Comparison of Accounting Assumptions

POC v CC
LIFO v FIFO
Cap v Exp
DPN – ACC v SL
Leases – Op Lease v Capital Lease
Investments – Held to Maturity, Available for Sale or Trading

Percentage of Completion v Completed Contract

	% of Completion	Completed Contract
When used	Long-term contracts - With reliable estimates of revenue & costs	Long-term contracts - If no reliable estimates of revenue & costs
Revenue recognised	% of work completed each year = % revenue recognised	Only when all work completed
Earnings variability		
Net Income – in construction		
Net income - overall		
Equity – in construction		
Debt to Equity In construction		
Return on Assets		
Cash Flows		

LIFO v FIFO

	LIFO	FIFO
Assuming rising prices – or reverse	Sell the expensive inventory (LIFO) Keep the cheap inventory	Sell the cheap inventory (FIFO) Keeps the expensive inventory
Cost of Goods Sold (OI + P – CI = COGS)		
Net Income		
Taxes Paid		
Post-tax cash flow		
Pre-tax cash flow		
Inventory on Balance Sheet		
Current Assets		
Total Assets		
Debt to Equity		
Current Ratio		
Return on Assets / Return on Equity		
Inventory Turnover (COGS/ave inventory)		
LIFO Liquidation		

Capitalizing v Expensing

In the year of capitalization	Capitalizing	Expensing
Net income		
Shareholder's equity		
Return on equity		
Return on assets		
Debt to equity		
Asset Turnover		
Stability of earnings		
Current ratio		
Cash flows		
Cash flow from Operating activities		
Cash flow from investing activities		
In the years after capitalization:		
Net income		
Return on equity		
Return on assets		
Asset Turnover		

Depreciation methods

	Straight Line	Accelerated
Methodology **Example:** **Cost - $15,000** **Residual - $5,000** **Economic Life – 5 yrs** **Digits =** **1+2+3+4+5 = 15**	Cost – Salvage value Useful Economic life $\frac{\$15,000 - \$5,000}{5}$ = $2,000 Yr 1 = $2,000 Yr 2 = $2,000 Yr 3 = $2,000 Yr 4 = $2,000 Yr 5	Sum of the years' digits Cost – salvage x $\frac{n - i + 1}{SYD}$ $\$15,000 - \$5,000 \times \frac{5 - 1 + 1}{15}$ = $3,333 Yr 1 = $2,667 Yr 2 = $2,000 Yr 3 = $1,333 Yr 4 = $667 Yr 5 Double - Declining Balance Cost – Accumulated Dpn x 2/n ($15,000 – 0) x 2/5 = $6,000 $9,000 x 2/5 = $3,600 $5,400 x 2/5 = **$400*** *** Don't dep past salvage value**
Ratios: Early Years		
Net Income		
Shareholder's equity		
Return on equity		
Return on assets		
Debt to equity		
Asset Turnover		
Stability of earnings		
Current ratio		
Cash flows		
Ratios: Later Years		

Operational Lease v Capital Lease

	Operational Lease	Capital Lease
Which method? **US GAAP – SFAS 13**	Short term leases & Long term leases (If all 4 conditions do not apply)	Long term leases – if ANY of the following applies: 1. Lease transfers ownership 2. Bargin purchase option 3. PV is 90% or more of lease fair value 4. Term is 75% or more of Useful E. Life
Overview of each	An Op Lease is effectively renting the equipment. The lessee pays the lease payment to the lessor. No asset is created, so the balance sheet is not affected Lease payments are expensed.	A Capital Lease is akin to owning the equipment. A long term asset and long term liability is created on the balance sheet. The next 12mths lease payments are a current liability. The asset is depreciated, and the liability amortised. As time goes by the liability is greater than the asset.
Capital Lease Method	N/A	1. Work out the PV of the lease - N - FV - PMT - I/Y (Use lower of int rate/rate implicit) CPT PV 2. Classify as Op or Capital Lease 3. If Capital Lease – the Lease PV is the Asset & the Liability Value 4. Depreciate the Asset – Straight Line 5. Amortise the Liability
Capital Lease Example: **- 4 yr lease** **- $10k pa lease pmts** **- UEL 4 yrs** **- No residual value** **- implicit rate 6%** **- borrowing rate 7%**	**PV of Lease** N – 4 FV – 0 PMT – 10,000 I/Y – 6% (lower rate) CPT PV = $34,651 **It is a Capital Lease** **Depreciate** over 4 yrs: $\frac{\$34,651}{4}$ = $8,663 per yr	**Long Term Asset value on B/Sheet** Yr 1. $34,651 – $8,663 = $25,988 Yr 2. $25,651 - $8,663 = $17,326 Yr 3. $17,326 - $8,663 = $$8,663 Yr 4. $8,663 - $8,663 = 0 **Long Term Liability on B/Sheet** Yr 1. $34,651 – $7,921 = $26,730 Lease Pmt = Int (CFO) + Capital (CFF) $10,000 = $2,079 + $7,921 ($34,651 x 0.06 = $2,079) Yr 2. $26,730 - $8,396 = $18,334 Yr 3. $18,334 - $8,900 = $9,434 Yr 4. $9,434 - $9,434 = 0

Operating v Capital Leases Continued

	Operating Lease	Capital Lease
Net income (Early Years)		
Net income (Later years)		
EBIT (Operating income)		
Assets		
Liabilities (Long-term)		
Liabilities(Short-term)		
Current ratio		
Asset Turnover		
Return on Assets		
Return on Equity		
Debt / Equity		
Classification of Cash flows		
CFO		
CFF		
Total cash flow		

Investments - Held to maturity, Available for Sale or Trading

	Held to maturity	Available for Sale	Trading
Definition	Debt securities acquired to hold to maturity	Debt and equity securities that are not expected to be held to maturity or traded in the near term	Debt and equity securities that are expected to be traded in the near term
Debt or/and Equity			
On balance sheet			
Realized gains / losses			
Unrealized gains / losses			
Dividends received or interest received			