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Exploring the Impact of Fixed Assets

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ABSTRACT

Fixed assets, also known as property, plant, and equipment (PP&E), are essential components of a company's balance sheet and play a crucial role in its operations and financial performance. This abstract explores the concept of fixed assets, discussing their definition, characteristics, valuation methods, and importance in financial reporting. It also highlights the significance of managing fixed assets effectively to maximize their value and ensure accurate representation in the financial statements. Fixed assets encompass tangible assets that have a long-term useful life and are not intended for sale in the normal course of business. These assets include land, buildings, machinery, equipment, vehicles, and other significant physical assets that enable a company to carry out its operations. Fixed assets are typically recorded at cost, including all expenditures necessary to acquire, construct, or prepare the asset for its intended use.

KEYWORDS

Capital Expenditures, Depreciation Expense, Fair Value, Impairment, Intangible Fixed Assets, Land.

I. INTRODUCTION

Keep in mind that the balance sheet's gross book value only includes assets that were bought for more than the threshold amount. Therefore, depending on what the corporation determined as the threshold, assets with a cost of less than $1,000, $5,000, or $50,000 may not be included in the gross book value. In essence, depreciation and net book value are accounting standards. The gross book value, which is a historical record of the sums paid for the assets when they were bought, is the sole company metric that really has value as an analytical tool. In light of this, the correlation between gross book value and computed depreciation offers a clue as to the age of the assets.

It is possible to get some understanding of a company's manufacturing capabilities by reading this information in its financial statements. If a corporation isn't changing its assets, either it can't afford to, it has a lot of surplus capacity, or the equipment hasn't seen a lot of technical advancement. The corporation will be encouraged to lower pricing and seek marginal, less lucrative business if there is too much capacity. In areas where technology has advanced, using outdated equipment will make operations less efficient. Margin levels will fall short of industry standards. The business with outdated equipment would undoubtedly take longer to process consumer orders and provide lower-quality service [1]–[3]. On the statement of cash flows, contrast the rise in gross book value with the capital expenditure amount. Then take into account the following three options:

1. The company's capital budget attempt is pure growth and/or diversification if the quantity of capital expenditures and the rise in gross book value are the same or comparable.

2. If the capital budget effort is primarily focused on replacement and modernization, the capital budget is substantially bigger than the rise in gross book value on the balance sheet.

3. If the corporation is replacing assets with far more technologically superior equipment if there are considerable capital expenditures but no change or a drop in the gross book value. A server that cost $25,000 five years ago may be replaced with one that costs $10,000 but has three times the power for the same amount of money.

Significant capital-intensive projects often reach positive cash flow in two to four years. In order to determine if the firm has made significant capital investments, look at the growth in both short- and long-term bank debt. A corporation will need to renew or renegotiate the loan every few months if a significant project is being funded using short-term debt. If financing requirements become too strict or if interest rates increase dramatically, this might result in a cash flow problem. The preferred method is to fund projects using long-term-maturity borrowings and/or with cash. Prior to the debt's due date, the project's advantages are to be realized. This turns into an auto-financing project.

Short-Term Debt

Here, we concentrate on a few topics that might be crucial in any analysis:

1. As was previously said, if this debt is utilized to fund initiatives that won't provide a positive cash flow for a number of years, difficulties may arise.

2. Compare the outstanding balance to the entire amount of the company's bank lines of credit. The footnotes include this information. If the line of credit is mostly or entirely used, the business will have few viable choices if it requires further funding. It can be required to use the whole company's assets as security for the loan.

3. Retail businesses should have significant debt from September to November and nearly no debt in January following Christmas.

4. A firm is utilizing banks to make up for poor working capital management if its short-term debt is rising while its inventories and accounts receivable increase even faster. The banks will eventually threaten or outright call the loan, which they may do with little or no warning, to deter management from continuing this conduct [4]–[6].

Contingent Debt

After 366 days or 20 years from the date of the financials, this might be repaid. Get the specifics from the footnotes to rule out any possible cash flow problems.

In the event that a firm's debt is ever "rescheduled," it implies that the company did not anticipate having the money available for a scheduled repayment to the debt holders, and as a result, the due date was "rescheduled," which means postponed. This offers the business additional time while also improving the appearance of the banks' balance sheets since they do not reflect past-due loans.

The use of convertible debt as long-term financing might be quite advantageous. When the business succeeds and the bondholders convert their debt to equity, it offers the corporation a low interest rate and additional equity. To confirm that the interest rate on this debt is actually a bargain, i.e., that it is the interest rates charged by comparable enterprises, please refer to the appropriate footnote. Issuing the convertible security may have been a way to get funding as an alternative to bankruptcy if the interest rate was not a good deal. Investors would refrain from investing in the company with equity under the circumstance. By purchasing convertible bonds, they would "invest," becoming creditors in the event of the company's failure but also having a stake in its success.

Favored Stock

If the business is a utility, this financing option is appealing. The value of this stock is part of the basis since it is a portion of shareholders' equity, which raises the amount that the utility may charge its consumers.

For the majority of businesses, preferred dividends are an extremely costly and unfavorable form of financing since the company cannot deduct them from its taxes. When financing is not an option and debt holders desire greater ownership in the firm, companies may issue preferred stock. Prior to the holders of preferred or ordinary shares, debt holders will have access to any surviving assets in a bankruptcy. Selling preferred shares is seldom ever seen to be a wise move. The high-dividend-yielding preferred stock made up a significant portion of the capital that the US government spent in banks and automakers as part of the TARP program in 2008/2009. A corporation will only issue cumulative preferred shares if its financial situation is very risky. Cumulative indicates that before the corporation may provide dividends to holders of ordinary shares, it must make up any missed scheduled dividend payments. Of fact, preferred shareholders would most likely lose their whole investment if the firm fails.

II. DISCUSSION

Typical Equity

Verify if the number of outstanding common shares has changed between financial statements. If it is rising, the business is likely selling shares, maybe to staff members who have stock options. If fewer shares are outstanding, the corporation is repurchasing its own stock on the open market. This aids in raising the company's profits per share. Recently, a lot of businesses have produced exceptional cash flow and spectacular earnings. A "return of capital" is what activist investors are demanding, which implies that any cash beyond what is required to operate the firm and finance future development should be returned to shareholders. After all, it is their money. Business entities had billions of dollars in cash in 2015, considerably more than they could possibly consume. Their desire to raise dividends and buy back shares is hindered somewhat by U.S. corporate tax responsibilities [7]–[10].

The majority of these monies were earned and are placed abroad. Businesses have previously paid taxes to countries outside the US. nations where they received these cash. Until the money is sent home, they are not required to pay corporation taxes in the United States. The corporation would have to send these monies back to the United States and pay $30 million in taxes in order to distribute a $100 million dividend, something they are quite reluctant to do. In order to avoid paying taxes, cash-rich firms are borrowing billions of dollars in the US and utilizing the money to pay dividends, which is a little off-topic but still significant. Apple just borrowed $15 billion to boost its dividend and broaden its share repurchase program even though it has over $150 billion in cash on hand. Divide the net income for current year by the number of outstanding shares for previous year to recalculate the profits per share. This will show you how much of the EPS growth from year to year is attributed to the decreased share count and how much is the consequence of actual better net income performance.

Many lessons may be learned from this first:

We have made considerable progress in our understanding of the terms and accounting principles that control how accounting information is presented. The financial statements are extremely interconnected, as you can see in the first three s. To see how this works, pay attention to the line references that exist in all three s. We must be careful to interpret the statistics appropriately when utilizing this financial data to examine a corporation. As we discussed in our last on EPS above, not everything is as it seems. The choice of measure has a significant impact on the result.

A Thought for the Day

An asset is an item a corporation holds that helps in running the enterprise. How much are the worker's worth? The hiring, compensation, and frequent significant "investments" in their training and development cost large organizations billions of dollars, yet these expenditures are rarely recorded in accounting since they do not produce a physical or marke asset like inventories. The sole important asset in consulting firms, legal firms, CPA firms, software development companies, and other service enterprises is often its workers. Yet the conventional financial accounts make no mention of their worth.

Financial Statement

The income statement, also known as a statement of operations or a profit and loss statement, provides information on how the firm performed during a certain time period, often one month a year or a quarter. This data assesses the accomplishment of the firm and the resources used to create that accomplishment. The following is a summary of the income statement:

Profit = Revenue – Expenses.

Profit or net income is the difference between revenues realized and costs expended. The specifics of the income statement are described in the paragraphs that follow. Exhibit 2-1 has a five-year history of the Metropolitan Manufacturing Company for your perusal. The balance sheet and this are both financial statements.

The line items on the income statement, which is shown as Exhibit 2-1, are identified by the numbers in the names. This represents the monetary amount of goods and services the company offered to its clients over the course of the year. This is often referred to as sales; in the UK, it is known as turnover or income. When the purchaser assumes responsibility for the merchandise, a sale has been made. "Making a sale" is a word that you could use when you and the customer come to an agreement on conditions; it is significantly different from 'achieving revenue'. You may argue that when the purchase order is received, the transaction is acknowledged. Revenue is not, however, recognized until the customer has received and approved the goods or services they ordered. The value of goods or services given to a happy client is referred to as revenue. Either the consumer makes a cash payment now or makes a future payment promise; in the latter situation, the sum is recorded as an accounts receivable.

Be clear that obtaining money in exchange for goods and services is not the same as producing income. Before income is recorded, money may be received. A consumer may pay a down payment or deposit or pay in advance for a magazine subscription, for instance. Accounts receivable are created more often when firms receive cash after revenue is made. The checkout counter of a supermarket is an example of a type of company where the receipt of cash and the recording of revenue may take place simultaneously.

Metropolitan Manufacturing Company generated $4,160,000 in sales. This is after price breaks, warranties, and potential returns are taken into account. For instance: In order to track their price-discounting policies and other income decreases, many businesses keep such thorough records of their revenues $2,759,000 was the cost of goods sold. The price of the commodities produced or purchased and delivered to clients is known as the cost of goods sold. To calculate gross profit or gross margin, this sum is deducted from revenue. The following components are included in cost of goods sold:

1. components raw
2. bought components
3. Direct work

Additional manufacturing costs, such as utility costs and upkeep of the industrial building. A portion of the difference between costs and expenditures, as mentioned in 1, is the sum that is reported as cost of products sold. Both the cost of production and the cost of items sold are expenditures. Due to changes in inventory, cost of products sold and cost of production will vary. The cost of products sold will be greater than the cost of production by the amount of the change in inventory if inventory levels decline over the period.

If this were a service-based company, direct cost would be used to describe the equivalent of cost of goods sold. The whole amount spent to provide clients of the business a worthwhile experience is known as the direct cost. the of the salaries provided to individuals who interact with consumers are included, as well as the support expenses required to enable them to do their tasks.

$1,401,000 in gross margin

This gauges the financial success attained by creating and offering goods and services. It gauges both the marketability of the company's goods and the efficacy of production. Another indicator of its achievement is the gross margin %.

$1,033,000 in general and administrative costs

The cost of running the company's whole infrastructure is represented by this sum. This category includes personnel costs, selling costs, promotional costs, and research and development costs.

Depreciation costs came to $56,000.

The share of previous capital expenditures that has been allocated to the current year and is accounted for as an expense in that year is this. It is not a financial outlay.

$312,000 in net income before taxes.

This sum is equivalent to the company's revenue less all operational and no operating costs. This is also known as "pre-tax income," and it is as follows for Metropolitan Manufacturing Company, Inc.:

$156,000 in federal income tax

Corporations in the United States pay the federal government in the form of income taxes around 34% of their earnings. However, in order to make the computations for the Metropolitan Manufacturing Company example easy, we utilized a rate of 50%. The rate that large corporations really pay is often significantly higher than this 34 percent average for corporate taxes. Many businesses do not pay corporate taxes in the United States on earnings made abroad. Actually, they don't pay such taxes until the money has been returned to the US.

$156,000 in profit

This is the total profit the company made over the course of the year. All costs associated with vendor purchases as well as all other operational costs have been considered. The business's owners have the option of keeping these earnings for their own use or reinvested it whole or in part into the company to fund growth and modernization. Public corporations compute profits per share using this. It is also the utilized in many of the calculations for financial ratios that have been described.

Dividends in cash, $46,000

This is the share of the year's earnings that was given to the company's owners. Every year, the remaining was kept inside the company.

$110,000 in Retained Earnings Change

This reflects the percentage of earnings that the owners invested back into the company in 2016. Since the company's founding, the proprietors have put a total of $1,357,000 back into it. This is the total retained profits, which can be seen on line 21 of the balance statement. Line 21 on the balance sheet rose by $110,000 in 2016, which corresponds to reinvestment for that year.

Income Statement Analysis

A drop in income is not always a negative thing. Sometimes sales are static while gross profit is increasing. This is often an indication that the business is "cleaning" its product mix, or getting rid of the items whose profitability is significantly below average. It might be doing this for a variety of reasons, including:

Simply said, the items lack professionalism.

The corporation will utilize these newly accessible facilities to develop faster-growing, higher-margin items since the amount of production capacity is restricted. The company's image as a supplier of high-quality items is damaged since the products being removed are not of sufficient quality. The removed goods were spending a lot of money since the company needed a lot of inventory and accounts receivable to support them. The business made the choice to hire outside vendors to produce these goods. Although it still offers the same items to its clients, it now receives a sales commission rather than the whole sum of money.

In place of direct sales, the corporation now rents certain equipment to consumers. For a period, revenue will decrease. When software vendors switch to a software licensing model rather than selling the product directly, this occurs. As more IT businesses start offering cloud computing services rather of buying or renting software outright, more of them will encounter this situation.

The corporation decides to unilaterally discontinue a certain product line in order to reevaluate its brand and positioning in the industry. The former pharmacy chain CVS is a great illustration of this. In 2014, CVS changed its name to a health corporation. It partially achieved this by banning the sale of all tobacco products, forgoing tens of millions of dollars in income and profits in the process. There was no demand from the public or the law to do this. CVS currently enjoys more revenue and profitability than it had before to the shift in strategy because to the addition of pharmacy benefit management and other medical services to its retail locations.

The firm is presumably getting more business by lowering its selling prices if revenue is rising but the gross profit margin is declining. The corporation is lowering its pricing to sell more goods, and the plan has been very effective. If sales are rising, gross profit percentage is down, but gross profit dollars are growing. The amount of gross profit increases, which enhances the company's cash flow. If the method is essential and effective, lowering prices has no negative connotation. This is particularly true if the business has extra capacity. Selling professional high-quality but lower-margin goods will increase cash flow and profitability.

Generally speaking, general and administrative costs should grow more slowly than income. This financial arrangement is made possible by scale economies, efficiency, and the reality that general and administrative expenditures are largely fixed costs. There are exceptions to this rule, however. R & expense may be included in the general and administrative expenditures line in certain businesses when research and development investments are the main source of revenue. A business that prioritizes R&D should undoubtedly increase this expenditure in accordance with the funds that is available and the effectiveness of its current initiatives.

The Federal Income Tax Provision

This is equal to the corporation tax rate multiplied by the income before taxes, which is often in the 34 percent range. It isn't always the precise amount of taxes that the business paid. This is due to the fact that the accounting technique used to prepare a company's tax return differs from the approach used to provide the company's financial reporting to shareholders. Approximately 20% is the average corporate tax rate that businesses in the US really pay. There are several reasons for this. These two are

American businesses that make money abroad are not liable to corporate income tax in the United States until their cash flow is brought back home. Under various iterations of the "reform" and "tax holiday" that Congress asks for; this is always susceptible to change.

Most businesses that undertake capital investments capitalize the costs on shareholders' reports while deducting the same costs from revenue on their tax returns. This is both legitimate and typical. This will result in a reduced payment since the company's earnings on the tax return will be lower. A liability known as deferred taxes or income taxes due will appear on the company's balance sheet as the difference between the accounting provision of 34% and the amount actually paid.

Net Profit

Keep in mind that this is not the real cash flow the company has earned. Many costs, including depreciation, are not considered expenditures even if cash from the produced income may not have yet been received.

If the business is doing well, net income ought to rise considerably more quickly than sales. Efficiency is improved through growth, which also provides funding for technical investment. High fixed cost companies should demonstrate significant profit improvement compared to sales growth. Naturally, the opposite is also accurate. A firm with large fixed costs might be destroyed by declining sales. Consider the 2008–2010 timeframe for the steel, aluminum, and automotive industries.

Even during a time of sharp revenue decline, net income may increase. This could occur as a consequence of significant overhead and staff cuts. More than five million jobs were lost as a result of the drastic cost reduction in 2008 and 2009.

More over half of these positions were categorized as administrative and general. Because of this, several businesses became profit in 2009 despite significant sales declines. While it lasts, this is fine. However, why did it require a decline in income to prompt the decision if the headcount cuts were of "unnecessary" employees? How long will it take the organization to re-hire those resources and reap the rewards of their labors if the headcount reductions included personnel working on R&D and other development initiatives essential for future prosperity?

Oil and gas firms had significant revenue decreases between 2014 and 2015, although not due of volume declines but rather as a consequence of price drops of almost 50%. Although it had been averaging $100 per barrel in 2013, oil sold in 2015 for as low as $45 per barrel. In fact, prior to 2014, it climbed to as high as $140 per barrel due to speculation and political unrest in several regions of the globe that produce oil.

III. CONCLUSION

In conclusion, fixed assets, which reflect large investments in actual resources, are important elements of a company's balance sheet. Financial reporting, decision-making, and operational effectiveness all depend on its correct appraisal and competent administration. Organizations may increase the value of their fixed assets, reduce risks, and safeguard the accuracy of their financial reports by managing them well. Fixed assets are essential to an organization's ability to run smoothly, make money, and provide goods and services. Therefore, improving operating efficiency, minimizing downtime, and maximizing the value of these assets all depend on good management of fixed assets. Fixed assets should be used effectively, maintained correctly, and protected from theft and damage via asset tracking systems, maintenance schedules, and periodic reviews.

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