331

The preceding expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, changes in foreign currency exchange rates, impairment of intangible assets, accelerated amortization of intangible assets and other events.

Other Assets

Firms will occasionally have assets that do not fit into one of the previously discussed classifications. These assets, termed "other," might include noncurrent receivables and noncurrent prepaids. Exhibit 3-10 summarizes types of other assets from a financial statement compilation in *Accounting Trends & Techniques*.

Liabilities

Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.[6] Liabilities are usually classified as either current or long-term liabilities.

Current Liabilities

Current liabilities are obligations whose liquidation is reasonably expected to require the use of existing current assets or the creation of other current liabilities within a year or an operating cycle, whichever is longer. They include the following items. Exhibit 3-11 shows the current liabilities of Starbucks Corporation.

Text not available due to copyright restrictions

Exhibit 3-11 STARBUCKS CORPORATION*

Current Liabilities

(In thousands)	October 1, 2006	October 2, 2005
Current Liabilities		
Accounts payable	$ 340,937	$ 220,975
Accrued compensation and related costs	288,963	232,354
Accrued occupancy costs	54,868	44,496
Accrued taxes	94,010	78,293
Short-term borrowings	700,000	277,000
Other accrued expenses	224,154	198,082
Deferred revenue	231,926	175,048
Current portion of long-term debt	762	748
Total current liabilities	$1,935,620	$1,226,996

*"Starbucks purchases and roasts high-quality whole bean coffees and sells them, along with fresh, rich-brewed coffees, Italian style espresso beverages, cold blended beverages, a variety of complementary food items, coffee-related accessories and equipment, a selection of premium teas and a line of compact discs, primarily through company-operated retail stores." 10-K

Payables

These include short-term obligations created by the acquisition of goods and services, such as accounts payable (for materials or goods bought for use or resale), wages payable, and taxes payable. Payables may also be in the form of a written promissory note, notes payable.

Unearned Income

Payments collected in advance of the performance of service are termed unearned. They include rent income and subscription income. Rather than cash, a future service or good is due the customer.

Other Current Liabilities

There are many other current obligations requiring payment during the year. Exhibit 3-12 displays other current liabilities reported by *Accounting Trends & Techniques* in 2006.

Long-Term Liabilities

Long-term liabilities are those due in a period exceeding one year or one operating cycle, whichever is longer. Long-term liabilities are generally of two types: financing arrangements of assets and operational obligations.

Liabilities Relating to Financing Agreements

The long-term liabilities that are financing arrangements of assets usually require systematic payment of principal and interest. They include notes payable, bonds payable, and credit agreements.

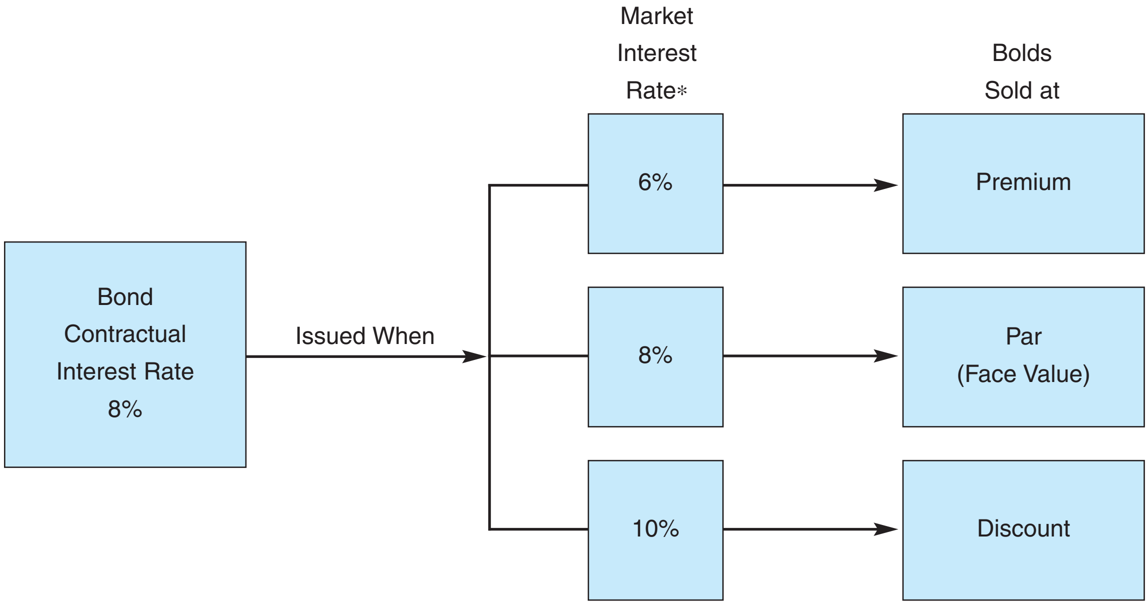
Notes Payable Promissory notes due in periods greater than one year or one operating cycle, whichever is longer, are classified as long term. If secured by a claim against real property, they are called mortgage notes.

Bonds Payable A bond is a debt security normally issued with $1,000 par per bond and requiring semiannual interest payments based on the coupon rate. Bonds payable is similar to notes payable. Bonds payable are usually for a longer duration than notes payable.

Bonds are not necessarily sold at par. They are sold at a premium if the stated rate of interest exceeds the market rate and at a discount if the stated rate of interest is less than the market rate. If sold for more than par, a premium on bonds payable arises and increases bonds payable to obtain the current carrying value. Similarly, if sold at less than par, a discount on bonds payable arises and decreases bonds payable on the balance sheet. Each of these accounts, discount or premium, will be gradually written off (amortized) to interest expense over the life of the bond. At the maturity date, the carrying value of bonds payable will be equal to the par value. Amortization of bond discount increases interest expense; amortization of bond premium reduces it. Exhibit 3-13 illustrates bonds sold at par, premium, or discount.

Bonds that are convertible into common stock at the option of the bondholder (creditor) are exchanged for a specified number of common shares, and the bondholder becomes a common stockholder. Often, convertible bonds are issued when the common stock price is low, in management's opinion, and the firm eventually wants to increase its common equity. By issuing a convertible bond, the firm may get more for the specified number of common shares than could be obtained by issuing the common shares. The conversion feature allows the firm to issue the bond

Exhibit 3-13 BONDS AT PAR, PREMIUM, OR DISCOUNT



*The market interest rate becomes the effective rate of interest.

at a more favorable interest rate than would be the case with a bond lacking the conversion feature. Also, the tax deductible interest paid on the convertible bond reduces the firm's cost for these funds. If common stock had been issued, the dividend on the common stock would not be tax deductible. Thus, a firm may find that issuing a convertible bond can be an attractive means of raising common equity funds in the long run. However, if the firm's stock price stays depressed after issuing a convertible bond, then the firm will have the convertible bond liability until the bond comes due. Convertible bonds of Quantum Corporation are displayed in Exhibit 3-14.

Exhibit 3-14 QUANTUM CORPORATION*

Convertible Bonds

	(In thousands)	
Liabilities	**March 31, 2007**	**March 31, 2006**
Current liabilities:		
Accounts payable	$ 98,757	$ 67,306
Accrued warranty	30,669	32,422
Accrued compensation	32,814	24,903
Income taxes payable	15,490	8,627
Deferred revenue, current	57,617	22,107
Current portion of long-term debt	25,000	—
Accrued restructuring charges	13,289	13,019
Other accrued liabilities	55,814	46,825
Total current liabilities	329,450	215,209
Long-term liabilities:		
Deferred income taxes	16,751	6,995
Long-term debt	337,500	—
Convertible subordinated debt	160,000	160,000
Deferred revenue, long-term	27,634	—
Other long-term liabilities	53	69
Total long-term liabilities	541,938	167,064

*"Quantum Corporation . . . is a leading global storage company specializing in backup, recovery and archive." 10-K

Credit Agreements Many firms arrange loan commitments from banks or insurance companies for future loans. Often, the firm does not intend to obtain these loans but has arranged the credit agreement just in case a need exists for additional funds. Such credit agreements do not represent a liability unless the firm actually requests the funds. From the point of view of analysis, the existence of a substantial credit agreement is a positive condition in that it could relieve pressure on the firm if there is a problem in meeting existing liabilities.

In return for giving a credit agreement, the bank or insurance company obtains a fee. This commitment fee is usually a percentage of the unused portion of the commitment. Also, banks often require the firm to keep a specified sum in its bank account, referred to as a compensating balance. Exhibit 3-15 shows credit agreements.

Liabilities Relating to Operational Obligations

Long-term liabilities relating to operational obligations include obligations arising from the operation of a business, mostly of a service nature, such as pension obligations, postretirement benefit obligations other than pension plans, deferred taxes, and service warranties. Chapter 7 covers at length pensions and postretirement benefit obligations other than pension plans.

Deferred Taxes Deferred taxes are caused by using different accounting methods for tax and reporting purposes. For example, a firm may use accelerated depreciation for tax purposes and straight-line depreciation for reporting purposes. This causes tax expense for reporting purposes to be higher than taxes payable according to the tax return. The difference is deferred tax. Any situation where revenue or expense is recognized in the financial statements in a different time period than for the tax return will create a deferred tax situation (asset or liability). For example, in the later years of the life of a fixed asset, straight-line depreciation will give higher depreciation and, therefore, lower net income than an accelerated method. Then tax expense for reporting purposes will be lower than taxes payable, and the deferred tax will be reduced (paid). Since firms often buy more and higher-priced assets, however, the increase in deferred taxes may exceed the decrease. In this case, a partial or a total reversal will not occur. The taxes may be deferred for a very long time, perhaps permanently. Chapter 7 covers deferred taxes in more detail.

Warranty Obligations Warranty obligations are estimated obligations arising out of product warranties. Product warranties require the seller to correct any deficiencies in quantity, quality, or performance of the product or service for a specific period of time after the sale. Warranty obligations are estimated in order to recognize the obligation at the balance sheet date and to charge the expense to the period of the sale.

Exhibit 3-16 shows warranty obligations of Ford Motor Company.

Minority Interest

Minority interest reflects the ownership of minority shareholders in the equity of consolidated subsidiaries less than wholly owned. Minority interest does not represent a liability or stockholders' equity in the firm being analyzed. Consider the following simple example. Parent P owns 90% of the common stock of Subsidiary S.

	Parent P Balance Sheet December 31, 2008	**Subsidiary S Balance Sheet December 31, 2008**
	(In millions)	
Current assets	$100	$10
Investment in Subsidiary S	18	—
Other long-term assets	382	40
	$500	$50
Current liabilities	$100	$10
Long-term liabilities	200	20
Stockholders' equity	200	20
	$500	$50

Exhibit 3-15 UNITED STATIONERS*

Credit Agreements

For the Fiscal Year Ended December 31, 2006

Notes to consolidated financial statements (in Part)

10. Long-Term Debt (in Part)

Credit Agreement and Other Debt (in Part)

On November 10, 2006, the Registrant and its wholly owned subsidiary, United Stationers Supply Co. ("USSC"), entered into Amendment No. 1 to the Amended and Restated Five-Year Revolving Credit Agreement (the "Amendment" or the "Revolving Credit Facility") with certain financial institutions listed and JPMorgan Chase Bank, National Association [successor by merger to Bank One, NA (Illinois)], as Agent. The Amendment modifies an existing Amended and Restated Five-Year Revolving Credit Agreement (the "2005 Agreement") originally entered into on October 12, 2005. As of December 31, 2006 and 2005, the Company had $110.5 million and $14.2 million, respectively, outstanding under the Revolving Credit Facility. The facility matures in October 2010.

USSC exercised its right under the 2005 Agreement to seek additional commitments to increase the aggregate committed principal amount under a revolving credit facility. The Amendment increased the aggregate committed principal amount from $275 million to $325 million, a $50 million increase. The Amendment also increased the permitted amount of additional commitments USSC may seek under the revolving credit facility to a total amount of up to $425 million, a $50 million increase from the $375 million limit under the 2005 Agreement. In addition, the Amendment increased the permitted size of USSC's third-party receivables securitization program to $350 million, a $75 million increase from the $275 million limit under the 2005 Agreement. All other provisions of the 2005 Agreement, as disclosed in previous filings with the Securities and Exchange Commission, remain unchanged.

The Amended Agreement provides for the issuance of letters of credit in an aggregate amount of up to a sublimit of $90 million. It also provides a sublimit for swingline loans in an aggregate outstanding principal amount not to exceed $25 million at any one time. These amounts, as sublimits, do not increase the maximum aggregate principal amount, and any undrawn issued letters of credit and all outstanding swingline loans under the facility reduce the remaining availability under the Revolving Credit Facility provided for in the Amended Agreement. As of December 31, 2006 and 2005, the Company had outstanding letters of credit of $17.3 million and $16.0 million, respectively.

Obligations of USSC under the Amended Agreement are guaranteed by USI and certain of USSC's domestic subsidiaries. USSC's obligations under the Amended Agreement and the guarantors' obligations under the guaranty are secured by liens on substantially all Company assets, including accounts receivable, chattel paper, commercial tort claims, documents, equipment, fixtures, instruments, inventory, investment property, pledged deposits and all other tangible and intangible personal property (including proceeds) and certain real property, but excluding accounts receivable (and related credit support) subject to any accounts receivable securitization program permitted under the Amended Agreement. Also securing these obligations are first priority pledges of all of the capital stock of USSC and the domestic subsidiaries of USSC.

*"United Stationers Inc. is North America's largest broad line wholesale distributor of business products, with consolidated net sales of approximately $4.5 billion." 10-K

In consolidation, the assets and liabilities of the subsidiary are added to those of the parent, with the elimination of the investment in Subsidiary S. Parent P owns 90% of the subsidiary's net assets of $20 ($50 – $30), and the minority shareholders own 10%.

Exhibit 3-16 FORD MOTOR COMPANY AND SUBSIDIARIES*

Warranty Obligations

For the Fiscal Year Ended December 31, 2006

Note 27. Commitments and Contingencies (in Part)

Warranty. Estimated warranty costs and additional service actions are accrued for at the time the vehicle is sold to a dealer. Included in the warranty cost accruals are costs for basic warranty coverages on vehicles sold. Additional service actions, such as product recalls and other customer service actions, are not included in the warranty reconciliation below, but are also accrued for at the time of sale. Estimates for warranty costs are made based primarily on historical warranty claim experience. The following is a tabular reconciliation of the product warranty accruals (in millions):

	2006	2005
Beginning balance	$ 6,243	$ 5,814
Payments made during the period	(4,106)	(3,986)
Changes in accrual related to warranties issued during the period	3,464	3,949
Changes in accrual related to pre-existing warranties	219	615
Foreign currency translation and other	212	(149)
Ending balance	$ 6,032	$ 6,243

*"We are one of the world's largest producers of cars and trucks combined." 10-K

This will be shown on the consolidated balance sheet as follows:

PARENT P AND SUBSIDIARY
Consolidated Balance Sheet
December 31, 2008

	(In millions)
Current assets	$110
Long-term assets	422
	$532
Current liabilities	$110
Long-term liabilities	220
Minority interest	2
Stockholders' equity	200
	$532

Because of the nature of minority interest, it has usually been presented after liabilities and before stockholders' equity.

Minority interest is seldom material. In a firm where minority interest is material, the analysis can be performed twice—once with minority interest as a liability to be conservative, and then as a stockholders' equity item. Refer to Exhibit 3-17 for an illustration of minority interest.

Other Noncurrent Liabilities

Many other noncurrent liabilities may be disclosed. It would not be practical to discuss all of the possibilities. An example would be deferred profit on sales.

Redeemable Preferred Stock

Redeemable preferred stock is subject to mandatory redemption requirements or has a redemption feature outside the control of the issuer. If this feature is coupled with such characteristics as no vote or fixed return, often preferred stock and bond characteristics, then this type of preferred stock is more like debt than equity. For this reason, the SEC directs that the three categories of stock—redeemable preferred stock, nonredeemable preferred stock, and

Exhibit 3-17 DIODES INCORPORATED AND SUBSIDIARIES*

Minority Interest

DIODES INCORPORATED AND SUBSIDIARIES*
CONSOLIDATED BALANCE SHEETS (in Part)

December 31,	2005	2006
LIABILITIES AND STOCKHOLDERS' EQUITY (in Part)		
CURRENT LIABILITIES (in Part)		
Total Current Liabilities	$ 54,081,000	$ 83,492,000
LONG-TERM DEBT, net of current portion 2.25% convertible senior notes due 2026		230,000,000
Others	4,865,000	7,115,000
CAPITAL LEASE OBLIGATIONS, net of current portion	1,618,000	1,477,000
OTHER LONG-TERM LIABILITIES	—	1,101,000
MINORITY INTEREST IN JOINT VENTURE	3,477,000	4,787,000
Total Liabilities	64,041,000	327,972,000
STOCKHOLDERS' EQUITY		
Preferred stock—par value $1.00 per share, 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock—par value $0.66 2/3 per share; 70,000,000 shares authorized, 25,258,119 and 25,961,267 issued at 2005 and 2006, respectively	16,839,000	17,308,000
Additional paid-in capital	94,664,000	113,449,000
Retained earnings	114,659,000	162,802,000
Accumulated other comprehensive gain (loss)	(688,000)	608,000
Total stockholders' equity	225,474,000	294,167,000
Total liabilities and stockholders' equity	$289,515,000	$622,139,000

*"We are a global supplier of low pin-count standard semiconductor products." 10-K

common stock—not be totaled in the balance sheet. Further, the stockholders' equity section should not include redeemable preferred stock. Redeemable preferred stock is illustrated in Exhibit 3-18. Because redeemable preferred stock is more like debt than equity, consider it as part of total liabilities for purposes of financial statement analysis.

Stockholders' Equity

Stockholders' equity is the residual ownership interest in the assets of an entity that remains after deducting its liabilities.[7] Usually divided into two basic categories, paid-in capital and retained earnings, other accounts may appear in stockholders' equity that are usually presented separately from paid-in capital and retained earnings. Other accounts include accumulated other comprehensive income, equity-oriented deferred compensation, and employee stock ownership plans (ESOPs).

Paid-In Capital

The first type of paid-in capital account is capital stock. Two basic types of capital stock are preferred and common.

Both preferred stock and common stock may be issued as par-value stock. (Some states call this *stated value stock*.) The articles of incorporation establish the par value, a designated dollar amount per share. Many states stipulate that the par value of issued stock times the number of shares outstanding constitutes the **legal capital**. Many states also designate that, if original-issue stock is sold below par value, the buyer is contingently liable for the difference between the par value and the lower amount paid. This does not usually pose a problem because the par value has no direct relationship to market value, the selling price of the stock. To avoid selling a stock below par, the par value is usually set very low in relation to the intended selling price. For example, the intended selling price may be $25.00, and the par value may be $1.00.

Exhibit 3-18 NIKE, INC.*

Redeemable Preferred Stock

NIKE, INC.
Consolidated Balance Sheet

	May 31, 2007	May 31, 2006
	(In millions)	
Total current liabilities	2,584.0	2,612.4
Long-term debt (Note 7)	409.9	410.7
Deferred income taxes and other liabilities (Note 8)	668.7	561.0
Commitments and contingencies (Notes 14 and 16)	—	—
Redeemable Preferred Stock (Note 9)	0.3	0.3
Shareholders' equity:		
Common stock at stated value (Note 10):		
Class A convertible—117.6 and 127.8 shares outstanding	0.1	0.1
Class B—384.1 and 384.2 shares outstanding	2.7	2.7
Capital in excess of stated value	1,960.0	1,447.3
Accumulated other comprehensive income (Note 13)	177.4	121.7
Retained earnings	4,885.2	4,713.4
Total shareholders' equity	7,025.4	6,285.2
Total liabilities and shareholders' equity	$10,688.3	$9,869.6

Notes to Consolidated Financial Statements (in Part)

Note 9—Redeemable Preferred Stock

Sojitz America is the sole owner of the company's authorized Redeemable Preferred Stock, $1 par value, which is redeemable at the option of Sojitz America or the Company at par value aggregating $0.3 million. A cumulative dividend of $0.10 per share is payable annually on May 31 and no dividends may be declared or paid on the common stock of the Company unless dividends on the Redeemable Preferred Stock have been declared and paid in full. There have been no changes in the Redeemable Preferred Stock in the three years ended May 31, 2007, 2006, and 2005. As the holder of the Redeemable Preferred Stock, Sojitz America does not have general voting rights but does have the right to vote as a separate class on the sale of all or substantially all of the assets of the Company and its subsidiaries, on merger, consolidation, liquidation or dissolution of the Company or on the sale or assignment of the NIKE trademark for athletic footwear sold in the United States.

*"Our principal business activity is the design, development and worldwide marketing of high quality footwear, apparel, equipment, and accessory products." 10-K

Some states allow the issuance of no-par stock (either common or preferred). Some of these states require that the entire proceeds received from the sale of the no-par stock be designated as legal capital.

Additional paid-in capital arises from the excess of amounts paid for stock over the par or stated value of the common and preferred stock. Also included here are amounts over cost from the sale of treasury stock (discussed later in this chapter), capital arising from the donation of assets to the firm, and transfer from retained earnings through stock dividends when the market price of the stock exceeds par.

Common Stock

Common stock shares in all the stockholders' rights and represents ownership that has voting and liquidation rights. Common stockholders elect the board of directors and vote on major corporate decisions. In the event of liquidation, the liquidation rights of common stockholders give them claims to company assets after all creditors' and preferred stockholders' rights have been fulfilled.

Preferred Stock

Preferred stock seldom has voting rights. When preferred stock has voting rights, it is usually because of missed dividends. For example, the preferred stockholders may possibly receive voting rights if their dividends have been missed two consecutive times. Some other preferred stock characteristics include the following:

- Preference as to dividends
- Accumulation of dividends
- Participation in excess of stated dividend rate
- Convertibility into common stock
- Callability by the corporation
- Redemption at future maturity date (see the previous discussion of redeemable preferred stock)
- Preference in liquidation

Preference as to Dividends

When preferred stock has a preference as to dividends, the current year's preferred dividend must be paid before a dividend can be paid to common stockholders. For par-value (or stated value) stock, the dividend rate is usually stated as a percentage of par. For example, if the dividend rate were 6% and the par were $100 per share, then the dividend per share would be $6. For no-par stock, if the dividend rate is stated as $5, then each share should receive $5 if a dividend is paid. A preference as to dividends does not guarantee that a preferred dividend will be paid in a given year. The Board of Directors must declare a dividend before a dividend is paid. The lack of a fixed commitment to pay dividends and the lack of a due date on the principal are the primary reasons that many firms elect to issue preferred stock instead of bonds. Preferred stock usually represents an expensive source of funds, compared to bonds. The preferred stock dividends are not tax deductible, while interest on bonds is deductible.

Accumulation of Dividends

If the Board of Directors does not declare dividends in a particular year, a holder of noncumulative preferred stock will never be paid that dividend. To make the preferred stock more attractive to investors, a corporation typically issues cumulative preferred stock. If a corporation fails to declare the usual dividend on the cumulative preferred stock, the amount of passed dividends becomes **dividends in arrears**. Common stockholders cannot be paid any dividends until the preferred dividends in arrears and the current preferred dividends are paid.

To illustrate dividends in arrears, assume a corporation has outstanding 10,000 shares of 8%, $100 par cumulative preferred stock. If dividends are not declared in 2006 and 2007, but are declared in 2008, the preferred stockholders would be entitled to dividends in arrears of $160,000 and current dividends in 2008 of $80,000 before any dividends could be paid to common stockholders.

Participation in Excess of Stated Dividend Rate

When preferred stock is participating, preferred stockholders may receive an extra dividend beyond the stated dividend rate. The terms of the participation depend on the terms included with the stock certificate. For example, the terms may state that any dividend to common stockholders over $10 per share will also be given to preferred stockholders.

To illustrate participating preferred stock, assume that a corporation has 8%, $100 par preferred stock. The terms of the participation are that any dividend paid on common shares over $10 per share will also be paid to preferred stockholders. For the current year, a dividend of $12 per share is declared on the common stock. Therefore, a dividend of $10 must be paid per share of preferred stock for the current year: (8% × $100) + $2.00 = $10.00.

Convertibility into Common Stock

Convertible preferred stock contains a provision that allows the preferred stockholders, at their option, to convert the share of preferred stock at a specific exchange ratio into another security of the corporation. The other security is almost always common stock. The conversion feature is very attractive to investors. For example, the terms may be that each share of preferred stock can be converted to four shares of common stock.

Convertible preferred stock is similar to a convertible bond, except that there are no fixed payout commitments with the convertible preferred stock. The preferred dividend need not be declared, and the preferred stock does not have a due date. The major reason for issuing convertible preferred stock is similar to that for issuing convertible bonds: If the current common stock price is low, in the opinion of management, and the firm eventually wants to increase its common equity, then the firm can raise more money for a given number of common shares by first issuing convertible preferred stock.

A firm usually prefers to issue convertible bonds rather than convertible preferred stock if its capital structure can carry more debt without taking on too much risk. The interest on the convertible bond is tax deductible, while the dividend on the preferred stock is not.

Callability by the Corporation

Callable preferred stock may be retired (recalled) by the corporation at its option. The call price is part of the original stock contract. When the preferred stock is also cumulative, the call terms normally require payment of dividends in arrears before the call is executed.

The call provision favors the company because the company decides when to call. Investors do not like call provisions. Therefore, to make a security that has a call provision marketable, the call provision can normally not be exercised for a given number of years. For example, callable preferred stock issued in 2007 may have a provision that the call option cannot be exercised prior to 2017.

Preference in Liquidation

Should the corporation liquidate, the preferred stockholders normally have priority over common stockholders for settlement of claims. However, the claims of preferred stockholders are secondary to the claims of creditors, including bondholders.

Preference in liquidation for preferred stock over common stock is not usually considered to be an important provision. This is because often, in liquidation, funds are not sufficient to pay claims of preferred stock. Even creditors may receive only a few cents on the dollar in satisfaction of their claims.

Disclosures

Preferred stock may carry various combinations of provisions. The provisions of each preferred stock issue should be disclosed either parenthetically in the stockholders' equity section of the balance sheet or in a note. A company may have various preferred stock issues, each with different provisions. Preferred stock is illustrated in Exhibit 3-19.

Donated Capital

Donated capital may be included in the paid-in capital. Capital is donated to the company by stockholders, creditors, or other parties (such as a city). For example, a city may offer land to a company as an inducement to locate a factory there to increase the level of employment. The firm records the donated land at the appraised amount and records an equal amount as donated capital in stockholders' equity.

Another example would be a company that needs to increase its available cash. A plan is devised, calling for existing common stockholders to donate a percentage of their stock to the company. When the stock is sold, the proceeds are added to the cash account, and the donated capital in stockholders' equity is increased. Exhibit 3-20 illustrates the presentation of donated capital by Lands' End.

Retained Earnings

Retained earnings are the undistributed earnings of the corporation—that is, the net income for all past periods minus the dividends (both cash and stock) that have been declared. Retained earnings, cash dividends, and stock dividends are reviewed in more detail in Chapter 4. Exhibit 3-20 illustrates the presentation of retained earnings.

Exhibit 3-19 UNITED STATES STEEL CORPORATION*

Consolidated Balance Sheet (in Part)
Preferred Stock

(Dollars in millions)	December 31, 2006	December 31, 2005
Stockholders' Equity		
Series B Mandatory Convertible Preferred shares (no par value, zero and 5,000,000 shares issued, 40,000,000 shares authorized, liquidation preference $50 per share) (*Note 17*)	—	216
Common stock issued—123,785,911 shares and 114,585,727 shares (par value $1 per share, authorized 400,000,000 shares) (*Note 17*)	124	115
Treasury stock, at cost (5,240,810 and 5,799,650 shares)	(317)	(253)
Additional paid-in capital	2,942	3,061
Retained earnings	2,902	1,605
Accumulated other comprehensive loss	(1,286)	(1,418)
Deferred compensation	—	(2)
Total stockholders' equity	4,365	3,324

*"U.S. Steel is an integrated steel producer with major production operations in the United States (U.S.) and Central Europe." 10-K

Exhibit 3-20 LANDS' END, INC. AND SUBSIDIARIES—2002 ANNUAL REPORT

Donated Capital

Consolidated Balance Sheets (in Part)

(In thousands)	February 1, 2002	January 26, 2001
Shareholders' investment		
Common stock, 40,221 shares issued	$ 402	$ 402
Donated capital	8,400	8,400
Additional paid-in capital	39,568	31,908
Deferred compensation	(56)	(121)
Accumulated other comprehensive income	3,343	5,974
Retained earnings	556,003	489,087
Treasury stock, 10,236 and 10,945 shares at cost, respectively	(206,942)	(221,462)
Total shareholders' investment	$ 400,718	$ 314,188

Quasi-Reorganization

A **quasi-reorganization** is an accounting procedure equivalent to an accounting fresh start. A company with a deficit balance in retained earnings "starts over" with a zero balance rather than a deficit. A quasi-reorganization involves the reclassification of a deficit in retained earnings. It removes the deficit and an equal amount from paid-in capital. A quasi-reorganization may also include a restatement of the carrying values of assets and liabilities to reflect current values.

When a quasi-reorganization is performed, the retained earnings should be dated as of the readjustment date and disclosed in the financial statements for a period of five to ten years. Exhibit 3-21 illustrates a quasi-reorganization of Owens Corning.

Accumulated Other Comprehensive Income

Conceptually, **accumulated other comprehensive income** represents retained earnings from other comprehensive income. In addition to the aggregate amount, companies are required to

Exhibit 3-21 OWENS CORNING*

Quasi-Reorganization
For the Fiscal Year Ended December 31, 2006

Owens Corning and Subsidiaries
Notes to Consolidated Financial Statements (in Part)

3. FRESH-START ACCOUNTING (in Part)**

On the Effective Date, the Company adopted fresh-start accounting in accordance with SoP 90-7. This resulted in a new reporting entity on November 1, 2006, which has a new basis of accounting, a new capital structure and no retained earnings or accumulated losses. The Company was required to implement fresh-start accounting as the holders of existing voting shares immediately before confirmation received less than 50% of the voting shares of the Successor Company. The fresh-start accounting principles pursuant to SoP 90-7 provide, among other things, for the Company to determine the value to be assigned to the equity of the reorganized Company as of a date selected for financial reporting purposes.

The reorganization value represents the amount of resources available for the satisfaction of post-petition liabilities and allowed claims, as negotiated between the Company and its creditors. The Company's total enterprise value at the time of emergence was $5.8 billion, with a total value for common equity of $3.7 billion, including the estimated fair value of the Series A Warrants and Service B Warrants issued on the Effective Date.

In accordance with fresh-start accounting, the reorganization value of the Company was allocated based on the fair market values of the assets and liabilities in accordance with SFAS 141. The fair values represented the Company's best estimates at the Effective Date based on internal and external appraisals and valuations. Liabilities existing at the Effective Date, other than deferred taxes, were stated at present values of amounts to be paid determined at appropriate current interest rates. Any portion not attributed to specific tangible or identified intangible assets was recorded as goodwill. While the Company believes that the enterprise value approximates fair value, differences between the methodology used in testing for goodwill impairment, as discussed in Note 10, and the negotiated value could adversely impact the Company's results of operations.

Pursuant to SoP 90-7, the results of operations of the ten months ended October 31, 2006 include a pre-emergence gain on the cancellation of debt of $5.9 billion resulting from the discharge of liabilities subject to compromise and other liabilities under the Plan; and a pre-emergence gain of $2.2 billion, net of tax, resulting from the aggregate remaining changes to the net carrying value of the Company's pre-emergence assets and liabilities to reflect the fair values under fresh-start accounting.

**Application of fresh-start accounting at October 31, 2006.

*"Owens Corning, a global company incorporated in Delaware, is headquartered in Toledo, Ohio, and is a leading producer of residential and commercial building materials and glass fiber reinforcements and other similar materials for composite systems." 10-K

disclose the separate categories that make up accumulated other comprehensive income. The disclosure of the separate components can be made on the face of the balance sheet, in the statement of stockholders' equity, or in the notes. Chapter 4 covers comprehensive income. Exhibit 3-20 illustrates the presentation of accumulated other comprehensive income.

Equity-Oriented Deferred Compensation

Equity-oriented deferred compensation arrangements encompass a wide variety of plans. The deferred compensation element of an equity-based deferred compensation arrangement is the amount of compensation cost deferred and amortized (expensed) to future periods as the services are provided.

If stock is issued in a plan before some or all of the services are performed, the unearned compensation should be shown as a reduction to stockholders' equity. This unearned compensation amount should be accounted for as an expense of future period(s) as services are performed. Thus, the unearned compensation amount is removed from stockholders' equity (amortized) and is recognized as an expense in future periods.

When a plan involves the potential issuance of only stock, then the unearned compensation is shown as a reduction in stockholders' equity, and the offsetting amount is also in the stockholders' equity section. If the plan involves cash or a subsequent election of either cash or stock, the unearned compensation appears as a reduction in stockholders' equity, and the offsetting amount appears as a liability.

Exhibit 3-22 illustrates an equity-oriented deferred compensation plan for Isle of Capri Casinos, Inc. It is apparently a stock-only plan. The deferred compensation will be amortized to expense over subsequent periods.

Exhibit 3-22 ISLE OF CAPRI CASINOS, INC.*

Equity-Oriented Deferred Revenue Compensation

(In thousands)	April 24, 2005	April 25, 2004
Stockholders' equity:		
Preferred stock, $.01 par value; 2,000 shares authorized; none issued	—	—
Common stock, $.01 par value; 45,000 shares authorized; shares issued and outstanding: 33,528 at April 24, 2005 and 33,055 at April 25, 2004	$ 335	$ 330
Class B common stock, $.01 par value; 3,000 shares authorized; none issued	—	—
Additional paid-in capital	148,177	143,385
Unearned compensation	(1,488)	(1,413)
Retained earnings	146,133	128,095
Accumulated other comprehensive income	2,858	521
	296,015	270,918
Treasury stock, 3,607 shares at April 24, 2005 and 3,338 shares at April 25, 2004	(34,619)	(29,512)
Total stockholders' equity	$261,396	$241,406

Notes to Consolidated Financial Statements (in Part)

II. Common Stock (in Part)

Stock-Based Compensation—Deferred Bonus Plan

In the fiscal 2001, the Company's stockholders approved the Deferred Bonus Plan. The Plan provides for the issuance of non-vested stock to eligible officers and employees who agree to receive a deferred bonus in the form of non-vested stock. The vesting of the stock is dependent upon continued service to the Company for a period of five years. At April 24, 2005, the non-vested stock issued in connection with the Plan totaled 203,687 shares, of which 36,400 shares were issued during fiscal year ended April 24, 2005 at $23.80, the weighted-average fair value of the non-vested stock at the grant date. For the fiscal year ended April 24, 2005, the Company recorded an unearned compensation contra account in consolidated stockholders' equity equal to the fair value of the non-vested award and recorded compensation expense for the portion of unearned compensation that had been earned through April 24, 2005. Compensation expense related to stock-based compensation under the Deferred Bonus Plan totaled $606,000 in fiscal 2005, $605,000 in fiscal 2004, and $617,000 in fiscal 2003.

*"We are a leading developer, owner and operator of branded games facilities and related lodging and entertainment facilities in growing markets in the United States and internationally." 10-K

Employee Stock Ownership Plans (ESOPs)

An **employee stock ownership plan (ESOP)** is a qualified stock-bonus, or combination stock-bonus and money-purchase pension plan, designed to invest primarily in the employer's securities. A qualified plan must satisfy certain requirements of the Internal Revenue Code. An ESOP must be a permanent trusteed plan for the exclusive benefit of the employees.

The trust that is part of the plan is exempt from tax on its income, and the employer/sponsor gets a current deduction for contributions to the plan. The plan participants become eligible for favorable taxation of distributions from the plan.

An ESOP may borrow the funds necessary to purchase the employer stock. These funds may be borrowed from the company, its stockholders, or a third party such as a bank. The company can guarantee the loan to the ESOP. Financial leverage—the ability of the ESOP to borrow in order to buy employer securities—is an important aspect.

The Internal Revenue Code favors borrowing for an ESOP. Commercial lending institutions, insurance companies, and mutual funds are permitted an exclusion from income for 50% of the interest received on loans used to finance an ESOP's acquisition of company stock. Thus, these institutions are willing to charge a reduced rate of interest for the loan.

From a company's perspective, there are advantages and disadvantages to an ESOP. One advantage is that an ESOP serves as a source of funds for expansion at a reasonable rate. Other possible advantages follow:

1. A means to buy the stock from a major shareholder or possibly an unwanted shareholder.
2. Help financing a leveraged buyout.
3. Reduction of potential of an unfriendly takeover.
4. Help in creating a market for the company's stock.

Some firms do not find an ESOP attractive, because it can result in a significant amount of voting stock in the hands of their employees. Existing stockholders may not find an ESOP desirable because it will probably dilute their proportional ownership.

The employer contribution to an ESOP reduces cash, and an unearned compensation item decreases stockholders' equity. The unearned compensation is amortized on the income statement in subsequent periods. When an ESOP borrows funds and the firm (in either an informal or formal guarantee) commits to future contributions to the ESOP to meet the debt-service requirements, then the firm records this commitment as a liability and as a deferred compensation deduction within stockholders' equity. As the debt is liquidated, the liability and deferred compensation are reduced.

Exhibit 3-23 shows the reporting of the ESOP of The Hershey Company.

Treasury Stock

A firm creates **treasury stock** when it repurchases its own stock and does not retire it. Since treasury stock lowers the stock outstanding, it is subtracted from stockholders' equity. Treasury stock is, in essence, a reduction in paid-in capital.

A firm may record treasury stock in two ways. One method records the treasury stock at par or stated value, referred to as the par value method of recording treasury stock. This method removes the paid-in capital in excess of par (or stated value) from the original issue. The treasury stock appears as a reduction of paid-in capital.

The other method, referred to as the *cost method*, records treasury stock at the cost of the stock (presented as a reduction of stockholders' equity). Most firms record treasury stock at cost.

Exhibit 3-24 illustrates the presentation of treasury stock for Dow Jones & Company. Note that a firm cannot record gains or losses from dealing in its own stock. Any apparent gains or losses related to treasury stock must impact stockholders' equity, such as a reduction in retained earnings.

Stockholders' Equity in Unincorporated Firms

These firms do not have stockholders. Stockholders' equity in an unincorporated firm is termed capital. The amount invested by the owner plus the retained earnings may be shown

Exhibit 3-23 THE HERSHEY COMPANY*

Employee Stock Ownership (ESOP)

(In thousands of dollars)	December 31, 2006	2005
Stockholders' Equity:		
Preferred Stock, shares issued: none in 2006 and 2005	—	—
Common Stock, shares issued: 299,085,666 in 2006 and 299,083,266 in 2005	299,085	299,083
Class B Common Stock, shares issued: 60,816,078 in 2006 and 60,818,478 in 2005	60,816	60,818
Additional paid-in capital	298,243	252,374
Unearned ESOP compensation	—	(3,193)
Retained earnings	3,965,415	3,641,483
Treasury—Common Stock shares, at cost: 129,638,183 in 2006 and 119,377,690 in 2005	(3,801,947)	(3,224,863)
Accumulated other comprehensive loss	(138,189)	(9,322)
Total stockholders' equity	683,423	1,016,380

Notes to Consolidated Financial Statements (in Part)

13. EMPLOYEE STOCK OWNERSHIP TRUST

Our Company's employee stock ownership trust ("ESOP") serves as the primary vehicle for employer contributions to The Hershey Company 401(k) Plan (formerly known as The Hershey Company Employee Savings Stock Investment and Ownership Plan) for participating domestic salaried and hourly employees. In December 1991, we funded the ESOP by providing a 15-year, 7.75% loan of $47.9 million. The ESOP used the proceeds of the loan to purchase our Common Stock. During 2006 and 2005, the ESOP received a combination of dividends on unallocated shares of our Common Stock and contributions from us. This equals the amount required to meet principal and interest payments under the loan. Simultaneously, the ESOP allocated to participants 318,351 shares of our Common Stock each year. As of December 31, 2006, all shares had been allocated. We consider all ESOP shares as outstanding for income per share computations.

The following table summarizes our ESOP expense and dividends:

For the year ended December 31,	2006	2005	2004
In millions of dollars			
Compensation (income) expense related to ESOP	$(.3)	$.4	$(.1)
Dividends paid on unallocated ESOP shares	.3	.5	.7

- We recognized net compensation expense equal to the shares allocated multiplied by the original cost of $10.03 per share less dividends received by the ESOP on unallocated shares.
- We reflect dividends paid on all ESOP shares as a reduction to retained earnings.

*"We are the largest North American manufacturer of quality chocolate and confectionery products and a leading snack food company." 10-K

as one sum. A sole proprietorship form of business has only one owner (one capital account). A partnership form of business has more than one owner (capital account for each owner). Chapter 2 reviewed these forms of business.

Statement of Stockholders' Equity

Firms are required to present reconciliations of the beginning and ending balances of their stockholder accounts. This is accomplished by presenting a "statement of stockholders' equity."

Exhibit 3-24 DOW JONES & COMPANY*

Treasury Stock

Consolidated Balance Sheets (in Part)
(Dollars in thousands, except per share amounts)

Stockholders' Equity	**As of December 31, 2006**	**2005**
Common stock, par value $1 per share; authorized 135,000,000 shares; issued 82,095,954 in 2006 and 81,737,520 in 2005	$ 82,096	$ 81,738
Class B common stock, convertible, par value $1 per share; authorized 25,000,000 shares; issued 20,085,067 in 2006 and 20,443,501 in 2005	20,085	20,443
	102,181	102,181
Additional paid-in capital	141,628	137,290
Retained earnings	1,120,165	817,168
Accumulated other comprehensive income, net of taxes:		
Unrealized gain on investments	563	2,636
Unrealized gain (loss) on hedging	175	(198)
Foreign currency translation adjustment	3,682	3,430
Defined benefit plan adjustments	(20,141)	(28,861)
	1,348,253	1,033,646
Less, treasury stock, at cost; 18,534,499 shares in 2006 and 19,074,641 shares in 2005	849,280	871,381
Total stockholders' equity	498,973	162,265
Total liabilities and stockholders' equity	$1,955,562	$1,781,972

*"We are a provider of global business and financial news, information and insight through multiple channels of media." 10-K

This statement will include all of the stockholders' equity accounts. It is important when performing analysis to be aware of changes in these accounts. For example, common stock will indicate changes in common stock, retained earnings will indicate changes in retained earnings, and treasury stock will indicate changes in treasury stock. This statement is illustrated in Chapter 4.

For many firms, changes to the account Accumulated Other Comprehensive Income (Loss) will be important to observe. This account is related to comprehensive income, which is covered in Chapter 4.

Problems in Balance Sheet Presentation

Numerous problems inherent in balance sheet presentation may cause difficulty in analysis. First, many assets are valued at cost, so one cannot determine the market value or replacement cost of many assets and should not assume that their balance sheet amount approximates current valuation.

Second, varying methods are used for asset valuation. For example, inventories may be valued differently from firm to firm and, within a firm, from product to product. Similar problems exist with long-term asset valuation and the related depreciation alternatives.

A different type of problem exists in that not all items of value to the firm are included as assets. For example, such characteristics as good employees, outstanding management, and a well-chosen location do not appear on the balance sheet. In the same vein, liabilities related to contingencies also may not appear on the balance sheet. Chapters 6 and 7 present many of the problems of the balance sheet.

These problems do not make statement analysis impossible. They merely require that qualitative judgment be applied to quantitative data in order to assess the impact of these problem areas.

Summary

The balance sheet shows the financial condition of an accounting entity as of a particular date. It is the most basic financial statement, and it is read by various users as part of their decision-making process.

to the net

1. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Cooper Tire" (or under Ticker Symbol, enter "CTB"). Select the 10-K filed March 1, 2007.
   a. What is the total stockholders' equity at December 31, 2006?
   b. What is the cost of treasury shares at December 31, 2006?
   c. Why is treasury stock subtracted from stockholders' equity?

2. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Yahoo" (or under Ticker Symbol, enter "YHOO"). Select the 10-K filed February 23, 2007.
   a. What is the total current assets at December 31, 2006?
   b. What is the net intangibles at December 31, 2006?
   c. Why are intangibles amortized?

3. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Boeing Co" (or under Ticker Symbol, enter "BA"). Select the 10-K filed February 16, 2007.
   a. What is the total for inventories at December 31, 2006?
   b. Go to Note 1, Summary of Significant Accounting Policies. Go to Inventories. Describe the inventory policy, consistent with industry practice, that is unique for this industry. How does this practice impact liquidity appearance?

4. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Gateway Inc" (or under Ticker Symbol, enter "GTW"). Select the 10-K filed February 26, 2007.
   a. What is the balance in accrued warranty at December 31, 2006?
   b. Comment on the subjectivity in determining this balance.

5. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "McDonalds" (or under Ticker Symbol, enter "MCD"). Select the 10-K filed February 26, 2007.
   a. What is the total assets at December 31, 2006?
   b. What is the total for investments in and advances to affiliates at December 31, 2006?
   c. In your opinion, are the companies receiving the "investments in and advances to affiliates" consolidated with McDonald's Corporation? Comment.
   d. Considering the balance in "investments in and advances to affiliates" in relation to "total assets," does this relationship of dollars likely represent the importance of affiliates to McDonald's Corporation? Comment.

6. Go to the SEC Web site (http://www.sec.gov). Under "Filings & Forms (EDGAR)," click on "Search for Company Filings." Click on "Companies & Other Filers." Under Company Name, enter "Hershey Food" (or under Ticker Symbol, enter "HSY"). Select the 10-K filed February 23, 2007.
   a. Note 13. Employee Stock Ownership Trust. Briefly describe the purpose of this plan.
   b. Note 14. Capital Stock and Net Income per Share. Comment on the voting control of Milton Hershey School Trust.

Questions

Q 3-1. Name and describe the three major categories of balance sheet accounts.

Q 3-2. Are the following balance sheet items (A) assets, (L) liabilities, or (E) stockholders' equity?

a. Cash dividends payable
b. Mortgage notes payable
c. Investments in stock
d. Cash
e. Land
f. Inventory
g. Unearned rent
h. Marketable securities
i. Patents
j. Capital stock
k. Retained earnings
l. Donated capital
m. Accounts receivable
n. Taxes payable
o. Accounts payable
p. Organizational costs
q. Prepaid expenses
r. Goodwill
s. Tools
t. Buildings

Q 3-3. Classify the following as (CA) current asset, (IV) investments, (IA) intangible asset, or (TA) tangible asset:

a. Land
b. Cash
c. Copyrights
d. Marketable securities
e. Goodwill
f. Inventories
g. Tools
h. Prepaids
i. Buildings
j. Accounts receivable
k. Long-term investment in stock
l. Machinery

Q 3-4. Usually, current assets are listed in a specific order, starting with cash. What is the objective of this order of listing?

Q 3-5. Differentiate between marketable securities and long-term investments. What is the purpose of owning each?

Q 3-6. Differentiate between accounts receivable and accounts payable.

Q 3-7. What types of inventory will a retailing firm have? A manufacturing firm?

Q 3-8. What is depreciation? Which tangible assets are depreciated, and which are not? Why?

Q 3-9. For reporting purposes, management prefers higher profits; for tax purposes, lower taxable income is desired. To meet these goals, firms often use different methods of depreciation for tax and reporting purposes. Which depreciation method is best for reporting and which for tax purposes? Why?

Q 3-10. A rental agency collects rent in advance. Why is the rent collected treated as a liability?

Q 3-11. A bond carries a stated rate of interest of 6% and par of $1,000. It matures in 20 years. It is sold at 83 (83% of $1,000, or $830).

a. Under normal conditions, why would the bond sell at less than par?
b. How would the discount be disclosed on the statements?

Q 3-12. To be conservative, how should minority interest on the balance sheet be handled for primary analysis?

Q 3-13. Many assets are presented at historical cost. Why does this accounting principle cause difficulties in financial statement analysis?

Q 3-14. Explain how the issuance of a convertible bond can be a very attractive means of raising common equity funds.

Q 3-15. Classify each of the following as a (CA) current asset, (NA) noncurrent asset, (CL) current liability, (NL) noncurrent liability, or (E) equity account. Choose the best or most frequently used classification.

a. Supplies
b. Notes receivable
c. Unearned subscription revenue
d. Accounts payable
e. Retained earnings
f. Accounts receivable
g. Preferred stock
h. Plant
i. Prepaid rent
j. Capital
k. Wages payable
l. Mortgage bonds payable
m. Unearned interest
n. Marketable securities
o. Paid-in capital from sale of treasury stock
p. Land
q. Inventories
r. Taxes accrued
s. Cash

Q 3-16. Explain these preferred stock characteristics:

a. Accumulation of dividends
b. Participation in excess of stated dividend rate
c. Convertibility into common stock
d. Callability by the corporation
e. Preference in liquidation

Q 3-17. Describe the account Unrealized Exchange Gains or Losses.

Q 3-18. What is treasury stock? Why is it deducted from stockholders' equity?

Q 3-19. A firm, with no opening inventory, buys 10 units at $6 each during the period. In which accounts might the $60 appear on the financial statements?

Q 3-20. How is an unconsolidated subsidiary presented on a balance sheet?

Q 3-21. When would minority interest be presented on a balance sheet?

Q 3-22. DeLand Company owns 100% of Little Florida, Inc. Will DeLand Company show a minority interest on its balance sheet? Would the answer change if it owned only 60%? Will there ever be a case in which the subsidiary, Little Florida, is not consolidated?

Q 3-23. Describe the item Unrealized Decline in Market Value of Noncurrent Equity Investments.

Q 3-24. What is redeemable preferred stock? Why should it be included with debt for purposes of financial statement analysis?

Q 3-25. Describe donated capital.

Q 3-26. Assume that a city donated land to a company. What accounts would be affected by this donation, and what would be the value?

Q 3-27. Describe quasi-reorganization.

Q 3-28. Assume that an equity-oriented deferred compensation plan involves cash or a subsequent election of either cash or stock. Describe the presentation of this plan on the balance sheet.

Q 3-29. Describe employee stock ownership plans (ESOPs).

Q 3-30. Why are commercial lending institutions, insurance companies, and mutual funds willing to grant loans to an employee stock ownership plan at favorable rates?

Q 3-31. What are some possible disadvantages of an employee stock ownership plan?

Q 3-32. How does a company recognize, in an informal or a formal way, that it has guaranteed commitments to future contributions to an ESOP to meet debt-service requirements?

Q 3-33. Describe depreciation, amortization, and depletion. How do they differ?

Q 3-34. What are the three factors usually considered when computing depreciation?

Q 3-35. An accelerated system of depreciation is often used for income tax purposes but not for financial reporting. Why?

Q 3-36. Which depreciation method will result in the most depreciation over the life of an asset?

Q-3-37. Should depreciation be recognized on a building in a year in which the cost of replacing the building rises? Explain.

Q 3-38. Describe the account Accumulated Other Comprehensive Income.

Problems

P 3-1. The following information was obtained from the accounts of Airlines International dated December 31, 2008. It is presented in alphabetical order.

Accounts payable	$ 77,916
Accounts receivable	67,551
Accrued expenses	23,952
Accumulated depreciation	220,541
Allowance for doubtful accounts	248
Capital in excess of par	72,913
Cash	28,837
Common stock (par $0.50, authorized 20,000 shares, issued 14,304 shares)	7,152
Current installments of long-term debt	36,875
Deferred income tax liability (long term)	42,070
Inventory	16,643
Investments and special funds	11,901
Long-term debt, less current portion	393,808
Marketable securities	10,042
Other assets	727
Prepaid expenses	3,963
Property, plant, and equipment at cost	809,980
Retained earnings	67,361
Unearned transportation revenue (airline tickets expiring within one year)	6,808

Required Prepare a classified balance sheet in report form.

P 3-2. The following information was obtained from the accounts of Lukes, Inc., as of December 31, 2008. It is presented in scrambled order.

Common stock, no par value, 10,000 shares authorized, 5,724 shares issued	$ 3,180
Retained earnings	129,950
Deferred income tax liability (long term)	24,000
Long-term debt	99,870
Accounts payable	35,000
Buildings	75,000
Machinery and equipment	300,000
Land	11,000
Accumulated depreciation	200,000
Cash	3,000
Receivables, less allowance of $3,000	58,000
Accrued income taxes	3,000
Inventory	54,000
Other accrued expenses	8,000
Current portion of long-term debt	7,000
Prepaid expenses	2,000
Other assets (long term)	7,000

Required Prepare a classified balance sheet in report form. For assets, use the classifications of current assets, plant and equipment, and other assets. For liabilities, use the classifications of current liabilities and long-term liabilities.

P 3-3. The following information was obtained from the accounts of Alleg, Inc., as of December 31, 2008. It is presented in scrambled order.

Common stock, authorized 21,000 shares at $1 par value, issued 10,000 shares	$ 10,000
Additional paid-in capital	38,000
Cash	13,000
Marketable securities	17,000
Accounts receivable	26,000
Accounts payable	15,000
Current maturities of long-term debt	11,000
Mortgages payable	80,000
Bonds payable	70,000
Inventory	30,000
Land and buildings	57,000
Machinery and equipment	125,000
Goodwill	8,000
Patents	10,000
Other assets	50,000
Deferred income taxes (long-term liability)	18,000
Retained earnings	33,000
Accumulated depreciation	61,000

Required Prepare a classified balance sheet in report form. For assets, use the classifications of current assets, plant and equipment, intangibles, and other assets. For liabilities, use the classifications of current liabilities and long-term liabilities.

P 3-4. The following is the balance sheet of Ingram Industries:

INGRAM INDUSTRIES
Balance Sheet
June 30, 2008

Assets		
Current assets:		
Cash (including $13,000 in sinking fund for bonds payable)	$ 70,000	
Marketable securities	23,400	
Investment in subsidiary company	23,000	
Accounts receivable	21,000	
Inventories (lower-of-cost-or-market)	117,000	$254,400
Plant assets:		
Land and buildings	$160,000	
Less: Accumulated depreciation	100,000	60,000
Investments:		
Treasury stock		4,000
Deferred charges:		
Discount on bonds payable	$ 6,000	
Prepaid expenses	2,000	8,000
		$326,400
Liabilities and Stockholders' Equity		
Liabilities:		
Notes payable to bank	$ 60,000	
Accounts payable	18,000	
Bonds payable	61,000	
Total liabilities		$139,000
Stockholders' equity:		
Preferred and common (each $10 par, 5,000 shares preferred and 6,000 shares common)	$110,000	
Capital in excess of par	61,000	
Retained earnings	16,400	
		187,400
Total liabilities and stockholders' equity		$326,400

Required Indicate your criticisms of the balance sheet and briefly explain the proper treatment of any item criticized.

P 3-5. The following is the balance sheet of Rubber Industries:

RUBBER INDUSTRIES
Balance Sheet
For the Year Ended December 31, 2008

Assets	
Current assets:	
Cash	$ 50,000
Marketable equity securities	19,000
Accounts receivable, net	60,000
Inventory	30,000
Treasury stock	20,000
Total current assets	$179,000
Plant assets:	
Land and buildings, net	160,000
Investments:	
Short-term U.S. notes	20,000
Other assets:	
Supplies	4,000
Total assets	$363,000
Liabilities and Stockholders' Equity	
Liabilities:	
Bonds payable	$123,000
Accounts payable	40,000
Wages payable	10,000
Total liabilities	$173,000
Stockholders' equity:	
Common stock ($20 par, 20,000 shares authorized, 6,000 shares outstanding)	120,000
Retained earnings	50,000
Redeemable preferred stock	20,000
Total liabilities and stockholders' equity	$363,000

Required Indicate your criticisms of the balance sheet and briefly explain the proper treatment of any item criticized.

P 3-6. The following is the balance sheet of McDonald Company:

McDONALD COMPANY
December 31, 2008

Assets			
Current assets:			
Cash (including $10,000 restricted for payment of note)		$ 40,000	
Marketable equity securities		20,000	
Accounts receivable, less allowance for doubtful accounts of $12,000		70,000	
Inventory		60,000	
Total current assets			$190,000
Plant assets:			
Land		$ 40,000	
Buildings, net		100,000	
Equipment	$80,000		
Less: Accumulated depreciation	20,000	60,000	
Patent		20,000	
Organizational costs		15,000	
			235,000
Other assets:			
Prepaid insurance			5,000
Total assets			$430,000

(continued)

Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 60,000	
Wages payable	10,000	
Notes payable, due July 1, 2012	20,000	
Bonds payable, due December 2016	100,000	
Total current liabilities		$190,000
Dividends payable		4,000
Deferred tax liability, long term		30,000
Stockholders' equity:		
Common stock ($10 par, 10,000 shares authorized, 5,000 shares outstanding)	$ 50,000	
Retained earnings	156,000	
Total stockholders' equity		206,000
Total liabilities and stockholders' equity		$430,000

Required Indicate your criticisms of the balance sheet and briefly explain the proper treatment of any item criticized.

P 3-7. You have just started as a staff auditor for a small CPA firm. During the course of the audit, you discover the following items related to a single client firm:

a. During the year, the firm declared and paid $10,000 in dividends.
b. Your client has been named defendant in a legal suit involving a material amount. You have received from the client's counsel a statement indicating little likelihood of loss.
c. Because of cost control actions and general employee dissatisfaction, it is likely that the client will suffer a costly strike in the near future.
d. Twenty days after closing, the client suffered a major fire in one of its plants.
e. The cash account includes a substantial amount set aside for payment of pension obligations.
f. Marketable securities include a large quantity of shares of stock purchased for control purposes.
g. Land is listed on the balance sheet at its market value of $1,000,000. It cost $670,000 to purchase 12 years ago.
h. During the year, the government of Uganda expropriated a plant located in that country. There was substantial loss.

Required How would each of these items be reflected in the year-end balance sheet, including notes?

P 3-8. Corvallis Corporation owns 80% of the stock of Little Harrisburg, Inc. At December 31, 2008, Little Harrisburg had the following summarized balance sheet:

LITTLE HARRISBURG, INC.
Balance Sheet
December 31, 2008

Current assets	$100,000	Current liabilities	$ 50,000
Property, plant, and equipment (net)	400,000	Long-term debt	150,000
		Capital stock	50,000
		Retained earnings	250,000
	$500,000		$500,000

The earnings of Little Harrisburg, Inc., for 2008 were $50,000 after tax.

Required

a. What would be the amount of minority interest on the balance sheet of Corvallis Corporation? How should minority interest be classified for financial statement analysis purposes?
b. What would be the minority share of earnings on the income statement of Corvallis Corporation?

P 3-9. Aggarwal Company has had 10,000 shares of 10%, $100 par-value preferred stock and 80,000 shares of $5 stated-value common stock outstanding for the last three years. During that period, dividends paid totaled $0, $200,000, and $220,000 for each year, respectively.

Required Compute the amount of dividends that must have been paid to preferred stockholders and common stockholders in each of the three years, given the following four independent assumptions:

a. Preferred stock is nonparticipating and cumulative.
b. Preferred stock participates up to 12% of its par value and is cumulative.
c. Preferred stock is fully participating and cumulative.
d. Preferred stock is nonparticipating and noncumulative.

P 3-10. Rosewell Company has had 5,000 shares of 9%, $100 par-value preferred stock and 10,000 shares of $10 par-value common stock outstanding for the last two years. During the most recent year, dividends paid totaled $65,000; in the prior year, dividends paid totaled $40,000.

Required Compute the amount of dividends that must have been paid to preferred stockholders and common stockholders in each year, given the following independent assumptions:

a. Preferred stock is fully participating and cumulative.
b. Preferred stock is nonparticipating and noncumulative.
c. Preferred stock participates up to 10% of its par value and is cumulative.
d. Preferred stock is nonparticipating and cumulative.

P 3-11. An item of equipment acquired on January 1 at a cost of $100,000 has an estimated life of 10 years.

Required Assuming that the equipment will have a salvage value of $10,000, determine the depreciation for each of the first three years by the:

a. Straight-line method
b. Declining-balance method
c. Sum-of-the-years'-digits method

P 3-12. An item of equipment acquired on January 1 at a cost of $60,000 has an estimated use of 25,000 hours. During the first three years, the equipment was used 5,000 hours, 6,000 hours, and 4,000 hours, respectively. The estimated salvage value of the equipment is $10,000.

Required Determine the depreciation for each of the three years, using the unit-of-production method.

P 3-13. An item of equipment acquired on January 1 at a cost of $50,000 has an estimated life of five years and an estimated salvage of $10,000.

Required

a. From a management perspective, from among the straight-line method, declining-balance method, and sum-of-the-years'-digits method of depreciation, which method should be chosen for the financial statements if income is to be at a maximum the first year? Which method should be chosen for the income tax returns, assuming that the tax rate stays the same each year? Explain and show computations.
b. Is it permissible to use different depreciation methods in financial statements than those used in tax returns?

P 3-14.

Required Answer the following multiple-choice questions:

a. Which of the following accounts would *not* appear on a conventional balance sheet?
    1. Accounts Receivable
    2. Accounts Payable
    3. Patents
    4. Gain from Sale of Land
    5. Common Stock
b. Current assets typically include all but which of the following assets?
    1. Cash restricted for the retirement of bonds
    2. Unrestricted cash
    3. Marketable securities
    4. Receivables
    5. Inventories
c. The Current Liabilities section of the balance sheet should include
    1. Land.
    2. Cash Surrender Value of Life Insurance.
    3. Accounts Payable.
    4. Bonds Payable.
    5. Preferred Stock.

d. Inventories are the balance of goods on hand. In a manufacturing firm, they include all but which of the following?
   1. Raw materials
   2. Work in process
   3. Finished goods
   4. Supplies
   5. Construction in process
e. Which of the following accounts would *not* usually be classified as a current liability?
   1. Accounts Payable
   2. Wages Payable
   3. Unearned Rent Income
   4. Bonds Payable
   5. Taxes Payable
f. For the issuing firm, redeemable preferred stock should be classified where for analysis purposes?
   1. Marketable security
   2. Long-term investment
   3. Intangible
   4. Liabilities
   5. Shareholders' equity
g. Which of the following accounts would *not* be classified as an intangible?
   1. Goodwill
   2. Patent
   3. Accounts Receivable
   4. Trademarks
   5. Franchises
h. Which of the following is *not* true relating to intangibles?
   1. Research and development usually represents a significant intangible on the financial statements.
   2. Goodwill arises from the acquisition of a business for a sum greater than the physical asset value.
   3. Purchased goodwill is not amortized but is subject to annual impairment reviews.
   4. The global treatment of goodwill varies significantly.
   5. Intangibles are usually amortized over their useful lives or legal lives, whichever is shorter.
i. Growth Company had total assets of $100,000 and total liabilities of $60,000. What is the balance of the stockholders' equity?
   1. $0
   2. $40,000
   3. $60,000
   4. $100,000
   5. None of the above
j. The Current Assets section of the balance sheet should include
   1. Inventory.
   2. Taxes Payable.
   3. Land.
   4. Patents.
   5. Bonds Payable.
k. Which of the following is *not* a typical current liability?
   1. Accounts payable
   2. Wages payable
   3. Interest payable
   4. Pension liabilities
   5. Taxes payable
l. Which of the following is a current liability?
   1. Unearned rent income
   2. Prepaid interest
   3. Land
   4. Common stock
   5. None of the above
m. Treasury stock is best classified as a
   1. Current liability.
   2. Current asset.
   3. Reduction of stockholders' equity.
   4. Contra asset.
   5. Contra liability.

Case 3-1

IT'S A TRIP

The August 26, 2006, and August 27, 2005, consolidated balance sheets of Winnebago Industries, Inc.* follow:

Winnebago Industries, Inc.
Consolidated Balance Sheets

(In thousands, except per share data)	August 26, 2006	August 27, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 24,934	$ 19,484
Short-term investments	129,950	93,100
Receivables, less allowance for doubtful accounts ($164 and $270, respectively)	20,859	40,910
Inventories	77,081	120,655
Prepaid expenses and other assets	5,269	4,333
Deferred income taxes	9,067	9,610
Total current assets	267,160	288,092
Property and equipment, at cost:		
Land	946	1,000
Buildings	59,378	60,282
Machinery and equipment	99,839	100,601
Transportation equipment	9,561	9,487
Total property and equipment, at cost	169,724	171,370
Accumulated depreciation	(112,817)	(107,517)
Total property and equipment, net	56,907	63,853
Investment in life insurance	20,814	22,066
Deferred income taxes	25,002	24,997
Other assets	14,832	13,952
Total assets	$ 384,715	$ 412,960
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 27,923	$ 34,660
Income taxes payable	7,876	4,458
Accrued expenses:		
Accrued compensation	12,498	16,380
Product warranties	9,523	12,183
Self-insurance	7,842	6,728
Promotional	5,253	5,495
Accrued dividends	3,109	2,963
Other	6,098	7,756
Total current liabilities	80,122	90,623
Postretirement health care and deferred compensation benefits, net of current portion	86,271	86,450
Contingent liabilities and commitments		
Stockholders' equity:		
Capital stock common, par value $0.50; authorized 60,000 shares, issued 51,776 shares	25,888	25,888
Additional paid-in capital	22,268	16,811
Retained earnings	480,446	447,518
Treasury stock, at cost (20,633 and 18,787 shares, respectively)	(310,280)	(254,330)
Total stockholders' equity	218,322	235,887
Total liabilities and stockholders' equity	$ 384,715	$ 412,960

*"Winnebago Industries, Inc., headquartered in Forest City, Iowa, is a leading United States manufacturer of motor homes which are self-contained recreation vehicles used primarily in leisure travel and outdoor recreation activities." 10-K

(continued)

Case 3-1 IT'S A TRIP (Continued)

Winnebago Industries, Inc.
Notes to Consolidated Financial Statements (in Part)

Note 1: Nature of Business and Significant Accounting Policies (in Part)

We are a leading U.S. manufacturer of motor homes, self-contained RVs used primarily in leisure travel and outdoor recreation activities. The RV market is highly competitive, both as to price and quality of the product. We believe our principal competitive advantages are our brand name recognition, the quality of our products and our warranty and service capability. We also believe that our prices are competitive with the competitions' units of comparable size and quality.

Principles of Consolidation

The consolidated financial statements include the parent company and subsidiary companies. All material intercompany balances and transactions with subsidiaries have been eliminated.

Fiscal Period

We follow a 52/53-week fiscal year period. The financial statements presented are all 52-week periods.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is based on historical loss experience and any specific customer collection issues identified. Additional amounts are provided through charges to income as we believe necessary after evaluation of receivables and current economic conditions. Amounts which are considered to be uncollectible are written off and recoveries of amounts previously written off are credited to the allowance upon recovery.

Inventories

Inventories are valued at the lower of cost or market, with cost being determined by using the last-in, first-out (LIFO) method and market defined as net realizable value.

Property and Equipment

Depreciation of property and equipment is computed using the straight-line method on the cost of the assets, less allowance for salvage value where appropriate, at rates based upon their estimated service lives as follows:

Asset Class	Asset Life
Buildings	10–30 yrs.
Machinery and equipment	3–10 yrs.
Transportation equipment	3–6 yrs.

We review our long-lived depreciable assets for impairment annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable from future cash flows. As of August 26, 2006, and August 27, 2005, we have determined there were no impairments.

Note 3: Inventories

Inventories consist of the following:

(In thousands)	August 26, 2006	August 27, 2005
Finished goods	$ 33,420	$ 67,998
Work-in-process	35,166	45,657
Raw materials	40,080	38,461
	108,666	152,116
LIFO reserve	(31,585)	(31,461)
	$ 77,081	$120,655

The above value of inventories, before reduction for the LIFO reserve, approximates replacement cost at the respective dates.

(continued)

Case 3-1 IT'S A TRIP (Continued)

During Fiscal 2006, inventory quantities were reduced. This reduction resulted in a liquidation of LIFO inventory values, the effect of which decreased cost of goods sold by $4.0 million and increased net income by $2.6 million or $0.08 per share.

Required

a. 1. The statement is entitled "Consolidated Balance Sheets." What does it mean to have a consolidated balance sheet?
   2. For subsidiaries (affiliates), where control is present, does Winnebago have 100% ownership? Explain.
   3. For subsidiaries (affiliates) where control is not present, have these investments been consolidated?

b. 1. What are the gross receivables at August 26, 2006?
   2. What is the estimated amount that will be collected on receivables outstanding at August 26, 2006?

c. 1. What is the total amount of inventory at August 26, 2006?
   2. What is the approximate replacement cost of inventory at August 26, 2006?
   3. What is the trend in inventory balance? Comment.

d. 1. What is the net property and equipment at August 26, 2006?
   2. What is the gross property and equipment at August 26, 2006?
   3. What depreciation method is used for financial reporting purposes?
   4. Does it appear that property and equipment is relatively old at August 26, 2006?
   5. What is the accumulated depreciation on the land at August 26, 2006?

e. 1. What is the balance of product warranties at August 26, 2006?
   2. Why is a product warranties account provided under accrued expenses?

f. 1. Describe the treasury stock account.
   2. What method is used to record treasury stock?
   3. Why is treasury stock presented as a reduction in stockholders' equity?

g. 1. What is the fiscal year?
   2. How many weeks are included for the fiscal years ended August 26, 2006, and August 27, 2005?

Case 3-2 UP, UP, AND AWAY

The December 31, 2006 and 2005 consolidated balance sheets of The Goodyear Tire & Rubber Company* included the following assets and notes:

THE GOODYEAR TIRE & RUBBER COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	December 31, 2006	December 31, 2005
Assets		
Current Assets:		
Cash and cash equivalents (Note 1)	$ 3,899	$ 2,162
Restricted cash (Note 1)	214	241
Accounts and notes receivable (Note 5)	2,973	3,158
Inventories (Note 6)	2,789	2,810
Prepaid expenses and other current assets	304	245
Total Current Assets	10,179	8,616

*"We are one of the world's leading manufacturers of tires and rubber products, engaging in operations in most regions of the world." 10-K

(continued)

Case 3-2 UP, UP, AND AWAY (Continued)

(Dollars in millions)	December 31, 2006	2005
Goodwill (Note 7)	685	637
Intangible Assets (Note 7)	166	159
Deferred Income Tax (Note 14)	155	102
Other Assets and Deferred Pension Costs (Notes 8 and 13)	467	860
Properties and Plants (Note 9)	5,377	5,231
Total Assets	$ 17,029	$ 15,605
Liabilities		
Current Liabilities:		
Accounts payable—trade	$ 2,037	$ 1,939
Compensation and benefits (Notes 12 and 13)	905	1,773
Other current liabilities	839	671
Unites States and foreign taxes	225	393
Notes payable and overdrafts (Note 11)	255	217
Long term debt and capital leases due within 1 year (Note 11)	405	448
Total Current Liabilities	4,666	5,441
Long Term Debt and Capital Leases (Note 11)	6,563	4,742
Compensation and Benefits (Notes 12 and 13)	4,965	3,828
Deferred and Other Noncurrent Income Taxes (Note 14)	333	304
Other Long Term Liabilities	383	426
Minority Equity in Subsidiaries	877	791
Total Liabilities	17,787	15,532
Commitments and Contingent Liabilities (Note 18)		
Shareholders' (Deficit) Equity		
Preferred Stock, no par value:		
Authorized 50,000,000 shares, unissued	—	—
Common Stock, no par value:		
Authorized, 450,000,000 shares (300,000,000 in 2005)		
Outstanding shares, 178,218,970 (176,509,751 in 2005) (Note 21)	178	177
Capital Surplus	1,427	1,398
Retained Earnings	968	1,298
Accumulated Other Comprehensive Loss (Note 17)	(3,331)	(2,800)
Total Shareholders' (Deficit) Equity	(758)	73
Total Liabilities and Shareholders' (Deficit) Equity	$ 17,029	$ 15,605

THE GOODYEAR TIRE & RUBBER COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in Part)

Note 1. Accounting Policies (in Part)

A summary of the significant accounting policies used in the preparation of the accompanying consolidated financial statements follows:

Principles of Consolidation

The consolidated financial statements include the accounts of all majority-owned subsidiaries in which no substantive participating rights are held by minority shareholders. All intercompany transactions have been eliminated. Our investments in companies in which we do not own a majority and we have the ability to exercise significant influence over operating and financial policies are accounted for using the equity method. Accordingly, our share of the earnings of these companies is included in the Consolidated Statement of Operations. Investments in other companies are carried at cost.

The consolidated financial statements also include the accounts of entities consolidated pursuant to the provisions of Interpretation No. 46 of the Financial Accounting Standards Board,

(continued)

"Consolidation of Variable Interest Entities ("VIEs")—an Interpretation of ARB No. 51," as amended by FASB Interpretation No. 46R (collectively, "FIN 46"). FIN 46 requires consolidation of VIEs in which a company holds a controlling financial interest through means other than the majority ownership of voting equity. Entities consolidated under FIN 46 include South Pacific Tyres ("SPT") and Tire and Wheel Assembly ("T&WA"). Effective in January 2006, we purchased the remaining 50% interest in SPT and no longer consolidate SPT under FIN 46.

Refer to Note 8.

Warranty

Warranties are provided on the sale of certain of our products and services and an accrual for estimated future claims is recorded at the time revenue is recognized. Tire replacement under most of the warranties we offer is on a prorated basis. Warranty reserves are based on past claims experience, sales history and other considerations. Refer to Note 18.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out or the average cost method. Costs include direct material, direct labor and applicable manufacturing and engineering overhead. We recognize abnormal manufacturing costs as period costs and allocate fixed manufacturing overheads based on normal production capacity. We determine a provision for excess and obsolete inventory based on management's review of inventories on hand compared to estimated future usage and sales. Refer to Note 6.

Goodwill and Other Intangible Assets (in Part)

Goodwill is recorded when the cost of acquired businesses exceeds the fair value of the identifiable net assets acquired. Goodwill and intangible assets with indefinite useful lives are not amortized, but are tested for impairment annually or when events or circumstances indicate that impairment may have occurred, as provided in Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." We perform the goodwill and intangible assets with indefinite useful lives impairment tests annually as of July 31.

Properties and Plants

Properties and plants are stated at cost. Depreciation is computed using the straight-line method. Additions and improvements that substantially extend the useful life of properties and plants, and interest costs incurred during the construction period of major projects, are capitalized. Repair and maintenance costs are expensed as incurred. Properties and plants are depreciated to their estimated residual values over their estimated useful lives, and reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Refer to Notes 9 and 15.

Note 5. Accounts and Notes Receivable (in Part)

(In millions)	2006	2005
Accounts and notes receivable	$3,076	$3,288
Allowance for doubtful accounts	(103)	(130)
	$2,973	$3,158

(continued)

Case 3-2 UP, UP, AND AWAY (Continued)

Accounts and Notes Receivable included non-trade receivables totaling $301 million and $300 million at December 31, 2006 and 2005 respectively. These amounts primarily related to value-added taxes and tax receivables.

Note 6. Inventories

(In millions)	2006	2005
Raw materials	$ 722	$ 587
Work in process	156	137
Finished products	1,911	2,086
	$2,789	$2,810

Note 9. Properties and Plants

	2006			2005		
(In millions)	Owned	Capital Leases	Total	Owned	Capital Leases	Total
Properties and plants, at cost:						
Land and improvements	$ 442	$ 5	$ 447	$ 415	$ 9	$ 424
Buildings and improvements	1,902	84	1,986	1,856	91	1,947
Machinery and equipment	10,408	108	10,516	9,885	110	9,995
Construction in progress	442	—	442	445	—	445
	13,194	197	13,391	12,601	210	12,811
Accumulated depreciation	(8,064)	(99)	(8,163)	(7,635)	(94)	(7,729)
	5,130	98	5,228	4,966	116	5,082
Spare parts	149	—	149	149	—	149
	$ 5,279	$ 98	$ 5,377	$ 5,115	$ 116	$ 5,231

The range of useful lives of property used in arriving at the annual amount of depreciation provided are as follows: buildings and improvements, 8 to 45 years; machinery and equipment, 3 to 30 years.

Required

a. The statement is entitled "Consolidated Balance Sheets." What does it mean to have a consolidated balance sheet?

b. 1. What is the gross amount for accounts and notes receivable at December 31, 2006?
   2. What is the net amount for accounts and notes receivable at December 31, 2006?
   3. What is the December 31, 2006, balance for allowance for doubtful accounts?

c. 1. What is the gross amount of properties and plants at December 31, 2006?
   2. What is the net amount of properties and plants at December 31, 2006?
   3. Describe the account Accumulated Depreciation.
   4. What would be the accumulated depreciation at December 31, 2006?
   5. Does it appear that properties and plants is relatively old at December 31, 2006?

d. 1. What is the amount of total assets at December 31, 2006?
   2. What is the amount of current assets at December 31, 2006?
   3. What is the depreciation method?

e. 1. What is the inventory cost method?
   2. What is the dominant inventory category at December 31, 2006?

f. Warranty. When is the warranty liability recorded?

Case 3-3 LINE OF HEALTH

The December 31, 2006 liabilities and shareholders' investment of the consolidated balance sheet for Abbot Laboratories and Subsidiaries* follow:

Abbott Laboratories and Subsidiaries
Consolidated Balance Sheet
(dollars in thousands)

	December 31, 2006	2005	2004
Liabilities and Shareholders' Investment			
Current Liabilities:			
Short-term borrowings	$ 5,305,985	$ 212, 447	$ 1,836,649
Trade accounts payable	1,175,590	1,032,516	1,054,464
Salaries, wages and commissions	807,283	625,254	637,333
Other accrued liabilities	3,850,723	2,722,685	2,491,956
Dividends payable	453,994	423,335	405,730
Income taxes payable	262,344	488,926	156,417
Current portion of long-term debt	95,276	1,849,563	156,034
Liabilities of operations held for sale	—	60,788	87,061
Total Current Liabilities	11,951,195	7,415,514	6,825,644
Long-Term Debt	7,009,664	4,571,504	4,787,934
Post-Employment Obligations and Other Long-Term Liabilities	3,163,127	2,154,775	2,606,410
Liabilities of Operations Held for Sale	—	1,062	1,644
Deferred Income Taxes	—	583,077	220,079
Commitments and Contingencies			
Shareholders' Investment:			
Preferred shares, one dollar par value Authorized—1,000,000 shares, none issued	—	—	—
Common shares, without par value Authorized—2,400,000,000 shares Issued at stated capital amount— Shares: 2006: 1,550,590,438; 2005: 1,553,769,958; 2004: 1,575,147,418	4,290,929	3,477,460	3,189,465
Common shares held in treasury, at cost— Shares: 2006: 13,347,272; 2005: 14,534,979; 2004: 15,123,800	(195,237)	(212,255)	(220,854)
Earnings employed in the business	9,568,728	10,404,568	10,033,440
Accumulated other comprehensive income (loss)	389,766	745,498	1,323,732
Total Shareholders' Investment	14,054,186	14,415,271	14,325,783
	$36,178,172	$29,141,203	$28,767,494

Required

a. 1. The statement is entitled "Consolidated Balance Sheet." What does it mean to have a consolidated balance sheet?
   2. Does it appear that the subsidiary is wholly owned?

b. 1. Describe the trend in current liabilities.
   2. What current liability increased the most for the year ended December 31, 2006?

c. 1. How many commons shares had been issued as of December 31, 2006?
   2. How many shares were held in the treasury at December 31, 2006?
   3. How many shares were outstanding at December 31, 2006?
   4. What is the treasury stock method?

d. Abbott Laboratories discloses the account Earnings Employed in the Business. What is this account usually called?

*"Abbott's principal business is the discovery, development, manufacture, and sale of a broad and diversified line of health care products." 10-K

Case 3-4

BUY NOW

The Best Buy* liabilities and shareholders' equity for the fiscal year ended March 31, 2007, follow:

Liabilities and Shareholders' Equity (In millions, except per share amounts)	**March 3, 2007**	**February 25, 2006**
Current Liabilities		
Accounts payable	$ 3,934	$ 3,234
Unredeemed gift card liabilities	496	469
Accrued compensation and related expenses	332	354
Accrued liabilities	990	878
Accrued income taxes	489	703
Short-term debt	41	—
Current portion of long-term debt	19	418
Total current liabilities	6,301	6,056
Long-Term Liabilities	443	373
Long-Term Debt	590	178
Minority Interests	35	—
Shareholders' Equity		
Preferred stock, $1.00 par value: Authorized—400,000 shares; Issued and outstanding—none	—	—
Common stock, $.10 par value: Authorized—1 billion shares; Issued and outstanding—480,655,000 and 485,098,000 shares, respectively	48	49
Additional paid-in capital	430	643
Retained earnings	5,507	4,304
Accumulated other comprehensive income	216	261
Total shareholders' equity	6,201	5,257
Total Liabilities and Shareholders' Equity	$13,570	$11,864

Required

a. Describe the following accounts:
   1. Shareholders' Equity
   2. Common Stock, $.10 par value
   3. Additional Paid-In Capital
   4. Minority Interests (balance sheet account)

b. Determine the number of shares of:
   1. Common stock authorized at March 3, 2007.
   2. Common stock issued and outstanding at March 3, 2007.

c. 1. What is the dollar amount of shareholders' equity at March 3, 2007?
   2. Would the dollar amount of shareholders' equity at March 3, 2007, equal the market value of shareholders' equity at March 3, 2007? Comment.

d. Compute the common stock amount of $48 (in millions) at March 3, 2007.

e. What is the total long-term debt at March 3, 2007?

f. Describe the account Unredeemed Gift Card Liabilities. Why is this a current liability?

*"Best Buy Co., Inc. . . . is a specialty retailer of consumer electronics, home-office products, entertainment software, appliance and related services." 10-K

Case 3-5

OUR PRINCIPAL ASSET IS OUR PEOPLE

Dana Corporation included the following in its 2001 financial report:

Foundation Business: Focused Excellence

Dana's foundation businesses are: axles, drive shafts, structures, brake and chassis products, fluid systems, filtration products, and bearing and sealing products.

These products hold strong market positions—number one or two in the markets they serve. They provide value-added manufacturing, are technically advanced, and each has features that are unique and patented.

(continued)

Case 3-5 OUR PRINCIPAL ASSET IS OUR PEOPLE (Continued)

Management Statement (in Part)

We believe people are Dana's most important asset. The proper selection, training and development of our people as a means of ensuring that effective internal controls are fair, uniform reporting are maintained as standard practice throughout the Company.

Required

a. Dana states that "We believe people are Dana's most important asset." Currently, generally accepted accounting principles do not recognize people as an asset. Speculate on why people are not considered to be an asset.
b. Speculate on what concept of an asset Dana is considering when it states "We believe people are Dana's most important asset."

Case 3-6 BRANDS ARE DEAD?

The September 1, 1993, issue of *Financial World* estimated that the brand value of Intel was $178 billion. *Financial World* arrived at this estimate using a valuation method developed by London-based Interbrand Group.

Required

a. Define an asset.
b. In your opinion, do brands represent a valuable asset? Comment.
c. Under generally accepted accounting principles, should an internally generated brand value be recognized as an asset? Comment.
d. If the brand was purchased, should it be recognized as an asset? Comment.

Case 3-7 ADVERTISING—ASSET?

Big Car Company did substantial advertising in late December. The company's year-end date was December 31. The president of the firm was concerned that this advertising campaign would reduce profits.

Required

a. Define an asset.
b. Would the advertising represent an asset? Comment.

Case 3-8 IFRS MODEL BALANCE SHEET*

Presented below is an outline of a balance sheet that conforms to IFRSs at December 31, 2006.

Consolidated Balance Sheet
at December 31, 2006

Assets:	31/12/06
Non-current assets	
Current assets	
Total assets	

Consolidated Balance Sheet
at December 31, 2006—continued

Equity and liabilities:	31/12/06
Capital and reserves	
Non-current liabilities	
Current liabilities:	
Total equity and liabilities	

*Adapted from IFRS Model Financial Statements, 2006 (http://www.iasplus.com/fs/fs.htm).

Required

a. Construct the balance sheet similar to a balance sheet presented under U.S. GAAP.
b. Does the IFRS balance sheet emphasize liquidity?

Case 3-9 CANADIAN GAAP VS. U.S. GAAP

Shaw Communications Inc.* included Note 21, "United States Accounting Principles," in its 2004 annual report.

21. United States Accounting Principles (in Part)
August 31, 2004, and 2003
(All amounts in thousands of Canadian dollars except per share amounts)

Balance sheet items using U.S. GAAP

	2004		2003	
	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
Investments and other assets (7)	$ 43,965	$ 72,998	$ 49,415	$ 74,758
Deferred charges (2) (10) (12) (13)	267,439	147,353	293,065	161,122
Broadcast licenses (1) (5) (6)	4,685,582	4,660,348	4,627,728	4,602,494
Other long-term liability (13)	16,993	51,345	9,409	40,397
Deferred credits (10) (12)	898,980	674,718	850,991	696,884
Derivatives instruments liability (9)	—	250,160	—	168,757
Future income taxes	982,281	943,531	939,281	896,263
Long-term debt (8)	2,344,025	3,037,603	2,645,548	3,363,685
Shareholders' equity	2,492,018	1,660,593	2,498,665	1,646,074

The cumulative effect of these adjustments on consolidated shareholders' equity is as follows:

	2004	2003
Shareholders' equity using Canadian GAAP	$2,492,018	$2,498,665
Amortization of intangible assets (1)	(124,179)	(123,542)
Deferred changes (2)	(35,817)	(44,973)
Equity in loss of investees (4)	(35,710)	(36,202)
Gain on sale of subsidiary (5)	15,309	13,822
Gain on sale of cable systems (6)	47,745	47,501
Equity instruments (3)(8)	(688,520)	(709,540)
Accumulated other comprehensive income	(9,809)	825
Cumulative translation adjustment	(444)	(482)
Shareholders' equity using U.S. GAAP	1,660,593	1,646,074

Required

a. In your opinion, is there a material difference between shareholders' equity at the end of 2004 using Canadian GAAP vs. U.S. GAAP? Comment.

b. The disclosure indicates "all amounts in thousands of Canadian dollars." In your opinion, does this present a challenge to U.S. investors?

*"Shaw Communications . . . is a diversified Canadian communications company whose core business is providing broadband cable television, internet and satellite, to direct-to-home ("DTH") services to over three million customers (from 2004 annual report). Annual report obtained from The Wall Street Journal annual report service."

Web Case Thomson One *Business School Edition*

Please complete the Web case that covers material discussed in this chapter at academic.cengage.com/accounting/Gibson. You'll be using Thomson One Business School Edition, a powerful tool, that combines a full range of fundamental financial information, earnings estimates, market data, and source documents for 500 publicly traded companies.

Endnotes

1. *Accounting Trends & Techniques* (New York, NY: American Institute of Certified Public Accountants, 2006), p. 149.
2. Ibid., p. 307.
3. *Statement of Financial Accounting Concepts No. 6*, "Elements of Financial Statements" (Stamford, Conn.: Financial Accounting Standards Board, 1985), par. 25.
4. *Accounting Trends & Techniques* (New York, NY: American Institute of Certified Public Accountants, 2006), p. 141.
5. *Statement of Financial Accounting Standards No. 142*, "Goodwill and Other Intangible Assets," issued June 1, 2001, represents the current standard relating to goodwill. Prior to this standard, goodwill was amortized over a period of 40 years or less. SFAS No. 142 was required to be applied starting with fiscal years beginning after December 15, 2001.
6. *Statement of Financial Accounting Concepts No. 6*, par. 35.
7. *Statement of Financial Accounting Concepts No. 6*, par. 212.