Solutions for Financial Accounting for Managers 1st Edition by Kimmel

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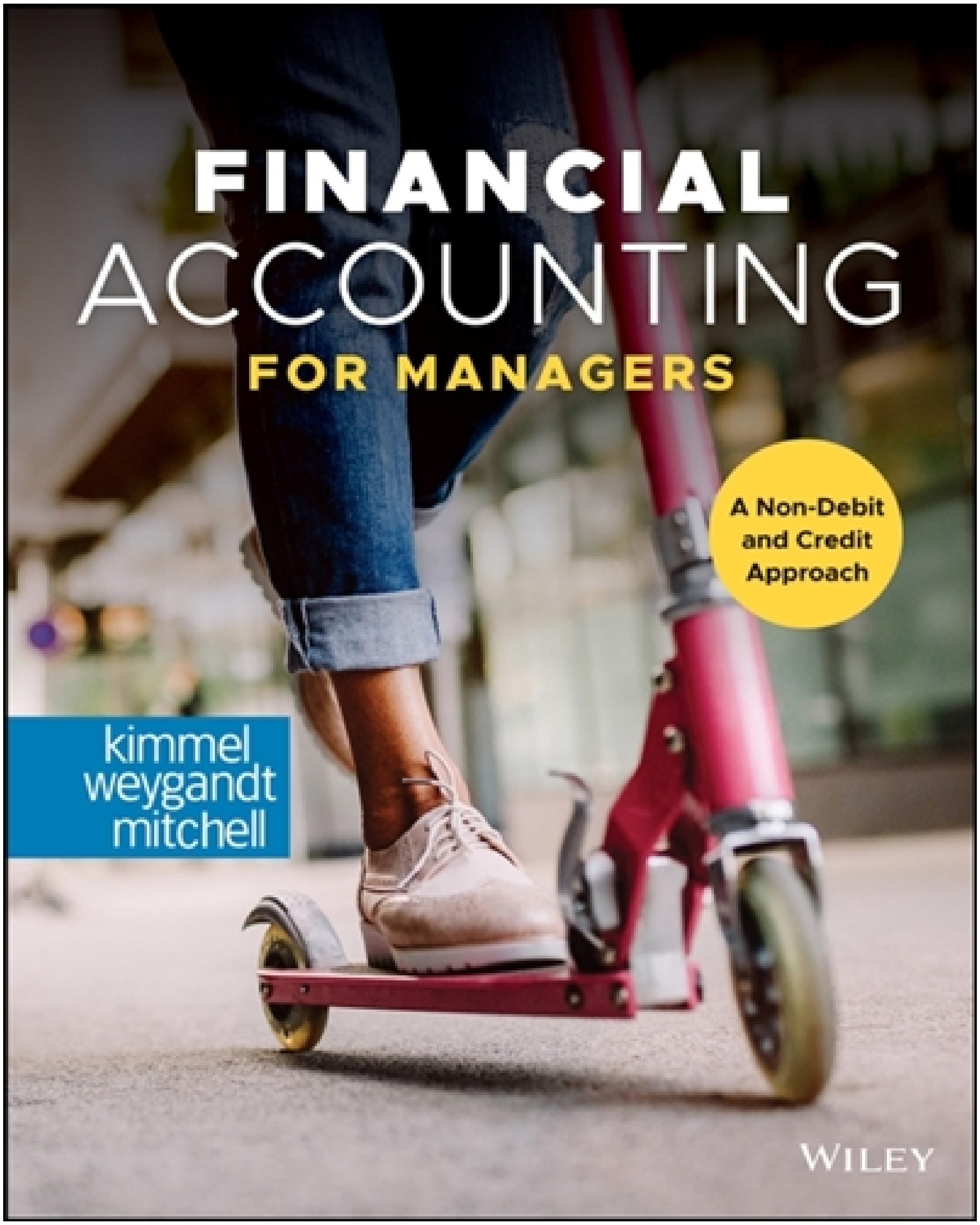

Solutions

CHAPTER 2

A Further Look at the Balance Sheet

Learning Objectives

1. Identify the sections of a classified balance sheet.
2. Use ratios to evaluate a company's balance sheet.

ANSWERS TO QUESTIONS

1. A company's operating cycle is the average time that is required to go from cash to cash in producing revenue.

LO 1 BT: K Diff: E TOT: 1 min. AACSB: None AICPA FC: Measurement

2. Current assets are assets that a company expects to convert to cash or use up within one year of the balance sheet date or the company's operating cycle, whichever is longer. Current assets are listed in the order in which they are expected to be converted into cash.

LO 1 BT: K Diff: E TOT: 1 min. AACSB: None AICPA FC: Reporting

3. Long-term investments are investments in stocks and bonds of other corporations that are held for more than one year, and long-term assets such as land or buildings that a company is not currently using in its operating activities. Property, plant, and equipment are assets with relatively long useful lives that are currently used in operating the business.

LO 1 BT: C Diff: M TOT: 2 min. AACSB: None AICPA FC: Reporting

4. Current liabilities are obligations that will be paid within the coming year or operating cycle, whichever is longer. Long-term liabilities are obligations that will be paid after one year.

LO 1 BT: C Diff: M TOT: 1 min. AACSB: None AICPA FC: Reporting

5. The two parts of stockholders' equity and the purpose of each are: (1) **Common stock** is used to record investments of assets in the business by the owners (stockholders). (2) **Retained earnings** is used to record net income retained in the business.

LO 1 BT: K Diff: M TOT: 2 min. AACSB: None AICPA FC: Reporting

6. Intangible assets include goodwill, patents, trademarks, tradenames, and copyrights.

LO 1 BT: K Diff: M TOT: 2 min. AACSB: None AICPA FC: Reporting

7. (a) Geena is not correct. There are three characteristics: liquidity, profitability, and solvency.

   (b) The three parties are not primarily interested in the same characteristics of a company. Short-term creditors are primarily interested in the liquidity of the company. In contrast, long-term creditors and stockholders are primarily interested in the profitability and solvency of the company.

LO 2 BT: C Diff: M TOT: 3 min. AACSB: None AICPA FC: Reporting

8. (a) Liquidity ratios: Working capital and current ratio.

   (b) Solvency ratio: Debt to assets.

LO 2 BT: K Diff: E TOT: 2 min. AACSB: None AICPA FC: Reporting

Questions Chapter 2 (Continued)

9. Debt financing is riskier than equity financing because debt must be repaid at specific points in time, whether the company is performing well or not. Thus, the higher the percentage of assets financed by debt, the riskier the company.

LO 2 BT: C Diff: E TOT: 2 min. AACSB: None AICPA FC: Reporting

10. (a) Liquidity ratios measure the short-term ability of the company to pay its maturing obligations and to meet unexpected needs for cash.

(b) Profitability ratios measure the income or operating success of a company for a given period of time.

(c) Solvency ratios measure the company's ability to survive over a long period of time.

LO 2 BT: K Diff: E TOT: 2 min. AACSB: None AICPA FC: Reporting

11. (a) An increase in the current ratio signals good news because the company improved its ability to meet maturing short-term obligations.

(b) The increase in the debt to assets ratio is bad news because it means that the company has increased its obligations to creditors and has lowered its equity "buffer."

LO 2 BT: AN Diff: M TOT: 3 min. AACSB: Analytic AICPA FC: Reporting

12. At September 26, 2020 Apple's largest current asset was Marketable securities of $52,927 million, its largest current liability is Other current liabilities of $42,684 million and its largest item under "Assets" was Marketable securities under Non-current assets of $100,887 million.

LO 1 BT: AN Diff: M TOT: 5 min. AACSB: Analytic AICPA FC: Reporting

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 2.1

CL	Accounts payable	CL	Income taxes payable
CA	Accounts receivable	LTI	Investment in long-term bonds
PPE	Accumulated depreciation	PPE	Land
PPE	Buildings	CA	Inventory
CA	Cash	IA	Patent
IA	Goodwill	CA	Supplies

LO 1 BT: K Difficulty: Easy TOT: 4 min. AACSB: None AICPA FC: Reporting

BRIEF EXERCISE 2.2

CHIN COMPANY
Partial Balance Sheet

Current assets	
Cash	$10,400
Debt investments	8,200
Accounts receivable	14,000
Supplies	3,800
Prepaid insurance	2,600
Total current assets	$39,000

LO 1 BT: AP Difficulty: Medium TOT: 3 min. AACSB: Analytic AICPA FC: Reporting

BRIEF EXERCISE 2.3

2	Long-term investments
5	Current liabilities
7	Stockholders' equity
4	Intangible assets
1	Current assets
6	Long-term liabilities
3	Property, plant, and equipment

LO 1 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Reporting

BRIEF EXERCISE 2.4

ALBERTA COMPANY
Partial Balance Sheet
December 31, 2027

Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 8,200	
Current maturity of long-term note payable	2,900	
Interest payable	3,200	
Total current liabilities		$ 14,300
Long-term liabilities		
Bonds payable	24,900	
Notes payable*	13,000	
Total long-term liabilities		37,900
Total liabilities		52,200
Stockholders' equity		
Common stock	76,100	
Retained earnings	54,500	
Total stockholders' equity		130,600
Total liabilities and stockholders' equity		$182,800

***($15,900 - $2,900)**

LO 1 BT: AP Difficulty: Medium TOT: 6 min. AACSB: Analytic AICPA FC: Reporting

BRIEF EXERCISE 2.5

TEXAS INSTRUMENTS, INC.
Balance Sheet
December 31, 2027
(in millions)

Assets		
Current assets		
Cash	$ 1,182	
Debt investments	1,743	
Accounts receivable	1,823	
Inventory	1,202	
Prepaid rent	164	
Total current assets		$ 6,114
Long-term investments		
Stock investments		637
Property, plant, and equipment		
Equipment	6,705	
Less: Accumulated depreciation—equipment	3,547	3,158
Intangible assets		
Patents		2,210
Total assets		$12,119

(Tot. current assets + L-T invest. + Prop., plant and equip. + Intang. assets)

Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$1,459	
Income taxes payable	128	
Total current liabilities		$ 1,587
Long-term liabilities		
Notes payable		810
Total liabilities		2,397
Stockholders' equity		
Common stock	2,826	
Retained earnings	6,896	
Total stockholders' equity		9,722
Total liabilities and stockholders' equity		$12,119

(Tot. current liab. + Notes pay. + Tot. stock. equity)

LO 1 BT: AP Difficulty: Medium TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

BRIEF EXERCISE 2.6

Working capital = Current assets – Current liabilities

Current assets	**$ 102.5 million**
Current liabilities	**(201.2) million**
Working capital	**($ 98.7) million**

(Current assets – Current liab.)

Current ratio:

$$\frac{\text{Current assets}}{\text{Current liabilities}} = \frac{\$102{,}500{,}000}{\$201{,}200{,}000}$$

$$= 0.51:1$$

(Current assets ÷ Current liab.)

LO 2 BT: AP Difficulty: Easy TOT: 3 min. AACSB: Analytic AICPA ACC: Reporting

BRIEF EXERCISE 2.7

(a) Current ratio

$$\frac{\text{Current assets}}{\text{Current liabilities}} = \frac{\$262{,}787}{\$293{,}625} = 0.89:1$$

(Current assets ÷ Current liab.)

(b) Debt to assets ratio

$$\frac{\text{Total liabilities}}{\text{Total assets}} = \frac{\$376{,}002}{\$439{,}832} = 85.5\%$$

(Tot. liab. ÷ Tot. assets)

LO 2 BT: AP Difficulty: Easy TOT: 3 min. AACSB: Analytic AICPA FC: Reporting

SOLUTIONS TO DO IT! EXERCISES

DO IT! 2.1a

MYLAR CORPORATION
Balance Sheet (partial)
December 31, 2027

Assets		
Current assets		
Cash	$ 13,000	
Accounts receivable	22,000	
Inventory	58,000	
Supplies	7,000	
Total current assets		$100,000
Property, plant, and equipment		
Equipment	180,000	
Less: Accumulated depreciation—equipment	50,000	130,000
Total assets		$230,000

(Cash + Accts. rec. + Inv. + Sup. + Equip. – Acc. dep.)

LO 1 BT: AP Difficulty: Medium TOT: 5 min. AACSB: Analytic AICPA FC: Reporting

DO IT! 2.1b

IA	Trademarks	CA	Inventory
CL	Notes payable (current)	PPE	Accumulated depreciation
NA	Interest revenue	PPE	Land
CL	Income taxes payable	SE	Common stock
LTI	Debt investments (long-term)	NA	Advertising expense
CL	Unearned sales revenue	LTL	Mortgage payable (due in 3 years)

LO 1 BT: K Difficulty: Easy TOT: 3 min. AACSB: Analytic AICPA FC: Reporting

DO IT! 2.2

(a)	**Current assets:**	**2027**	**$6,700 (1,700 + 900 + 3,700 + 400)**
		2026	**$8,500 (2,400 + 1,200 + 4,200 + 700)**
	Current liabilities:	**2027**	**$6,100 (3,900 + 2,200)**
		2026	**$4,600 (3,000 + 1,600)**
(b)	**Working capital**	**2027**	**$6,700 – $6,100 = $600**
		2026	**$8,500 – $4,600 = $3,900**
	Current ratio	**2027**	**$6,700 ÷ $6,100 = 1.10:1**
		2026	**$8,500 ÷ $4,600 = 1.85:1**
(c)	**Debt to assets ratio**	**2027**	**$42,100 ÷ $72,700 = 57.91%**
		2026	**$34,600 ÷ $80,500 = 42.98%**

(d) **The company's working capital and current ratio decreased. This suggests that its ability to pay its short-term obligations declined. The company's debt to assets ratio increased. This suggests that its ability to pay interest and principal on its debts as they come due has declined.**

LO 2 BT: AN Difficulty: Medium TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

SOLUTIONS TO EXERCISES

EXERCISE 2.1

CL	Accounts payable	CA	Inventory
CA	Accounts receivable	CA	Stock investments (To be sold in 7 months)
PPE	Accumulated depreciation—equip.	PPE	Land (in use)
PPE	Buildings	LTL	Mortgage payable
CA	Cash	CA	Supplies
CL	Interest payable	PPE	Equipment
IA	Goodwill	CA	Prepaid rent
CL	Income taxes payable		

LO 1 BT: K Difficulty: Easy TOT: 3 min. AACSB: None AICPA FC: Reporting

EXERCISE 2.2

CA	Prepaid advertising	IA	Patents
PPE	Equipment	LTL	Bonds payable
IA	Trademarks	SE	Common stock
CL	Salaries and wages payable	PPE	Accumulated depreciation—equipment
CL	Income taxes payable	CL	Unearned sales revenue
SE	Retained earnings	CA	Inventory
CA	Accounts receivable		
LTI	Land (held for future use)		

LO 1 BT: K Difficulty: Easy TOT: 3 min. AACSB: None AICPA FC: Reporting

EXERCISE 2.3

THE BOEING COMPANY
Partial Balance Sheet
December 31, 2027
(in millions)

Assets		
Current assets		
Cash	$ 9,215	
Debt investments	2,008	
Accounts receivable	5,785	
Notes receivable	368	
Inventory	16,933	
Total current assets		$34,309
Long-term investments		
Notes receivable		5,466
Property, plant, and equipment		
Buildings	21,579	
Less: Accumulated depreciation—buildings	12,795	8,784
Intangible assets		
Patents		12,528
Total assets		$61,087

(Current assets + Long-term invest. + Prop., plant, and equip. + Intang. assets)

LO 1 BT: AP Difficulty: Medium TOT: 5 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.4

H. J. HEINZ COMPANY
Partial Balance Sheet
April 30, 2027
(in thousands)

Assets			
Current assets			
Cash		$ 373,145	
Accounts receivable		1,171,797	
Inventory		1,237,613	
Prepaid insurance		125,765	
Total current assets			$ 2,908,320
Property, plant, and equipment			
Land		76,193	
Buildings	$4,033,369		
Less: Accumulated depreciation—buildings	2,131,260	1,902,109	1,978,302
Intangible assets			
Goodwill		3,982,954	
Trademarks		757,907	4,740,861
Total assets			$ 9,627,483

(Current assets + Prop., plant, and equip. + Intang. assets)

LO 1 BT: AP Difficulty: Medium TOT: 5 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.5

LONGHORN COMPANY
Balance Sheet
December 31, 2027

Assets			
Current assets			
Cash		$11,840	
Accounts receivable		12,600	
Prepaid insurance		3,200	
Total current assets			$ 27,640
Property, plant, and equipment			
Land		61,200	
Buildings	$105,800		
Less: Accumulated depreciation—buildings	45,600	60,200	
Equipment	82,400		
Less: Accumulated depreciation—equipment	18,720	63,680	185,080
Total assets			$212,720

(Tot. current assets + Tot. prop., plant, and equip.)

Liabilities and Stockholders' Equity			
Current liabilities			
Accounts payable		$ 9,500	
Current maturity of note payable		13,600	
Interest payable		3,600	
Total current liabilities			$ 26,700
Long-term liabilities			
Note payable ($93,600 – $13,600)			80,000
Total liabilities			106,700
Stockholders' equity			
Common stock		60,000	
Retained earnings ($40,000 + $6,020*)		46,020	
Total stockholders' equity			106,020
Total liabilities and stockholders' equity			$212,720

(Tot. current liab. + Note pay. + Com. stock + Ret. earn.)

***Net income = $14,700 – $780 – $5,300 – $2,600 = $6,020**

LO 1 BT: AP Difficulty: Medium TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.6

CARMEN CO.
Balance Sheet
December 31, 2027

Assets			
Current assets			
Cash		$11,840	
Debt investments		4,100	
Accounts receivable		21,700	
Notes receivable		5,300	
Supplies		9,200	
Total current assets			$ 52,140
Long-term investments			
Stock investments			71,500
Property, plant, and equipment			
Land		195,600	
Buildings	$261,200		
Less: Accumulated depreciation—buildings	32,600	228,600	
Equipment	82,400		
Less: Accumulated depreciation—equipment	18,720	63,680	
Land improvements	45,780		
Less: Accumulated depreciation—land improvements		12,600	33,180
Total property, plant, and equipment			521,060
Intangible assets			
Patents			46,700
Total assets			$691,400

EXERCISE 2.6 (Continued)

Liabilities and Stockholders' Equity

Current liabilities		
Accounts payable	$ 9,500	
Current portion of mortgage payable	9,100	
Income taxes payable	14,700	
Interest Payable	3,600	
Total current liabilities		$36,900
Long-term liabilities*		
Mortgage payable		84,500
Total liabilities		121,400
Stockholders' equity		
Common stock	75,000	
Retained earnings	495,000	
Total stockholders' equity		570,000
Total liabilities and stockholders' equity		$691,400

*($93,600 - $9,100)

[(current assets. + L-T invest + Prop., plant, & equip. + Intang.assets) = (Current liable. + L-T liable. +SE)]

[(($11,840 + $4,100 + $21,700 + $5,300 + $9,200) + $71,500 + ($195,600 + ($261,200-$32,600) + ($82,400-$18,720) + ($45,780-$12,600)) + $46,700) = (($9,500 + $9,100 +$14,700 + $3,600) + $84,500 + ($75,000 + $495,000))]

LO 1 BT: AP Difficulty: Medium TOT: 12 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.7

(a)

FAIRVIEW CORPORATION
Income Statement
For the Year Ended July 31, 2027

Revenues		
Service revenue	$66,100	
Rent revenue	8,500	
Total revenues		$74,600
Expenses		
Salaries and wages expense	57,500	
Supplies expense	15,600	
Depreciation expense	4,000	
Total expenses		77,100
Net loss		$ (2,500)
		(Tot. rev. – Tot. exp.)

FAIRVIEW CORPORATION
Retained Earnings Statement
For the Year Ended July 31, 2027

Retained earnings, August 1, 2026		$34,000
Less: Net loss	$2,500	
Dividends	4,000	6,500
Retained earnings, July 31, 2027		$27,500
		(Beg. ret. earn. – Net loss – Div.)

EXERCISE 2.7 (Continued)

(b)

FAIRVIEW CORPORATION
Balance Sheet
July 31, 2027

Assets		
Current assets		
Cash	$29,200	
Accounts receivable	9,780	
Total current assets		$38,980
Property, plant, and equipment		
Equipment	18,500	
Less: Accumulated depreciation—equipment	6,000	12,500
Total assets		$51,480

(Tot. current assets + Tot. prop., plant and equip.)

Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 4,100	
Salaries and wages payable	2,080	
Total current liabilities		$ 6,180
Long-term liabilities		
Notes payable		1,800
Total liabilities		7,980
Stockholders' equity		
Common stock	16,000	
Retained earnings	27,500	
Total stockholders' equity		43,500
Total liabilities and stockholders' equity		$51,480

(Tot. current liab. + Notes pay. + Tot. stock. equity)

LO 1 BT: AP Difficulty: Hard TOT: 15 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.8

RANDAL INC.
Balance Sheet (partial)
October 28, 2027
(in millions)

Liabilities and Stockholders' Equity

Current liabilities		
Accounts payable	$ 431.6	
Income taxes payable	14.8	
Unearned sales revenue	16.0	
Current portion of long-term debt	254.9	
Total current liabilities		$ 717.3
Long-term liabilities		
Long-term debt	$1,209.8	
Other long-term liabilities	122.6	
Total long-term liabilities		1,332.4
Total liabilities		2,049.7
Stockholders' equity		
Common stock	$ 642.4	
Retained earnings	979.8	
Total stockholders' equity		1,622.2
Total liabilities and stockholders' equity		$3,671.9

LO 1 BT: AP Difficulty: Medium Time: 20 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.9

a. Net income ....= Revenues – Expenses
= $183,040 – $158,680 – $4,550 – $5,200
= $14,610

Retained earnings = Beginning retained earnings + Net income – Dividends declared
= $116,520 + $14,610 – $0
= $131,130

EXERCISE 2.9 (Continued)

b.

SUMMIT LTD.
Balance Sheet
December 31, 2027

Assets			
Current assets			
Cash		$ 24,040	
Accounts receivable		20,780	
Supplies		1,240	
Prepaid insurance		1,420	
Total current assets			$47,480
Long-term investments			28,970
Property, plant, and equipment			
Land		194,000	
Buildings	$133,800		
Less: Accumulated depreciation	50,600	83,200	
Equipment	66,100		
Less: Accumulated depreciation	21,470	44,630	
Total property, plant, and equipment			321,830
Total assets			$398,280
Liabilities and Stockholders' Equity			
Current liabilities			
Accounts payable		$21,050	
Interest payable		2,100	
Current portion of mortgage payable		30,500	
Total current liabilities			$ 53,650
Mortgage payable ($104,000 – $30,500)			73,500
Total liabilities			127,150
Stockholders' equity			
Common stock		140,000	
Retained earnings		131,130	
Total stockholders' equity			271,130
Total liabilities and stockholders' equity			$398,280

LO 1 BT: AP Difficulty: M Time: 25 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.10

BATRA CORPORATION
Income Statement
Year Ended July 31, 2027

Revenues		
Service revenue	$113,600	
Rent revenue	18,500	
Total revenues		$132,100
Expenses		
Salaries and wages expense	44,700	
Operating expenses	32,500	
Rent expense	10,800	
Depreciation expense	3,000	
Utilities expense	2,600	
Interest expense	2,000	
Supplies expense	900	
Total expenses		96,500
Income before income tax		35,600
Income tax expense		5,000
Net Income		$30,600

[Revenues – Expenses = Net income or (loss)]

BATRA CORPORATION
Retained Earnings Statement
Year Ended July 31, 2027

Retained earnings, August 1, 2026	$17,940
Add: Net income	30,600
	48,540
Less: Dividends	12,000
Retained earnings, July 31, 2027	$36,540

EXERCISE 2.10 (Continued)

BATRA CORPORATION
Balance Sheet
July 31, 2027

Assets		
Current assets		
Cash	$ 5,060	
Debt investments (short-term)	20,000	
Accounts receivable	17,100	
Supplies	1,500	
Total current assets		$ 43,660
Property, plant, and equipment		
Equipment	62,900	
Less: Accumulated depreciation	6,000	
Total property, plant, and equipment		56,900
Total assets		$100,560
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 4,220	
Interest payable	1,000	
Unearned sales revenue	12,000	
Bank loan payable	21,800	
Total liabilities		$ 39,020
Stockholders' equity		
Common stock	25,000	
Retained earnings	36,540	
Total stockholders' equity		61,540
Total liabilities and stockholders' equity		$100,560

(Assets = Liabilities + Stockholders' equity)

LO 1 BT: AP Difficulty: M Time: 45 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.11

(a)

	Beginning of Year	End of Year
Working capital	\$3,361 – \$1,635 = \$1,726	\$3,217 – \$1,601 = \$1,616
Current ratio	$\frac{\$3,361}{\$1,635}$ = 2.06:1	$\frac{\$3,217}{\$1,601}$ = 2.01:1

(Current assets – Current liab.) and (Current assets ÷ Current liab.)

(b) Nordstrom's liquidity decreased slightly during the year. Its current ratio decreased from 2.06:1 to 2.01:1. Also, Nordstrom's working capital decreased by \$110 million.

(c) Nordstrom's current ratio at both the beginning and the end of the recent year exceeds Best Buy's current ratio for 2020 (and 2019). Nordstrom's end-of-year current ratio (2.01) exceeds Best Buy's 2020 current ratio (1.10*). Nordstrom would be considered much more liquid than Best Buy for the recent year.

***Per Illustration 2.6**

LO 2 BT: AP Difficulty: Medium TOT: 10 min. Difficulty: Analytic AICPA FC: Reporting

EXERCISE 2.12

(a) $$\text{Current ratio} = \frac{\$60,000}{\$30,000} = 2.0:1$$

(Current assets ÷ Current assets)

Working capital = $60,000 – $30,000 = $30,000

(Current assets – Current liab.)

(b) $$\text{Current ratio} = \frac{\$40,000^{*}}{\$10,000^{**}} = 4.0:1$$

(Current assets ÷ Current liab.)

Working capital = $40,000 – $10,000 = $30,000

(Current assets – Current liab.)

***$60,000 – $20,000 **$30,000 – $20,000**

(c) **Liquidity measures indicate a company's ability to pay current obligations as they become due. Satisfaction of current obligations usually requires the use of current assets.**

If a company has more current assets than current liabilities, it is more likely that it will meet obligations as they become due. Since working capital and the current ratio compare current assets to current liabilities, both are measures of liquidity.

Payment of current obligations frequently requires cash. Neither working capital nor the current ratio indicate the composition of current assets. If a company's current assets are largely comprised of items such as inventory and prepaid expenses, it may have difficulty paying current obligations even though its working capital and current ratio are large enough to indicate favorable liquidity. In Myeneke's case, payment of $20,000 of accounts payable will leave only $5,000 cash. Since salaries payable will require $10,000, the company may need to borrow in order to make the required payment for salaries and wages.

(d) **The CFO's decision to use $20,000 of cash to pay off accounts payable is not in itself unethical. However, doing so just to improve the year-end current ratio could be considered unethical if this action misled creditors. Since the CFO requested preparation of a "preliminary" balance sheet before deciding to pay off the liabilities he seems to be "managing" the company's financial position, which is usually considered unethical.**

LO 2 BT: AP Difficulty: Medium TOT: 15 min. Difficulty: Analytic AICPA FC: Reporting

EXERCISE 2.13

	2027	2026
(a) Current ratio (Current assets ÷ Current liab.)	$\frac{\$925,359}{\$401,763} = 2.30:1$	$\frac{\$1,020,834}{\$376,178} = 2.71:1$
(b) Debt to assets ratio (Tot. liab. ÷ Tot. assets)	$\frac{\$554,645}{\$1,963,676} = 28.2\%$	$\frac{\$527,216}{\$1,867,680} = 28.2\%$

(c) **Using the debt to assets ratio as a measure of solvency for American Eagle Outfitters shows that solvency remained constant from 2026 to 2027.**

LO 2 BT: AP Difficulty: Medium TOT: 15 min. Difficulty: Analytic AICPA FC: Reporting

SOLUTIONS TO PROBLEMS

PROBLEM 2.1

YAHOO! INC.
Balance Sheet
December 31, 2027
(Amounts are in millions)

Assets		
Current assets		
Cash	$ 2,292	
Debt investments	1,160	
Accounts receivable	1,061	
Prepaid rent	233	
Total current assets		$ 4,746
Long-term investments		
Stock investments		3,247
Property, plant, and equipment		
Equipment	1,737	
Less: Accumulated depreciation—equipment	201	1,536
Intangible assets		
Goodwill	3,927	
Patents	234	4,161
Total assets		$13,690

(Tot. current assets + L-T. Invest. + Tot. prop., plant, and equip. + Tot. intang. assets)

PROBLEM 2.1 (Continued)

Liabilities and Stockholders' Equity

Current liabilities		
Accounts payable	**$ 152**	
Unearned sales revenue	**413**	
Total current liabilities		**$ 565**
Long-term liabilities		
Notes payable		**734**
Total liabilities		**1,299**
Stockholders' equity		
Common stock	**6,283**	
Retained earnings	**6,108**	
Total stockholders' equity		**12,391**
Total liabilities and stockholders' equity		**$13,690**

(Tot. current liab. + L-T. liabl. + Com. stock + Ret. earn.)

LO 1 BT: AP Difficulty: Medium TOT: 12 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.2

MARTIN CORPORATION
Income Statement
For the Year Ended December 31, 2027

Revenues		
Service revenue		$68,000
Expenses		
Salaries and wages expense	$37,000	
Depreciation expense	3,600	
Insurance expense	2,200	
Utilities expense	2,000	
Maintenance and repairs expense	1,800	
Total expenses		46,600
Net income		$21,400

(Serv. rev. – Tot. exp.)

MARTIN CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2027

Retained earnings, January 1, 2027	$31,000
Add: Net income	21,400
	52,400
Less: Dividends	12,000
Retained earnings, December 31, 2027	$40,400

(Beg. ret. earn. + Net inc. – Div.)

PROBLEM 2.2 (Continued)

MARTIN CORPORATION
Balance Sheet
December 31, 2027

Assets		
Current assets		
Cash	$10,100	
Accounts receivable	11,700	
Prepaid insurance	3,500	
Total current assets		$25,300
Property, plant, and equipment		
Equipment	66,000	
Less: Accumulated depreciation—equipment	17,600	48,400
Total assets		$73,700

(Tot. current assets + Equip. – Acc. depr.-equip.)

Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$18,300	
Salaries and wages payable	3,000	
Total current liabilities		$21,300
Stockholders' equity		
Common stock	12,000	
Retained earnings	40,400	
Total stockholders' equity		52,400
Total liabilities and stockholders' equity		$73,700

(Tot. current liab. + Com stock + Ret. earn.)

LO 1 BT: AP Difficulty: Medium TOT: 15 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.3

(a)

LAZURIS ENTERPRISES
Income Statement
For the Year Ended April 30, 2027

Sales revenue		**$5,100**
Expenses		
Cost of goods sold	**$1,060**	
Salaries and wages expense	**700**	
Interest expense	**400**	
Depreciation expense	**335**	
Insurance expense	**210**	
Income tax expense	**165**	
Total expenses		**2,870**
Net income		**$2,230**

(Sales rev. – Tot. exp.)

LAZURIS ENTERPRISES
Retained Earnings Statement
For the Year Ended April 30, 2027

Retained earnings, May 1, 2026	**$1,600**
Add: Net income	**2,230**
	3,830
Less: Dividends	**325**
Retained earnings, April 30, 2027	**$3,505**

(Beg. ret. earn. + Net inc. – Div.)

PROBLEM 2.3 (Continued)

(b)

LAZURIS ENTERPRISES
Balance Sheet
April 30, 2027

Assets

Current assets			
Cash		$1,270	
Stock investments		1,200	
Accounts receivable		810	
Inventory		967	
Prepaid insurance		60	
Total current assets			$4,307
Property, plant, and equipment			
Land		3,100	
Equipment	$2,420		
Less: Accumulated depreciation—equipment	670	1,750	4,850
Total assets			$9,157

(Tot. current assets + Land + Equip. – Acc. depr.-equip.)

Liabilities and Stockholders' Equity

Current liabilities		
Notes payable	$ 61	
Accounts payable	834	
Salaries and wages payable	222	
Income taxes payable	135	
Total current liabilities		$1,252
Long-term liabilities		
Mortgage payable		3,500
Total liabilities		4,752
Stockholders' equity		
Common stock	900	
Retained earnings	3,505	
Total stockholders' equity		4,405
Total liabilities and stockholders' equity		$9,157

(Tot. current liab. + Mort. pay. + Com. stock + Ret. earn.)

LO 1 BT: AP Difficulty: Medium TOT: 15 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.4

(a) Loeb appears to be more liquid. Loeb's 2027 working capital of \$340,875 (\$407,200 – \$66,325) is more than twice as high as Bowsh's working capital of \$156,620 (\$190,336 – \$33,716). In addition, Loeb's 2027 current ratio of 6.1:1 (\$407,200 ÷ \$66,325) is higher than Bowsh's current ratio of 5.6:1 (\$190,336 ÷ \$33,716).

(b) Loeb appears to be slightly more solvent. Loeb's 2027 debt to assets ratio of 18.6% (\$174,825 ÷ \$939,200)[a] is lower than Bowsh's ratio of 22.5% (\$74,400 ÷ \$330,064)[b]. The lower the percentage of debt to assets, the lower the risk is that a company may be unable to pay its debts as they come due.

[a]<u>\$174,825</u> (\$66,325 + \$108,500) is Loeb's 2027 total liabilities.
<u>\$939,200</u> (\$407,200 + \$532,000) is Loeb's 2027 total assets.

[b]<u>\$74,400</u> (\$33,716 + \$40,684) is Bowsh's 2027 total liabilities.
<u>\$330,064</u> (\$190,336 + \$139,728) is Bowsh's 2027 total assets.

LO 2 BT: AN Difficulty: Hard TOT: 15 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.5

(a) (i) Working capital = \$458,900 – \$195,500 = \$263,400.

(Current assets – Current liab.)

(ii) Current ratio = $\frac{\$458,900}{\$195,500}$ **= 2.35:1.**

(Current assets ÷ Current liab.)

(iII) Debt to assets ratio = $\frac{\$395,500}{\$1,034,200}$ **= 38.2%.**

(Tot. liab. ÷ Tot. assets)

(b) During 2027, the company's current ratio increased from 1.65:1 to 2.35:1 and its working capital increased from \$160,500 to \$263,400. Both measures indicate an improvement in liquidity during 2027.

The company's debt to assets ratio increased from 31.0% in 2026 to 38.2% in 2027 indicating that the company is less solvent in 2027.

LO 2 BT: AP Difficulty: Medium TOT: 15 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.6

	2026	2027
(a) Working capital.		
	(\$20,000 + \$62,000 + \$73,000) – \$70,000 = \$85,000	**(\$28,000 + \$70,000 + \$90,000) – \$75,000 = \$113,000**
	(Current assets – Current liab.)	
(b) Current ratio.		
	$\dfrac{\$155{,}000}{\$70{,}000} = 2.2:1$	$\dfrac{\$188{,}000}{\$75{,}000} = 2.5:1$
	(Current assets ÷ Current liab.)	
(c) Debt to assets ratio.		
	$\dfrac{\$160{,}000}{\$685{,}000} = 23.4\%$	$\dfrac{\$155{,}000}{\$760{,}000} = 20.4\%$
	(Tot. liab. ÷ Tot. assets)	

(d) The liquidity of the corporation as shown by the working capital and the current ratio has improved slightly. Also, the corporation improved its solvency by improving its debt to assets ratio.

LO 2 BT: AP Difficulty: Medium TOT: 20 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.7

	Ratio	Target	Walmart
		(All Dollars are in Millions)	
(a)	**Working capital**	**\$17,488 – \$10,512 = \$6,976**	**\$48,949 – \$55,390 = (\$6,441)**
		(Current assets – Current liab.)	
(b)	**Current ratio**	**1.66:1 (\$17,488 ÷ \$10,512)**	**0.88:1 (\$48,949 ÷ \$55,390)**
		(Current assets ÷ Current liab.)	
(c)	**Debt to assets ratio**	**68.9% (\$30,394 ÷ \$44,106)**	**60% (\$98,144 ÷ \$163,429)**
		(Tot. liab. ÷ Tot. assets)	

(d) The comparison of the two companies shows the following:

Liquidity—Target's current ratio of 1.66:1 is much better than Walmart's 0.88:1 and Target has significantly higher working capital than Walmart.

Solvency—Walmart's debt to assets ratio is lower than Target's, indicating that Walmart is more solvent than Target.

LO 2 BT: AP Difficulty: Medium TOT: 20 min. AACSB: Analytic AICPA FC: Reporting

CT2.1 FINANCIAL REPORTING PROBLEM

(a) **Total current assets were $143,713 million at September 26, 2020, and $162,819 million at September 28, 2019.**

(b) **Current assets are properly listed in the order of liquidity. As you will learn in a later chapter, inventories are considered to be less liquid than receivables. Thus, they are listed below receivables and before prepaid expenses.**

(c) **The asset classifications are similar to the text: (a) current assets, (b) long-term marketable securities, (c) property, plant, and equipment, and (d) other non-current assets.**

(d) **Total current liabilities were $105,392 million at September 26, 2020, and $105,718 million at September 28, 2019.**

LO 1 BT: AP Difficulty: Medium TOT: 8 min. AACSB: Analytic AICPA FC: Reporting

CT2.2 COMPARATIVE ANALYSIS PROBLEM

(a)

($ in thousands)	Columbia Sportswear	Under Armour
1. Working capital	$1,855,621 – $552,622 = $1,302,999 (Current assets – Current liab.)	$3,222,975 – $1,413,276 = $1,809,699
2. Current ratio	$1,855,621 ÷ $552,622 = 3.36:1 (Current assets ÷ Current liab.)	$3,222,975 ÷ $1,413,276 = 2.28:1
3. Debt to assets ratio	$1,003,800 ÷ $2,836,571 = 35.4% (Tot. liab. ÷ Tot. assets)	$3,354,635 ÷ $5,030,628 = 66.7%

(b) ***Liquidity***

Under Armour appears more liquid since it has more working capital than Columbia; however, looking at the current ratios, we see that Columbia's ratio is greater than that of Under Armour.

Solvency

Based on the debt to assets ratio, Columbia is more solvent. Columbia's debt to assets ratio is significantly lower than Under Armour's and, therefore, Columbia would be considered better able to pay its debts as they come due.

LO 2 BT: AN Difficulty: Hard TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

CT2.3 INTERPRETING FINANCIAL STATEMENTS

(a) **The percentage decrease in Gap's total assets during this period is calculated as:**

$$\frac{\$7{,}065 - \$8{,}544}{\$8{,}544} = (17.3\%)$$

The average decrease per year can be approximated as:

$$\frac{(17.3\%)}{4 \text{ years}} = (4.3\%) \text{ per year}$$

(2027 Total assets – 2023 Total assets) ÷ 2023 Total assets)

(b) **Gap's working capital and current ratio decreased (2024), increased (2025 and 2026) and then decreased (2027) during this period, indicating a decline, an improvement and then another decline in liquidity. The current ratio is a better measure of liquidity because it provides a relative measure; that is, current assets compared to current liabilities. Working capital only tells us the net amount of current assets less current liabilities. It is hard to say whether a given amount of working capital is adequate or inadequate without knowing the size of the company.**

(c) **The debt to assets ratio suggests that Gap's solvency didn't change much during the period. Debt to assets was 0.39 in 2023, rose to 0.45 in 2024 and then bounced between 0.39 and 0.42 the next three years.**

LO 2 BT: AN Difficulty: Hard TOT: 15 min. AACSB: Analytic AICPA FC: Reporting

REAL-WORLD FOCUS

CT2.4

Answers will vary depending on the company chosen and the date.
LO 2 BT: AN Difficulty: Hard TOT: 20 min. AACSB: Analytic and Technology AICPA AC: Reporting

CT2.5

Answers will vary depending on the company chosen and the date.
LO 1, 2 BT: E Difficulty: Hard TOT: 25 min. AACSB: Analytic, Technology AICPA FC: Reporting AICPA BB: Critical Thinking

CT2.6 DECISION MAKING ACROSS THE ORGANIZATION

The current ratio increase is a favorable indication as to liquidity, but alone tells little about the prospects of the client. From this ratio change alone, it is impossible to know the amount and direction of the changes in individual accounts, total current assets, and total current liabilities. Also unknown are the reasons for the changes.

The working capital increase is also a favorable indication as to liquidity, but again the amount and direction of the changes in individual current assets and current liabilities cannot be determined from this measure.

The decrease in the debt to assets ratio is a favorable indicator for solvency and going-concern prospects. The lower the percentage of debt to assets, the lower the risk that a company may be unable to pay its debts as they come due. A decline in the debt to assets ratio is also a positive sign regarding going-concern potential.

The increase in net income is a favorable indicator for both solvency and profitability prospects although much depends on the quality of receivables generated from sales and how quickly they can be converted into cash. A significant factor here may be that despite a decline in sales the client's management has been able to reduce costs to produce this increase. Indirectly, the improved income picture may have a favorable impact on solvency and going-concern potential by enabling the client to borrow currently to meet cash requirements.

LO 2 BT: E Difficulty: Hard TOT: 20 min. AACSB: Communication AICPA PC: Interaction, Leadership, and Communication

CT2.7 COMMUNICATION ACTIVITY

To: BPPalmer@FutureProducts.com

From: AStudent@StateUniversity.edu

Subject: Financial Statement Analysis

(a) Ratios can be classified into three types, which measure three different aspects of a company's financial health:

1. Liquidity ratios—These measure a company's ability to pay its current obligations.

2. Solvency ratios—These measure a company's ability to pay its long-term obligations and survive over the long-term.

3. Profitability ratios—These measure the ability of the company to generate a profit.

(b) 1. Examples of liquidity measures are:

Working capital = Current assets – Current liabilities
Indicates the absolute differences between a company's current assets and its current liabilities.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Indicates the relative amount of current assets available to cover each dollar of current liabilities.

2. Example of solvency measures are:

$$\text{Debt to assets ratio} = \frac{\text{Total liabilities}}{\text{Total assets}}$$

Measures the percentage of total financing provided by creditors instead of stockholders.

CT2.7 (Continued)

(c) There are three bases for comparing a company's results:

The bases of comparison are:

1. **Intracompany—This basis compares an item or financial relationship within a company in the current year with the same item or relationship in one or more prior years.**

2. **Industry averages—This basis compares an item or financial relationship of a company with industry averages (or norms).**

3. **Intercompany—This basis compares an item or financial relationship of one company with the same item or relationship in one or more competing companies.**

LO 2 BT: AP Difficulty: Medium TOT: 18 min. AACSB: Communication AICPA PC: Communication

CT2.8 ETHICS CASE

(a) The stakeholders in this case are: Boeing's management; CEO, public relations manager, Boeing's stockholders, McDonnell Douglas stockholders, other users of the financial statements; especially potential investors of the new combined company.

(b) The ethical issues center around full disclosure of financial information. Management attempted to "time" the release of bad news in order to complete a merger that would have been revoked if cost overruns had been disclosed as soon as management became aware of them.

(c) It is not ethical to "time" the release of bad news. GAAP requires that all significant financial information be released to allow users to make informed decisions.

(d) Answers will vary. One possibility: Release the information regarding cost overruns as it became available. Describe the causes of such overruns and explain how Boeing would address them (probably by improving production methods to eliminate the inefficiencies alluded to in the text).

(e) Investors and analysts should be aware that Boeing's management will probably "manage" information in the future in ways that will interfere with full disclosure.

LO 3 BT: E Difficulty: Hard TOT: 20 min. AACSB: Ethics AICPA FC: Reporting AICPA PC: Professional Demeanor

CT2.9 ALL ABOUT YOU

Answers will vary.

LO - BT: S Difficulty: Hard TOT: 30 min. AACSB: Communication AICPA BB: Critical Thinking AICPA PC: Communication

CT2.10 CONSIDERING ENVIRONMENTAL, SOCIAL, AND GOVERNANCE REPORTING

(a) The existence of different forms of certification would most likely create confusion for coffee purchasers. It would be difficult to know what aspects of the coffee growing process each certification covered. Similarly, if there were multiple groups that certified financial statements, each with different criteria, it would be difficult for financial statement users to know what each certification promised.

(b) The certifications have multiple objectives including organic farming as a means to protect bird species, biodiversity and wildlife habitat. Some included requirements are to improve workers' living conditions, ensure that farmers are paid a premium over costs that will allow them to make a profit, provide running water in worker housing, child labor regulations and education requirements. Certifications can also be financially beneficial because companies can benefit from the positive public relations effects of either producing or buying coffee produced using sustainable practices.

LO - BT: S Difficulty: Hard TOT: 30 min. AACSB: Technology and Communication AICPA FC: Measurement and Reporting AICPA BB:Resource Management

