CONTENTS

Preface xi
Organization of the Ninth Edition xii
Uses for the Ninth Edition xiv
Features of the Ninth Edition xv
Acknowledgments xvii
About the Authors xviii

Chapter 1 Financial Statements: An Overview 1
Map or Maze 1
Usefulness 3
Volume of Information 3
Where to Find a Company’s Financial Statements 6
The Financial Statements 7
Notes to the Financial Statements 7
Auditor’s Report 10
Sarbanes-Oxley Act of 2002 16
Management Discussion and Analysis 17
Five-Year Summary of Selected Financial Data and Market Data 19
Pandora (A.K.A. “PR Fluff”) 19
Proxy Statement 19
Missing and Hard-to-Find Information 20
Complexities 21
Accounting Choices 21
The Future of Financial Statements 22
Quality of Financial Reporting 22
Timing of Revenue and Expense Recognition 22
Discretionary Items 23
The Journey Through the Maze Continues 23
Self-Test 24
Study Questions, Problems, and Cases 27

Chapter 2 The Balance Sheet 36
Financial Condition 36
Consolidation 37
Chapter 4  Statement of Cash Flows  107
Preparation of a Statement of Cash Flows  108
Calculating Cash Flow from Operating Activities  113
Indirect Method  114
Cash Flow from Investing Activities  116
Cash Flow from Financing Activities  117
Change in Cash  118
Analyzing the Statement of Cash Flows  119
Cash Flow from Operations  119
Nocash Corporation  120
R.E.C. Inc.: Analysis of the Statement of Cash Flows  122
R.E.C. Inc. Analysis: Cash Flow from Operating Activities  122
Summary Analysis of the Statement of Cash Flows  124
Analysis of Cash Inflows  125
Analysis of Cash Outflows  126
Are We There Yet?  126
Self-Test  127
Study Questions, Problems, and Cases  131
APPENDIX 4A  Statement of Cash Flows—Direct Method  144
Direct Method  144
Chapter 5  A Guide to Earnings and Financial Reporting  
Quality  148

Using the Checklist  150
I. Sales or Revenues  150
II. Cost of Goods Sold  156
III. Operating Expenses  159
IV. Nonoperating Revenue and Expense  166
V. Other Issues  169

What Are the Real Earnings?  171
Quality of Financial Reporting—The Balance Sheet  171
Quality of Financial Reporting—The Statement of Cash Flows  172
Self-Test  173

Study Questions, Problems, and Cases  178

Chapter 6  The Analysis of Financial Statements  180

Objectives of Analysis  180
Sources of Information  182
Proxy Statement  182
Auditor’s Report  182
Management Discussion and Analysis  182
Supplementary Schedules  182
Form 10-K and Form 10-Q  183
Other Sources  183

Tools and Techniques  185
Common-Size Financial Statements  185
Key Financial Ratios  186
Liquidity Ratios: Short-Term Solvency  188
Cash Conversion Cycle or Net Trade Cycle  191
Activity Ratios: Asset Liquidity, Asset Management Efficiency  192
Leverage Ratios: Debt Financing and Coverage  194
Profitability Ratios: Overall Efficiency and Performance  197
Market Ratios  199

Analyzing the Data  200
Background: Economy, Industry, and Firm  202
Short-Term Liquidity  203
Operating Efficiency  205
Contents ix

Capital Structure and Long-Term Solvency 205
Profitability 209
Relating the Ratios—The Du Pont System 211
Projections and Pro Forma Statements 212
Summary of Analysis 213

Self-Test 215
Study Questions, Problems, and Cases 221

Appendix A Summary of Financial Ratios 251
Appendix B Solutions to Self-Tests 254
Appendix C Glossary 256
Index 265