Solutions Manual for Accounting Tools for Business Decision Making 8th Kimmel

CASE 2

1. **ABC is beneficial when traditional overhead allocation results in inaccurate product costing. Wall Dêcor should investigate the product costing system because in order to sell the unframed prints the stores must mark them up only slightly above their cost, while the framed prints enjoy a large profit margin. Traditional overhead allocation often results in inappropriate overhead allocation when one product is a high-volume item (in this case, the unframed prints) and another product is a more complex, low-volume item (in this case, the framed prints).**

   Another indication that ABC would be beneficial occurs when company managers have begun to develop their own costing systems because they have lost faith in the traditional system. In this case, the production manager does not have faith in the company's costing system and instead has developed her own costing system.

2. **The activity-based overhead rates can be calculated by dividing the estimated overhead associated with each activity by the expected use of the cost driver.**

CASE 2 (Continued)

Activity	Cost Driver	Estimated Overhead	Expected Use of Cost Driver	Activity-Based Overhead Rate
Picking prints	Number of prints	$ 30,600	(80,000 + 15,000 + 7,000) = 102,000 prints	$0.30 per pick
Inventory selection and management	Number of components: Print (1) Print and frame (2) Print, mat, and frame (3)	$ 91,700	Prints: 80,000 components Print and frame: 15,000 × 2 = 30,000 components Print, mat, and frame: 7,000 × 3 = 21,000 components Total = 131,000 components	$0.70 per component
Website optimization	Number of prints at capacity			
Unframed		$ 25,800	Unframed prints—100,000 print capacity	$0.258 per print
Framed		$103,200	Framed or framed and matted prints—25,000 capacity	$4.128 per framed or framed and matted print
Framing and matting	Number of components at capacity	$123,900	Print and frame: 16,000 × 2 = 32,000 components at capacity Print, mat, and frame: 9,000 × 3 = 27,000 components at capacity Total = 59,000 components	$2.10 per component
		$375,200		

CASE 2 (Continued)

3.

Description	Lance Armstrong Print	John Elway Steel-Framed Print, No Matting	Lambeau Field Wood-Framed Print, with Matting
Direct materials			
Print	$12.00	$16.00	$20.00
Frame and glass		4.00	6.00
Matting			4.00
Total	12.00	20.00	30.00
Direct labor			
Picking			
([10/60] × $12)	2.00	2.00	2.00
Matting and framing			
([20/60] × $21)		7.00	
([30/60] × $21)			10.50
Total	2.00	9.00	12.50
Manufacturing overhead by activity			
Picking prints			
@ $0.30 per pick	0.30	0.30	0.30
Inventory selection and management			
@ $0.70 per component (1, 2, and 3)	0.70	1.40	2.10
Website optimization			
@ $0.258 per print	0.258	0.00	0.00
@ $4.128 per framed or framed and matted		4.128	4.128
Framing and matting			
@ $2.10 per component		4.20	6.30
Total	1.258	10.028	12.828
Total product cost	$15.258	$39.028	$55.328

4. **In Case 1 the high-volume prints consumed the greatest amount of overhead because it was assumed all manufacturing overhead was driven by print cost combined with sales volume, regardless of the mix of unframed prints and framed prints. Since far more unframed prints were sold, most of the overhead was allocated to unframed prints.**

Under ABC, this changes. Although still based on estimates, ABC first provides an analysis of how resources were consumed by activity. Next, in the second step of allocation, activity costs are allocated to unframed prints and framed prints using different types of drivers. These drivers are designed to model how manufacturing overhead resources were consumed at the product level. For example, the last activity (framing and matting) is allocated to framed items only. The reason is that unframed prints do not consume framing and matting equipment, space, and general overhead resources.

The primary implication for the company is that the product costs will be more accurate, which will result in better product pricing and more accurate evaluation of the relative profitability of the products.

5. There are some costs that are very difficult to allocate because it is difficult to determine a meaningful cost driver that captures differences across products. Time and resources dedicated to web optimization for an integrated system fall into this category. In this case, in order to reflect the significant difference between the amount of time spent on web optimization by the IT staff on unframed prints versus framed prints, the total cost of web optimization was first split between these two categories. Time of IT staff was used to subdivide the cost by resource consumption between unframed prints and framed prints. This allocation, although it may appear simple, is sometimes very difficult to accomplish in the real world. Once identified, management can see that much of IT's resources are being consumed by framed and matted items.

6. The advantage of ABC versus traditional predetermined overhead allocation is that ABC allocates costs based on the activities that generate those costs. This results in more accurate product costing. By breaking costs down into more refined categories, product costing will be even more accurate. However, having more categories is costly from a record-keeping perspective. Increasingly, there is an effort by ABC consultants to "keep it simple" so as to reduce the cost of implementing ABC. It is believed that many of the benefits of ABC can be attained with relatively simple systems.

7. By allocating fixed overhead costs using operating capacity as the basis, management can see how much, approximately, each item costs at capacity. Although this is somewhat arbitrary, it does provide a benchmark for comparability and improvement. The advantage is that management can manage costs based on a standard.

   If expected sales volume is used to allocate fixed overhead costs, then the allocation rate will fluctuate as sales fluctuate. This reduces the usefulness of analysis across years and makes planning very difficult. In fact, it can result in a vicious cycle: As volume decreases, the fixed cost per unit goes up, so product cost goes up. In response, management raises prices (because the product cost has risen). When the price rises, volume falls even further, and the cycle starts over again. Keep in mind that costs must be controlled at the activity level. Therefore, an activity cost at a standard is what is necessary for measurement, resource allocation, and evaluation. By allocating based on capacity these fluctuations can be eliminated (as long as capacity doesn't vary). Therefore, the use of operating capacity for allocating fixed overhead costs can result in better decision making.

8. (a) The allocation of the overhead to the three product categories would be as follows:

Unframed prints

Activity Cost Pool	Expected Use of Cost Driver	Overhead Rate	Cost Assigned
Picking prints	80,000	$0.30	$ 24,000
Inventory selection management	80,000	0.70	56,000
Website optimization	80,000	0.258	20,640
Framing and matting	na		
Total			$100,640

Steel-framed prints

Activity Cost Pool	Expected Use of Cost Driver	Overhead Rate	Cost Assigned
Picking prints	15,000	$0.30	$ 4,500
Inventory selection management	30,000	0.70	21,000
Website optimization	15,000	4.128	61,920
Framing and matting	30,000	2.10	63,000
Total			$150,420

CASE 2 (Continued)

Wood-framed prints with matting

Activity Cost Pool	Expected Use of Cost Driver	Overhead Rate	Cost Assigned
Picking prints	7,000	$0.30	$ 2,100
Inventory selection management	21,000	0.70	14,700
Website optimization	7,000	4.128	28,896
Framing and matting	21,000	2.10	44,100
Total			$89,796

(b) The total overhead allocated was $340,856, ($100,640 + $150,420 + $89,796). This is $34,344 less than the total overhead of $375,200. The overhead rates for website optimization and framing and matting were both determined using the capacity amount rather than the expected sales amount. The reasons for this were discussed earlier. Since expected/ actual sales were less than capacity, the overhead is underapplied. This cost of $34,344 can be viewed as the cost of operating at less than capacity. In order to reduce this amount, management should either figure out ways to increase sales or reduce fixed costs by shifting resources to other products.

Chapter Two

Challenge Exercise 1

LO: 1, 2

These items were taken from the financial statements of Bush Company at December 31, 2022:

Buildings	$105,800	Common stock (20,000 shares)	$60,000
Accounts receivable	15,600	Retained earnings (1/1/22)	40,000
Prepaid insurance	3,200	Accumulated depreciation-buildings	45,800
Cash	11,800	Accounts payable	8,500
Equipment	82,720	Notes payable	93,600
Land	61,000	Accumulated depreciation-equipment	18,720
Insurance expense	700	Interest payable	3,600
Depreciation expense	4,900	Service revenue	17,700
Interest expense	2,200		

Instructions
(a) Prepare a classified balance sheet. Assume that $16,300 of the note payable will be paid in 2022.
(b) Compute the following: (1) working capital, (2) current ratio, (3) debt to assets ratio, and (4) earnings per share.

Challenge Exercise 1 – Solution

(a)

BUSH COMPANY
Balance Sheet
December 31, 2022
Assets

Current assets				
Cash			$11,800	
Accounts receivable		15,600		
Prepaid insurance			3,200	
Total current assets				$ 30,600
Property, plant, and equipment				
Land			61,000	
Buildings	$105,800			
Less: Accumulated depreciation—buildings	45,800	60,000		
Equipment	82,720			
Less: Accumulated depreciation—equipment	18,720	64,000	185,000	
Total assets				$215,600

Liabilities and Stockholders' Equity

Current liabilities			
Accounts payable	$ 8,500		
Current maturity of note payable	16,300		
Interest payable		3,600	
Total current liabilities			$ 28,400
Long-term liabilities			
Note payable ($93,600 – $16,300)			77,300
Total liabilities			105,700
Stockholders' equity			
Common stock		60,000	
Retained earnings ($40,000 + $9,900*)		49,900	
Total stockholders' equity			109,900
Total liabilities and stockholders' equity			$215,600

* Net income = $17,700 - $700 - $4,900 - $2,200 = $9,900

(b) (1) Working capital: $30,600 - $28,400 = $2,200

(2) Current ratio: $30,600 ÷ $28,400 = 1.08 : 1

(3) Debt to assets ratio: $105,700 ÷ $215,600 = 49%

(4) Earnings per share: $9,900 ÷ 20,000 shares = $0.495 per share

Challenge Exercise 2

LO: 3

Mendez Company had three major business transactions during 2022.

(a) Security investments with a market value of $10,000 were reported in the financial statements at their original cost $9,300.
(b) The death of the company's Chief Executive Officer was reported as a $1,000,000 loss in the company's income statement.
(c) The annual report did not include any notes to the financial statements.

Instructions
In each situation, identify the assumption or principle that has been violated, if any, and discuss what the company should have done.

Challenge Exercise 2 – Solution

(a) This is a violation of the fair value principle. Security investments should be reported at their fair market value in the financial statements.

(b) This is a violation of the monetary unit assumption. Only those transactions that can be measured in dollars and cents are recorded and reported in the financial statements. The death of the CEO should be reported in a news release and possibly in the management discussion and analysis section of the annual report.

(c) This is a violation of the full disclosure principle. All information capable of making a difference in financial statement users' decision-making should be disclosed in the financial statements. The notes to the financial statements are an integral part of the financial statements, and should be included.

Chapter Two

Challenge Exercise 1

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Total liabilities			105,700
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Total liabilities and stockholders' equity			$215,600

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CHAPTER 2

A Further Look at Financial Statements

Learning Objectives

1. Identify the sections of a classified balance sheet.
2. Use ratios to evaluate a company's profitability, liquidity, and solvency.
3. Discuss financial reporting concepts.

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—to purchase inventory, sell it on account, and then collect cash from customers..

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

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 companies where the conversion into cash is not expected within one year or the operating cycle, whichever is longer, and plant assets not currently in operational use. Property, plant, and equipment are tangible resources of a relatively permanent nature that are being used in the business and not intended for sale.

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) and (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. (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

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

   (b) Solvency ratios: Debt to assets and free cash flow.

   (c) Profitability ratio: Earnings per share.

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

8. 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

9. (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

10. (a) The increase in earnings per share is good news because it means that profitability has improved.

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

(c) 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

11. (a) The debt to assets ratio and free cash flow indicate the company's ability to repay the face value of the debt at maturity and make periodic interest payments.

(b) The current ratio and working capital indicate a company's liquidity and short-term debt-paying ability.

(c) Earnings per share indicates the earning power (profitability) of an investment.

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

12. (a) Generally accepted accounting principles (GAAP) are a set of rules and practices, having substantial support, that are recognized as a general guide for financial reporting purposes.

(b) The body that provides authoritative support for GAAP is the Financial Accounting Standards Board (FASB).

LO 3 BT: K Diff: E TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

13. (a) The primary objective of financial reporting is to provide information useful for decision making.

(b) The fundamental qualitative characteristics are relevance and faithful representation. The enhancing qualities are comparability, consistency, verifiability, timeliness, and understandability.

LO 3 BT: K Diff: M TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

14. Dietz is correct. Consistency means using the same accounting principles and accounting methods from period to period within a company. Without consistency in the application of accounting principles, it is difficult to determine whether a company is better off, worse off, or the same from period to period.

LO 3 BT: AN Diff: M TOT: 2 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation, Reporting

15. Comparability results when different companies use the same accounting principles. Consistency means using the same accounting principles and methods from year to year within the same company.

LO 3 BT: C Diff: E TOT: 1 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

16. The cost constraint allows accounting standard-setters to weigh the cost that companies will incur to provide information against the benefit that financial statement users will gain from having the information available.

LO 3 BT: K Diff: E TOT: 1 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

17. Accounting standards are not uniform because individual countries have separate standard-setting bodies. Currently many non-U.S. countries are choosing to adopt International Financial Reporting Standards (IFRS). Accounting standards in the United States are converging towards IFRS.

LO 3 BT: C Diff: M TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

18. Accounting relies primarily on two measurement principles. Fair value is sometimes used when market price information is readily available. However, in many situations reliable market price information is not available. In these instances, accounting relies on historical cost as its basis.

LO 3 BT: C Diff: M TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

19. The economic entity assumption states that every economic entity can be separately identified and accounted for. This assumption requires that the activities of the entity be kept separate and distinct from (1) the activities of its owners (the shareholders) and (2) all other economic entities. A shareholder of a company charging personal living costs as expenses of the company is an example of a violation of the economic entity assumption.

LO 3 BT: C Diff: M TOT: 3 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

20. At September 26, 2020 Apple's largest current asset was marketable securities of $52,927 million, its largest current liability was other current liabilities of $42,684 million and its largest item under "Assets" was non-current marketable securities of $100,887 million.

LO 1 BT: C Diff: M TOT: 5 min. AACSB: None AICPA FC: Reporting

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 2.1

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

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

BRIEF EXERCISE 2.2

Identify the order of asset classifications.

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 2.3

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 2.4

$$\text{Earnings per share} = \frac{\text{Net income} - \text{Preferred dividends}}{\text{Average common shares outstanding}}$$

$$= \frac{\$220 \text{ million} - \$0}{333 \text{ million shares}} = \$.66 \text{ per share}$$

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

BRIEF EXERCISE 2.5

Working capital = Current assets – Current liabilities

Current assets	$102,500,000
Current liabilities	201,200,000
Working capital	($ 98,700,000)

Current ratio:

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

$$= .51:1$$

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

BRIEF EXERCISE 2.6

(a) $\text{Current ratio} = \dfrac{\text{Current assets}}{\text{Current liabilities}} \qquad \dfrac{\$262{,}787}{\$293{,}625} = 0.89:1$

(b) $\text{Debt to assets} = \dfrac{\text{Total liabilities}}{\text{Total assets}} \qquad \dfrac{\$376{,}002}{\$439{,}832} = 85.5\%$

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

BRIEF EXERCISE 2.7

(a) True.
(b) False. The primary standard-setting body in the U.S. is the FASB.

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.8

(a) Predictive value.
(b) Confirmatory value.
(c) Materiality.
(d) Complete.
(e) Free from error.
(f) Comparability.
(g) Verifiability.
(h) Timeliness.

LO 3 BT: K Difficulty: Easy TOT: 3 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.9

(a) Relevant.
(b) Faithful representation.
(c) Consistency.

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.10

(a) 1. Predictive value.
(b) 2. Neutral.
(c) 3. Verifiable.
(d) 4. Timely.

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.11

(c) financial statements should disclose sufficient detail regarding events and circumstances that would make a difference to users of financial statements.

LO 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

SOLUTIONS TO DO IT! EXERCISES

DO IT! 2.1a

MYLAR CORPORATION
Balance Sheet (partial)
December 31, 2025

Assets		
Current assets		
Cash	$ 13,000	
Accounts receivable	22,000	
Inventory	58,000	
Supplies	7,000	
Total current assets		$100,000
Long-term investments		
Stock-investments		1,900
Property, plant, and equipment		
Equipment	180,000	
Less: Accumulated depreciation—equipment	50,000	130,000
Intangible assets		
Goodwill		4,100
Total assets		$236,000

(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets = Tot. assets)
[($13,000 + $22,000 + $58,000 + $7,000) + $1,900 + ($180,000 – $50,000) + $4,100 = $236,000]
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: AP Difficulty: Easy TOT: 3 min. AACSB: Analytic AICPA FC: Reporting

DO IT! 2.2

(a)

2025	2024
$\frac{(\$80{,}000 - \$6{,}000)}{(40{,}000 + 75{,}000)/2} = \$1.29$	$\frac{(\$40{,}000 - \$6{,}000)}{(30{,}000 + 40{,}000)/2} = \$0.97$

Nguoi's profitability, as measured by the amount of income available for each share of common stock, increased by 33 percent (($1.29 – $0.97)/$0.97) during 2025. Earnings per share should not be compared across companies because the number of shares issued by companies varies widely. Thus, we cannot conclude that Nguoi Corporation is more profitable than Matisse Corporation based on its higher EPS in 2025.

$$\frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Average Common Shares Outstanding}}$$

(b)

	2025	2024
Current ratio	$\frac{\$54{,}000}{\$22{,}000} = 2.45{:}1$	$\frac{\$36{,}000}{\$30{,}000} = 1.20{:}1$

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

	2025	2024
Debt to assets ratio	$\frac{\$72{,}000}{\$240{,}000} = 30\%$	$\frac{\$100{,}000}{\$205{,}000} = 49\%$

$$\frac{\text{Total liabilities}}{\text{Total assets}}$$

The company's liquidity, as measured by the current ratio improved from 1.20:1 to 2.45:1. Its solvency also improved, because the debt to assets ratio declined from 49% to 30%.

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

DO IT! 2.3

1. **Monetary unit assumption**
2. **Faithful representation**
3. **Economic entity assumption**
4. **Cost constraint**
5. **Consistency**
6. **Historical cost principle**
7. **Relevance**
8. **Periodicity assumption**
9. **Full disclosure principle**
10. **Materiality**
11. **Going concern assumption**
12. **Comparability**

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

EXERCISE 2.3

BOEING COMPANY
Partial Balance Sheet
December 31, 2025
(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

[(Cash + Debt invest. + Accts. rec. + Notes rec. + Inv.) + Notes rec. + (Bldgs. – Accum. depr.-bldgs.) + Patents = Tot. assets]
[($9,215 + $2,008 + $5,785 + $368 + $16,933)) + $5,466 + ($21,579 – $12,795) + $12,528 = $61,087]
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, 2025
(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

[(Cash + Accts. rec. + Inv. + Prepd. ins.) + (Land + (Bldgs. – Accum. depr.-bldgs.)) + (Goodwill + Trademarks) = Tot. assets]
[($373,145 + $1,171,797 + $1,237,613 + $125,765) + ($76,193 + ($4,033,369 – $2,131,260)) + ($3,982,954 + $757,907) = $9,627,483]
LO 1 BT: AP Difficulty: Medium TOT: 5 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.5

LONGHORN CO.
Balance Sheet
December 31, 2025

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
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

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

[(Current assets + Prop., plant & equip.) = Current liabl. + Long-term liabl. + SE)]
[(($11,840 + $12,600 + $3,200) + ($61,200 + ($105,800 – $45,600) + ($82,400 – $18,720))) = (($9,500 + $13,600 + $3,600) + $80,000 + ($60,000 + $46,020))

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

EXERCISE 2.6

CARMEN CO.
Balance Sheet
December 31, 2025

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

*($691,400 − $121,400 = $570,000)
**($570,000 – $75,000)

[(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets) = (Current liabl. + L-T liabl. + 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

TEXAS INSTRUMENTS, INC.
Balance Sheet
December 31, 2025
(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
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

[(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets) = (Current liabl. + L-T liabl. + SE)]
[(($1,182 + $1,743 + $1,823 + $1,202 + $164) + $637 + ($6,705 – $3,547) + $2,210) = (($1,459 + $128) + $810 + ($2,826 + $6,896))]
LO 1 BT: AP Difficulty: Medium TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.8

RANDAL INC.
Balance Sheet (partial)
October 28, 2025
(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, 2025

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, 2025

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, 2025

Retained earnings,, August 1, 2024		$17,940
Add: Net income		30,600
	48,540	
Less: Dividends		12,000
Retained earnings, July 31, 2025		$36,540

EXERCISE 2.10 (Continued)

BATRA CORPORATION
Balance Sheet
July 31, 2025

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) Earnings per share = $\dfrac{\text{Net income} - \text{Preferred dividends}}{\text{Average common shares outstanding}}$

2025: $\dfrac{\$66{,}176{,}000 - 0}{(66{,}282{,}000 + 64{,}507{,}000) / 2} = \$\ 1.01$

2024: $\dfrac{\$54{,}587{,}000 - 0}{(73{,}139{,}000 + 66{,}282{,}000) / 2} = \$\ .78$

(b) Using net income (loss) as a basis to evaluate profitability, Callaway Golf's income improved by 21% [($66,176 – $54,587) ÷ $54,587] between 2024 and 2025. Its earnings per share increased by 29% [($1.01 – $0.78) ÷ $0.78].

(c) To determine earnings per share, dividends on preferred stock are subtracted from net income, but dividends on common stock are not subtracted.

LO 2 BT: AP Difficulty: Medium TOT: 7 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.12

(a)

FAIRVIEW CORPORATION
Income Statement
For the Year Ended July 31, 2025

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. = Net loss)
[($66,100 + $8,500) – ($57,500 + $15,600 + $4,000) = ($2,500)]

FAIRVIEW CORPORATION
Retained Earnings Statement
For the Year Ended July 31, 2025

Retained earnings, August 1, 2024		$34,000
Less: Net loss	$2,500	
Dividends	4,000	6,500
Retained earnings, July 31, 2025		$27,500

(Beg. ret. earn. – (Net loss + Div.)= End. ret. earn.)
[$34,000 – ($2,500 + $4,000) = $27,500]

EXERCISE 2.12 (Continued)

(b)

FAIRVIEW CORPORATION
Balance Sheet
July 31, 2025

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

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

[(Current assets + Prop., plant, & equip.) = (Current liabl. + L-T liabl. + SE)]

[(($29,200 + $9,780) + ($18,500 – $6,000)) = (($4,100 + $2,080) + $1,800 + ($16,000 + $27,500))]

(c)

$$\text{Current ratio} = \frac{\$38{,}980}{\$6{,}180} = 6.3:1$$

$$\text{Debt to assets ratio} = \frac{\$7{,}980}{\$51{,}480} = 15.5\%$$

(Current assets ÷ Current liabl.) and (Tot. liabl.÷ Tot. assets)

($38,980 ÷ $6,180) and ($7,980 ÷ $51,480)

EXERCISE 2.12 (Continued)

(d) The current ratio would not change because equipment is not a current asset and a 5-year note payable is a long-term liability rather than a current liability.

The debt to assets ratio would increase from 15.5% to 39.1%*.

Looking solely at the debt to assets ratio, I would favor making the sale because Fairview's debt to assets ratio of 15.5% is very low. Looking at additional financial data, I would note that Fairview reported a loss for the current year which would lead me to question its ability to make interest and loan payments (and even remain in business) in the future. I would not make the proposed sale unless Fairview convinced me that it would be capable of earnings in the future rather than losses.

I would also consider making the sale but requiring a substantial down-payment and smaller note.

*($7,980 + $20,000) ÷ ($51,480 + $20,000)

LO 1, 2 BT: AP Difficulty: Hard TOT: 20 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.13

(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 liabl.) and (Current assets ÷ Current liabl.)
[Beg. of yr.: ($3,361 – $1,635) and ($3,361 ÷ $1,635)]; [End of yr.: ($3,217 – $1,601) and ($3,217 ÷ $1,601)]

(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. Nordstrom's end-of-year current ratio (2.01) exceeds Best Buy's 2020 current ratio (1.10) as shown in the chapter. Nordstrom would be considered much more liquid than Best Buy for the recent year.

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

EXERCISE 2.14

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

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

(Current assets ÷ Current liabl.) and (Current assets – Current liabl.)
($60,000 ÷ $30,000) and ($60,000 – $30,000)

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

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

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

(Current assets ÷ Current liabl.) and (Current assets – Current liabl.)
[($60,000 – $20,000) ÷ ($30,000 – $20,000)]and ($40,000 – $10,000)

(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 and wages payable will require $10,000, the company may need to borrow in order to make the required payment for salaries.

EXERCISE 2.14 (Continued)

(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 2.15

	2025	2024
(a) Current ratio	$\frac{\$925,359}{\$401,763} = 2.30:1$	$\frac{\$1,020,834}{\$376,178} = 2.71:1$
(b) Earnings per share	$\frac{\$179,061}{205,169} = \$0.87$	$\frac{\$400,019}{216,119} = \$1.85$
(c) Debt to assets ratio	$\frac{\$554,645}{\$1,963,676} = 28.2\%$	$\frac{\$527,216}{\$1,867,680} = 28.2\%$

(d) American Eagles' solvency remained constant from 2024 to 2025 since its debt to total assets ratio remained the same for both years.

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

EXERCISE 2.16

a.	7	g.	1
b.	10	h.	6
c.	11	i.	4
d.	3	j.	5
e.	2	k.	9
f.	8	l.	12

LO 3 BT: K Difficulty: M Time: 20 min. AACSB: None AICPA FC: Reporting

EXERCISE 2.17

(a) __2__ Going concern assumption
(b) __6__ Economic entity assumption
(c) __3__ Monetary unit assumption
(d) __4__ Periodicity assumption
(e) __5__ Historical cost principle
(f) __1__ Full disclosure principle

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Reporting

EXERCISE 2.18

a. 4 Whether omitting or misstating an item could influence the decision of a financial statement user.
b. 5 Constraint that weighs the cost that companies will incur to provide the information against the benefit that financial statement users will gain from having the information available.
c. 11 Obligations that a company expects to pay within the next year or operating cycle, whichever is longer.
d. 6 Information that is complete, neutral, and free from error.
e. 3 The primary accounting standard-setting body in the United States.
f. 10 A set of accounting standards that has substantial authoritative support and which guide accounting professionals.
g. 7 The ability of a company to pay obligations that are expected to become due within the next year or operating cycle.
h. 9 The average time required to purchase inventory, sell it on account, and then collect cash from customers—that is, go from cash to cash.
i. 12 The quality of information that has predictive value and that confirms or corrects prior expectations.
j. 1 The agency of the U.S. government that oversees U.S. financial markets and accounting standard-setting bodies.
k. 13 The quality of information that occurs when independent observers, using the same methods, obtains similar results.
l. 8 The difference between the amounts of current assets and current liabilities.
m. 2 The ability of a company to pay interest as it comes due and to repay the balance of a debt due at its maturity.

LO 1, 2, 3 BT: K Difficulty: Easy TOT: 10 min. AACSB: None AICPA FC: Reportig

EXERCISE 2.19

(a) **This is a violation of the historical cost principle. The inventory was written up to its fair value when it should have remained at cost.**

(b) **This is a violation of the economic entity assumption. The treatment of the transaction treats Victor Lopez and Lopez Co. as one entity when they are two separate entities. The cash used to purchase the truck should have been treated as part of dividends.**

(c) **This is a violation of the periodicity assumption. This assumption states that the economic life of a business can be divided into artificial time periods (months, quarters, or a year). By adding two more weeks to the year, Lopez Co. would be misleading financial statement readers. In addition, 2025 results would not be comparable to previous years' results. The company should use a 52 week year.**

LO 3 BT: C Difficulty: Medium TOT: 5 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

SOLUTIONS TO PROBLEMS

PROBLEM 2.1

YAHOO! INC.
Balance Sheet
December 31, 2025
(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
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

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

PROBLEM 2.1 (Continued)

[(($2,292 + $1,160 + $1,061 + $233) + $3,247 + ($1,737 – $201) + ($3,927 + $234)) = (($152 + $413) + $734 + ($6,283 + $6,108))]

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, 2025

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. = Net inc.)
[$68,000 – ($37,000 + $3,600 + $2,200 + $2,000 + $1,800) = $21,400]

MARTIN CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2025

Retained earnings, January 1, 2025	$31,000
Add: Net income	21,400
	52,400
Less: Dividends	12,000
Retained earnings, December 31, 2025	$40,400

(Beg. ret. earn. + Net inc. – Div. = End. ret. earn.)
($31,000 + $21,400 – $12,000 = $40,400)

PROBLEM 2.2 (Continued)

MARTIN CORPORATION
Balance Sheet
December 31, 2025

Assets

Current assets		
Cash	$10,100	
Accounts receivable	11,700	
Supplies	3,100	
Prepaid insurance	3,500	
Total current assets		$28,400
Long-term investments		
Debt investments		5,700
Property, plant, and equipment		
Equipment	66,000	
Less: Accumulated depreciation—equipment	17,600	48,400
Intangible assets		
Trademarks		2,000
Total assets		$84,500

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	22,800	
Retained earnings	40,400	
Total stockholders' equity		63,200
Total liabilities and stockholders' equity		$84,500

[(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets) = (Current liabl. + SE)]
[(($10,100 + $11,700 + $3,100 + $3,500) + $5,700 + ($66,000 – $17,600) + $2,000) = (($18,300 + $3,000) + ($22,800 + $40,400))]
LO 1 BT: AP Difficulty: Medium TOT: 25 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.3

(a)

LAZURIS ENTERPRISES
Income Statement
For the Year Ended April 30, 2025

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. = Net inc.)
[$5,100 – ($1,060 + $700 + $400 + $335 + $210 + $165) = $2,230]

LAZURIS ENTERPRISES
Retained Earnings Statement
For the Year Ended April 30, 2025

Retained earnings, May 1, 2024	$1,600
Add: Net income	2,230
	3,830
Less: Dividends	325
Retained earnings, April 30, 2025	$3,505

(Beg. ret. earn. + net inc. – Div. = End. ret. earn.)
($1,600 + $2,230 – $325 = $3,505)

PROBLEM 2.3 (Continued)

(b)

LAZURIS ENTERPRISES
Balance Sheet
April 30, 2025

Assets

Current assets			
Cash		$1,270	
Stock investments		1,200	
Accounts receivable		810	
Inventory		967	
Prepaid insurance		60	
Total current assets			$ 4,307
Long-term investments			
Investment in land			14,200
Property, plant, and equipment			
Land		3,100	
Equipment	$2,420		
Less: Accumulated depreciation—equipment	670	1,750	4,850
Intangible assets			
Goodwill			1,800
Total assets			$25,157

PROBLEM 2.3 (Continued)

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..	16,900	
Retained earnings..	3,505	
Total stockholders' equity		20,405
Total liabilities and stockholders' equity		$25,157

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

[(($1,270 + $1,200 + $810 + $967 + $60) + $14,200 + ($3,100 + ($2,420 – $670)) + $1,800) = (($61 + $834 + $222 + $135) + $3,500 + ($16,900 + $3,505))

LO 1 BT: AP Difficulty: Medium TOT: 25 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.4

(a) **Loeb Company's net income for 2025 is $248,000 ($1,800,000 – $1,175,000 – $283,000 – $9,000 – $85,000). Its earnings per share is $3.10 ($248,000 ÷ 80,000 shares outstanding). Bowsh's net income for 2025 is $142,200 ($620,000 – $340,000 – $98,000 – $3,800 – $36,000). Its earnings per share is $2.84 ($142,200 ÷ 50,000 common shares outstanding).**

(b) **Loeb appears to be more liquid. Loeb's 2025 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 2025 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).**

(c) **Loeb appears to be slightly more solvent. Loeb's 2025 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 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 2025 total liabilities.
<u>$939,200</u> ($407,200 + $532,000) is Loeb's 2025 total assets.

[b]<u>$74,400</u> ($33,716 + $40,684) is Bowsh's 2025 total liabilities.
<u>$330,064</u> ($190,336 + $139,728) is Bowsh's 2025 total assets.

LO 2 BT: AN Difficulty: Hard TOT: 25 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation

PROBLEM 2.5

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

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

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

(iv) Earnings per share = $$\frac{\$153{,}100}{50{,}000 \text{ common shares outstanding}} = \$3.06$$

(b) During 2025, 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 2025.

The company's debt to assets ratio increased from 31.0% in 2024 to 38.2% in 2025 indicating that the company is less solvent in 2025.

Earnings per share decreased from \$3.15 in 2024 to \$3.06 in 2025. This indicates a decline in profitability during 2025.

LO 2 BT: AP Difficulty: Medium TOT: 15 min. AACSB: Analytic AICPA FC: Measurement Analysis ad Interpretation

PROBLEM 2.6

	2024	2025
(a) Earnings per share.		
	$\frac{\$60,000}{30,000 \text{ common shares}} = \$2.00$	$\frac{\$70,000}{33,000 \text{ common shares}} = \$2.12$
(b) Working capital.		
	(\$20,000 + \$62,000 + \$73,000) – \$70,000 = \$85,000	(\$28,000 + \$70,000 + \$90,000) – \$75,000 = \$113,000
(c) Current ratio.		
	$\frac{\$155,000}{\$70,000} = 2.2:1$	$\frac{\$188,000}{\$75,000} = 2.5:1$
(d) Debt to assets ratio.		
	$\frac{\$160,000}{\$685,000} = 23.4\%$	$\frac{\$155,000}{\$760,000} = 20.4\%$

(e) Net income and earnings per share have increased, indicating that the underlying profitability of the corporation has improved. 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: Measurement Analysis and Interpretation

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)
(b)	Current ratio	1.66:1 ($17,488 ÷ $10,512)	.88:1 ($48,949 ÷ $55,390)
(c)	Debt to assets ratio	68.9% ($30,394 ÷ $44,106)	60.1% ($98,144 ÷ $163,429)
(d)	Earnings per share	$\$2.86 = \frac{\$2,214}{774}$	$\$3.39 = \frac{\$13,400}{3,951}$

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

<u>Liquidity</u>—Target's current ratio of 1.66:1 is much better than Walmart's .88:1 and Target has significantly higher working capital than Wal-Mart.

<u>Solvency</u>—Walmart's debt to assets ratio is about 13% less than Target's.

LO 2 BT: AP Difficulty: Medium TOT: 20 min. AACSB: Analytic AICPA FC: Measurement Analysis and interpretation

PROBLEM 2.8

(a) Accounting information is the compilation and presentation of financial information for a company. It provides information in the form of financial statements and additional disclosures that is useful for decision-making.

The accounting rules and practices that have substantial authoritative support and are recognized as a general guide for financial reporting purposes are referred to as generally accepted accounting principles (GAAP). The biotechnology company that employs Saira will follow GAAP to report its assets, liabilities, stockholders' equity, revenues, and expenses as it prepares financial statements.

(b) Saira is correct in her understanding that the low success rate for new biotech products will be a cause of concern for investors. Her suggestion that detailed scientific findings be reported to prospective investors might offset some of their concerns but it probably won't conform to the qualitative characteristics of accounting information.

These characteristics consist of relevance, faithful representation, comparability, consistency, verifiability, timeliness, and understandability. They apply to accounting information rather than the scientific findings that Saira wants to include.

LO 3 BT: E Difficulty: Medium TOT: 15 min. AACSB: Reflective Thinking AICPA FC: Measurement and Reporting

CCC2	CONTINUING COOKIE CREATIONS

(a) **The balance sheet reports the assets, liabilities, and stockholders' equity of a company at a specific date. The income statement presents the revenues and expenses and resulting net income or net loss of a company for a specific period of time. The retained earnings statement summarizes the changes in retained earnings for a specific period of time. Finally, the cash flow statement provides information about the cash inflows and cash outflows for a specific period of time.**

(b) **By looking at the balance sheet and the cash flow statement and calculating liquidity ratios we can measure a company's short term ability to pay its obligations. Liquidity ratios include the calculation of working capital (current assets minus current liabilities) and current ratio (current assets divided by current liabilities).**

(c) **By looking at the balance sheet and the cash flow statement and calculating solvency ratios we are able to measure a company's ability to survive over a long period of time. These solvency ratios include debt to assets (total liabilities divided by total assets).**

(d) **By looking at the income statement we can determine if Biscuits is profitable. If revenues earned by Biscuits exceed expenses incurred, then Biscuits is profitable. Profitability ratios can measure a company's ability to generate earnings over a period of time. One profitability ratio is earnings per share (net income minus preferred dividends divided by average common shares outstanding).**

(e) **By looking at the balance sheet we can determine if Biscuits has any debt. By looking at the balance sheet and cash flow statement and calculating solvency ratios we are able to determine whether a company has the ability to repay its long-term debt. Profitability ratios will help in determining whether a company is able to pay its interest expense. The more profitable the company the better able it is to repay its long-term obligations as well as the amount of interest it is paying on its debt.**

CCC 2 (Continued)

(f) By looking at the statement of cash flows we can determine whether Biscuits has paid any dividends to its shareholders.

(g) Be aware that financial statements of Biscuits provide a historical perspective of what has already taken place. The financial statements may prove to be a good indicator of what will happen in the future but remember that is not necessarily guaranteed. Consumer tastes change, and as a result, the demand for Biscuits' product may also change.

There are other issues that Natalie must consider as well. Does she have the ability to meet the demands of Biscuits? Will she be able to produce 1,500 dozen cookies a week? Does she have enough staff to enable her to do so? Does she have a large enough oven to do so? Does she have enough cash to pay her staff, purchase supplies, and cover operating expenses until she receives payment from Biscuits?

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 accounts receivable. 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: AN Difficulty: Medium TOT: 8 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation

CT2.2 COMPARATIVE ANALYSIS PROBLEM

(a)

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

(b) ***Liquidity***

Under Armour appears much 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: Measurement Analysis and Interpretation

CT2.3 COMPARATIVE ANALYSIS PROBLEM

(a)

	($ in millions)	Amazon	Walmart
1.	Working capital	$132,733 – $126,385 = $6,348	$90,067 – $92,645 = $(2,578)
2.	Current ratio	$132,733 ÷ $126,385 = 1.05:1	$90,067 ÷ $92,645 = .97:1
3.	Debt to assets ratio	$\frac{\$227,791^{*}}{\$321,195} = 70.9\%$	$\frac{\$164,965^{**}}{\$252,496} = 65.3\%$

*$126,385 + $52,573 + $31,816 + $17,017

**$92,645 + $41,194 +$12,909 +$3,847 + $14,370

(b) ***Liquidity***

Amazon appears more liquid since it has $8,926 million more working capital than Walmart. Also, Amazon's current ratio is slightly better than Walmart's.

Solvency

Based on the debt to assets ratio, Walmart is slightly more solvent. Walmart's debt to assets ratio is lower than Amazon's and, therefore, Walmart 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: Measurement Analysis and Interpretation

CT2.4 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:

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

(b) **Gap's working capital and current ratio decreased (2022), increased (2023 and 2024) and then decreased (2025) 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 .39 in 2021, rose to .45 in 2022 and then came back down to .42 in 2025.**

(d) **The earnings per share suggest that Gap's profitability improved significantly from 2021 to 2025, increasing from $0.94 to $1.89.**

LO 2 BT: AN Difficulty: Hard TOT: 15 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation

REAL-WORLD FOCUS

CT 2.5

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 FC: Reporting

CT 2.6

Answers will vary depending on the company chosen and the date.

LO 1, 2 BT: E Difficulty: Hard TOT: 25 min. AACSB: Analytic, Technology, and Reflective Thinking AICPA FC: Reporting AICPA BB: Decision Making

CT2.7 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.

The earnings per share increase is a favorable indicator for profitability. A 109% (from $1.15 to $2.40) increase indicates a significant increase in net income and provides a favorable sign regarding going-concern potential.

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

CT2.8	COMMUNICATION ACTIVITY

To: B. P. Palmer

From: Accounting Major

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

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

2. Example of solvency measures:

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

CT2.8 (Continued)

3. **Example of profitability measure:**

$$\textbf{Earnings per share} = \frac{\text{Net income} - \text{Preferred dividends}}{\text{Average common shares outstanding}}$$

(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: C Difficulty: Medium TOT: 18 min. AACSB: Communication AICPA PC: Communication

CT2.9 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) The periodicity assumption requires that financial results be reported on specific, pre-determined dates.

The full disclosure principle requires that all circumstances and events that make a difference to financial statement users must be disclosed.

(d) 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.

(e) 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).

(f) 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: Measurement Analysis ad Interpretation AICPA PC: Ethical Conduct

CT2.10 ALL ABOUT YOU

Answers will vary.

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

CT2.11 FASB CODIFICATION ACTIVITY

(a) 1. Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.

2. Current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities.

(b) Access FASB Codification 210-20-45

A right of set off exists when all of the following conditions are met:

1. Each of two parties owes the other determinable amounts.

2. The reporting party has the right to offset the amount owed with the amount owed by the other party.

3. The reporting party intends to offset.

4. The right of offset is enforceable at law. As a result, a company may not offset accounts payable against cash on its balance sheet.

LO 1 BT: C Difficulty: Medium TOT: 15 min. AACSB: Analytic and Technology AICPA FC: Research

CT2.12 PEOPLE, PLANET, AND PROFIT

(a) The existence of three 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 purchasing and using safety equipment, worker and environmental health conditions, child labor regulations, standard of living and income changes, and quality control. 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 Reflective Thinking AICPA FC: Measurement Analysis and Interpretation, Reporting AICPA BB: Global and Industry Perspectives

CHAPTER 2

A Further Look at Financial Statements

Learning Objectives

1. Identify the sections of a classified balance sheet.
2. Use ratios to evaluate a company's profitability, liquidity, and solvency.
3. Discuss financial reporting concepts.

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—to purchase inventory, sell it on account, and then collect cash from customers..

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

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 companies where the conversion into cash is not expected within one year or the operating cycle, whichever is longer, and plant assets not currently in operational use. Property, plant, and equipment are tangible resources of a relatively permanent nature that are being used in the business and not intended for sale.

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) and (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. (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

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

(b) Solvency ratios: Debt to assets and free cash flow.

(c) Profitability ratio: Earnings per share.

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

8. 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

9. (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

10. (a) The increase in earnings per share is good news because it means that profitability has improved.

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

(c) 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

11. (a) The debt to assets ratio and free cash flow indicate the company's ability to repay the face value of the debt at maturity and make periodic interest payments.

(b) The current ratio and working capital indicate a company's liquidity and short-term debt-paying ability.

(c) Earnings per share indicates the earning power (profitability) of an investment.

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

12. (a) Generally accepted accounting principles (GAAP) are a set of rules and practices, having substantial support, that are recognized as a general guide for financial reporting purposes.

(b) The body that provides authoritative support for GAAP is the Financial Accounting Standards Board (FASB).

LO 3 BT: K Diff: E TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

13. (a) The primary objective of financial reporting is to provide information useful for decision making.

(b) The fundamental qualitative characteristics are relevance and faithful representation. The enhancing qualities are comparability, consistency, verifiability, timeliness, and understandability.

LO 3 BT: K Diff: M TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

14. Dietz is correct. Consistency means using the same accounting principles and accounting methods from period to period within a company. Without consistency in the application of accounting principles, it is difficult to determine whether a company is better off, worse off, or the same from period to period.

LO 3 BT: AN Diff: M TOT: 2 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation, Reporting

15. Comparability results when different companies use the same accounting principles. Consistency means using the same accounting principles and methods from year to year within the same company.

LO 3 BT: C Diff: E TOT: 1 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

16. The cost constraint allows accounting standard-setters to weigh the cost that companies will incur to provide information against the benefit that financial statement users will gain from having the information available.

LO 3 BT: K Diff: E TOT: 1 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

17. Accounting standards are not uniform because individual countries have separate standard-setting bodies. Currently many non-U.S. countries are choosing to adopt International Financial Reporting Standards (IFRS). Accounting standards in the United States are converging towards IFRS.

LO 3 BT: C Diff: M TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

18. Accounting relies primarily on two measurement principles. Fair value is sometimes used when market price information is readily available. However, in many situations reliable market price information is not available. In these instances, accounting relies on historical cost as its basis.

LO 3 BT: C Diff: M TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

19. The economic entity assumption states that every economic entity can be separately identified and accounted for. This assumption requires that the activities of the entity be kept separate and distinct from (1) the activities of its owners (the shareholders) and (2) all other economic entities. A shareholder of a company charging personal living costs as expenses of the company is an example of a violation of the economic entity assumption.

LO 3 BT: C Diff: M TOT: 3 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

20. At September 26, 2020 Apple's largest current asset was marketable securities of $52,927 million, its largest current liability was other current liabilities of $42,684 million and its largest item under "Assets" was non-current marketable securities of $100,887 million.

LO 1 BT: C Diff: M TOT: 5 min. AACSB: None AICPA FC: Reporting

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 2.1

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

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

BRIEF EXERCISE 2.2

Identify the order of asset classifications.

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 2.3

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 2.4

$$\text{Earnings per share} = \frac{\text{Net income} - \text{Preferred dividends}}{\text{Average common shares outstanding}}$$

$$= \frac{\$220 \text{ million} - \$0}{333 \text{ million shares}} = \$.66 \text{ per share}$$

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

BRIEF EXERCISE 2.5

Working capital = Current assets – Current liabilities

Current assets	$102,500,000
Current liabilities	201,200,000
Working capital	($ 98,700,000)

Current ratio:

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

$$= .51 : 1$$

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

BRIEF EXERCISE 2.6

(a) $\text{Current ratio} = \dfrac{\text{Current assets}}{\text{Current liabilities}} \qquad \dfrac{\$262{,}787}{\$293{,}625} = 0.89{:}1$

(b) $\text{Debt to assets} = \dfrac{\text{Total liabilities}}{\text{Total assets}} \qquad \dfrac{\$376{,}002}{\$439{,}832} = 85.5\%$

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

BRIEF EXERCISE 2.7

(a) True.
(b) False. The primary standard-setting body in the U.S. is the FASB.

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.8

(a) Predictive value.
(b) Confirmatory value.
(c) Materiality.
(d) Complete.
(e) Free from error.
(f) Comparability.
(g) Verifiability.
(h) Timeliness.

LO 3 BT: K Difficulty: Easy TOT: 3 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.9

(a) Relevant.
(b) Faithful representation.
(c) Consistency.

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.10

(a) 1. Predictive value.
(b) 2. Neutral.
(c) 3. Verifiable.
(d) 4. Timely.

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

BRIEF EXERCISE 2.11

(c) financial statements should disclose sufficient detail regarding events and circumstances that would make a difference to users of financial statements.

LO 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: None AICPA FC: Measurement Analysis and interpretation

SOLUTIONS TO DO IT! EXERCISES

DO IT! 2.1a

MYLAR CORPORATION
Balance Sheet (partial)
December 31, 2025

Assets		
Current assets		
Cash	$ 13,000	
Accounts receivable	22,000	
Inventory	58,000	
Supplies	7,000	
Total current assets		$100,000
Long-term investments		
Stock-investments		1,900
Property, plant, and equipment		
Equipment	180,000	
Less: Accumulated depreciation—equipment	50,000	130,000
Intangible assets		
Goodwill		4,100
Total assets		$236,000

(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets = Tot. assets)
[($13,000 + $22,000 + $58,000 + $7,000) + $1,900 + ($180,000 – $50,000) + $4,100 = $236,000]
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: AP Difficulty: Easy TOT: 3 min. AACSB: Analytic AICPA FC: Reporting

DO IT! 2.2

(a)

2025

$$\frac{(\$80{,}000 - \$6{,}000)}{(40{,}000 + 75{,}000)/2} = \$1.29$$

2024

$$\frac{(\$40{,}000 - \$6{,}000)}{(30{,}000 + 40{,}000)/2} = \$0.97$$

Nguoi's profitability, as measured by the amount of income available for each share of common stock, increased by 33 percent (($1.29 – $0.97)/$0.97) during 2025. Earnings per share should not be compared across companies because the number of shares issued by companies varies widely. Thus, we cannot conclude that Nguoi Corporation is more profitable than Matisse Corporation based on its higher EPS in 2025.

$$\frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Average Common Shares Outstanding}}$$

(b)

	2025	**2024**
Current ratio	$\frac{\$54{,}000}{\$22{,}000} = 2.45{:}1$	$\frac{\$36{,}000}{\$30{,}000} = 1.20{:}1$

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

	2025	**2024**
Debt to assets ratio	$\frac{\$72{,}000}{\$240{,}000} = 30\%$	$\frac{\$100{,}000}{\$205{,}000} = 49\%$

$$\frac{\text{Total liabilities}}{\text{Total assets}}$$

The company's liquidity, as measured by the current ratio improved from 1.20:1 to 2.45:1. Its solvency also improved, because the debt to assets ratio declined from 49% to 30%.

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

DO IT! 2.3

1. **Monetary unit assumption**
2. **Faithful representation**
3. **Economic entity assumption**
4. **Cost constraint**
5. **Consistency**
6. **Historical cost principle**
7. **Relevance**
8. **Periodicity assumption**
9. **Full disclosure principle**
10. **Materiality**
11. **Going concern assumption**
12. **Comparability**

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

EXERCISE 2.3

BOEING COMPANY
Partial Balance Sheet
December 31, 2025
(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

[(Cash + Debt invest. + Accts. rec. + Notes rec. + Inv.) + Notes rec. + (Bldgs. – Accum. depr.-bldgs.) + Patents = Tot. assets]
[($9,215 + $2,008 + $5,785 + $368 + $16,933)) + $5,466 + ($21,579 – $12,795) + $12,528 = $61,087]
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, 2025
(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

[(Cash + Accts. rec. + Inv. + Prepd. ins.) + (Land + (Bldgs. – Accum. depr.-bldgs.)) + (Goodwill + Trademarks) = Tot. assets]
[($373,145 + $1,171,797 + $1,237,613 + $125,765) + ($76,193 + ($4,033,369 – $2,131,260)) + ($3,982,954 + $757,907) = $9,627,483]
LO 1 BT: AP Difficulty: Medium TOT: 5 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.5

LONGHORN CO.
Balance Sheet
December 31, 2025

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

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

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

[(Current assets + Prop., plant & equip.) = Current liabl. + Long-term liabl. + SE)]
[(($11,840 + $12,600 + $3,200) + ($61,200 + ($105,800 – $45,600) + ($82,400 – $18,720))) = (($9,500 + $13,600 + $3,600) + $80,000 + ($60,000 + $46,020))

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

EXERCISE 2.6

CARMEN CO.
Balance Sheet
December 31, 2025

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

*($691,400 − $121,400 = $570,000)
**($570,000 – $75,000)

[(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets) = (Current liabl. + L-T liabl. + 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

TEXAS INSTRUMENTS, INC.
Balance Sheet
December 31, 2025
(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
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

[(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets) = (Current liabl. + L-T liabl. + SE)]
[(($1,182 + $1,743 + $1,823 + $1,202 + $164) + $637 + ($6,705 – $3,547) + $2,210) = (($1,459 + $128) + $810 + ($2,826 + $6,896))]
LO 1 BT: AP Difficulty: Medium TOT: 10 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.8

RANDAL INC.
Balance Sheet (partial)
October 28, 2025
(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, 2025

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, 2025

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, 2025

Retained earnings,, August 1, 2024	$17,940
Add: Net income	30,600
	48,540
Less: Dividends	12,000
Retained earnings, July 31, 2025	$36,540

BATRA CORPORATION
Balance Sheet
July 31, 2025

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) Earnings per share $= \dfrac{\text{Net income} - \text{Preferred dividends}}{\text{Average common shares outstanding}}$

2025: $\dfrac{\$66{,}176{,}000 - 0}{(66{,}282{,}000 + 64{,}507{,}000) / 2} = \$\ 1.01$

2024: $\dfrac{\$54{,}587{,}000 - 0}{(73{,}139{,}000 + 66{,}282{,}000) / 2} = \$\ .78$

(b) Using net income (loss) as a basis to evaluate profitability, Callaway Golf's income improved by 21% [($66,176 – $54,587) ÷ $54,587] between 2024 and 2025. Its earnings per share increased by 29% [($1.01 – $0.78) ÷ $0.78].

(c) To determine earnings per share, dividends on preferred stock are subtracted from net income, but dividends on common stock are not subtracted.

LO 2 BT: AP Difficulty: Medium TOT: 7 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.12

(a)

FAIRVIEW CORPORATION
Income Statement
For the Year Ended July 31, 2025

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. = Net loss)
[($66,100 + $8,500) – ($57,500 + $15,600 + $4,000) = ($2,500)]

FAIRVIEW CORPORATION
Retained Earnings Statement
For the Year Ended July 31, 2025

Retained earnings, August 1, 2024		$34,000
Less: Net loss	$2,500	
Dividends	4,000	6,500
Retained earnings, July 31, 2025		$27,500

(Beg. ret. earn. – (Net loss + Div.)= End. ret. earn.)
[$34,000 – ($2,500 + $4,000) = $27,500]

(b)

FAIRVIEW CORPORATION
Balance Sheet
July 31, 2025

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

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

[(Current assets + Prop., plant, & equip.) = (Current liabl. + L-T liabl. + SE)]
[(($29,200 + $9,780) + ($18,500 – $6,000)) = (($4,100 + $2,080) + $1,800 + ($16,000 + $27,500))]

(c)

$$\text{Current ratio} = \frac{\$38{,}980}{\$6{,}180} = 6.3:1$$

$$\text{Debt to assets ratio} = \frac{\$7{,}980}{\$51{,}480} = 15.5\%$$

(Current assets ÷ Current liabl.) and (Tot. liabl.÷ Tot. assets)
($38,980 ÷ $6,180) and ($7,980 ÷ $51,480)

EXERCISE 2.12 (Continued)

(d) The current ratio would not change because equipment is not a current asset and a 5-year note payable is a long-term liability rather than a current liability.

The debt to assets ratio would increase from 15.5% to 39.1%*.

Looking solely at the debt to assets ratio, I would favor making the sale because Fairview's debt to assets ratio of 15.5% is very low. Looking at additional financial data, I would note that Fairview reported a loss for the current year which would lead me to question its ability to make interest and loan payments (and even remain in business) in the future. I would not make the proposed sale unless Fairview convinced me that it would be capable of earnings in the future rather than losses.

I would also consider making the sale but requiring a substantial down-payment and smaller note.

*($7,980 + $20,000) ÷ ($51,480 + $20,000)

LO 1, 2 BT: AP Difficulty: Hard TOT: 20 min. AACSB: Analytic AICPA FC: Reporting

EXERCISE 2.13

(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 liabl.) and (Current assets ÷ Current liabl.)
[Beg. of yr.: ($3,361 – $1,635) and ($3,361 ÷ $1,635)]; [End of yr.: ($3,217 – $1,601) and ($3,217 ÷ $1,601)]

(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. Nordstrom's end-of-year current ratio (2.01) exceeds Best Buy's 2020 current ratio (1.10) as shown in the chapter. Nordstrom would be considered much more liquid than Best Buy for the recent year.

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

EXERCISE 2.14

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

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

(Current assets ÷ Current liabl.) and (Current assets – Current liabl.)
(\$60,000 ÷ \$30,000) and (\$60,000 – \$30,000)

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

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

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

(Current assets ÷ Current liabl.) and (Current assets – Current liabl.)
[(\$60,000 – \$20,000) ÷ (\$30,000 – \$20,000)]and (\$40,000 – \$10,000)

(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 and wages payable will require \$10,000, the company may need to borrow in order to make the required payment for salaries.

EXERCISE 2.14 (Continued)

(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 2.15

	2025	2024
(a) Current ratio	$\frac{\$925,359}{\$401,763} = 2.30:1$	$\frac{\$1,020,834}{\$376,178} = 2.71:1$
(b) Earnings per share	$\frac{\$179,061}{205,169} = \$0.87$	$\frac{\$400,019}{216,119} = \$1.85$
(c) Debt to assets ratio	$\frac{\$554,645}{\$1,963,676} = 28.2\%$	$\frac{\$527,216}{\$1,867,680} = 28.2\%$

(d) **American Eagles' solvency remained constant from 2024 to 2025 since its debt to total assets ratio remained the same for both years.**

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

EXERCISE 2.16

a.	7	g.	1
b.	10	h.	6
c.	11	i.	4
d.	3	j.	5
e.	2	k.	9
f.	8	l.	12

LO 3 BT: K Difficulty: M Time: 20 min. AACSB: None AICPA FC: Reporting

EXERCISE 2.17

(a) 2 Going concern assumption
(b) 6 Economic entity assumption
(c) 3 Monetary unit assumption
(d) 4 Periodicity assumption
(e) 5 Historical cost principle
(f) 1 Full disclosure principle

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: None AICPA FC: Reporting

EXERCISE 2.18

a. 4 Whether omitting or misstating an item could influence the decision of a financial statement user.
b. 5 Constraint that weighs the cost that companies will incur to provide the information against the benefit that financial statement users will gain from having the information available.
c. 11 Obligations that a company expects to pay within the next year or operating cycle, whichever is longer.
d. 6 Information that is complete, neutral, and free from error.
e. 3 The primary accounting standard-setting body in the United States.
f. 10 A set of accounting standards that has substantial authoritative support and which guide accounting professionals.
g. 7 The ability of a company to pay obligations that are expected to become due within the next year or operating cycle.
h. 9 The average time required to purchase inventory, sell it on account, and then collect cash from customers—that is, go from cash to cash.
i. 12 The quality of information that has predictive value and that confirms or corrects prior expectations.
j. 1 The agency of the U.S. government that oversees U.S. financial markets and accounting standard-setting bodies.
k. 13 The quality of information that occurs when independent observers, using the same methods, obtains similar results.
l. 8 The difference between the amounts of current assets and current liabilities.
m. 2 The ability of a company to pay interest as it comes due and to repay the balance of a debt due at its maturity.

LO 1, 2, 3 BT: K Difficulty: Easy TOT: 10 min. AACSB: None AICPA FC: Reportig

EXERCISE 2.19

(a) This is a violation of the historical cost principle. The inventory was written up to its fair value when it should have remained at cost.

(b) This is a violation of the economic entity assumption. The treatment of the transaction treats Victor Lopez and Lopez Co. as one entity when they are two separate entities. The cash used to purchase the truck should have been treated as part of dividends.

(c) This is a violation of the periodicity assumption. This assumption states that the economic life of a business can be divided into artificial time periods (months, quarters, or a year). By adding two more weeks to the year, Lopez Co. would be misleading financial statement readers. In addition, 2025 results would not be comparable to previous years' results. The company should use a 52 week year.

LO 3 BT: C Difficulty: Medium TOT: 5 min. AACSB: None AICPA FC: Measurement Analysis and Interpretation

SOLUTIONS TO PROBLEMS

PROBLEM 2.1

YAHOO! INC.
Balance Sheet
December 31, 2025
(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
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

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

PROBLEM 2.1 (Continued)

[(($2,292 + $1,160 + $1,061 + $233) + $3,247 + ($1,737 – $201) + ($3,927 + $234)) = (($152 + $413) + $734 + ($6,283 + $6,108))]

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, 2025

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. = Net inc.)
[$68,000 – ($37,000 + $3,600 + $2,200 + $2,000 + $1,800) = $21,400]

MARTIN CORPORATION
Retained Earnings Statement
For the Year Ended December 31, 2025

Retained earnings, January 1, 2025	$31,000
Add: Net income	21,400
	52,400
Less: Dividends	12,000
Retained earnings, December 31, 2025	$40,400

(Beg. ret. earn. + Net inc. – Div. = End. ret. earn.)
($31,000 + $21,400 – $12,000 = $40,400)

PROBLEM 2.2 (Continued)

MARTIN CORPORATION
Balance Sheet
December 31, 2025

Assets		
Current assets		
Cash	$10,100	
Accounts receivable	11,700	
Supplies	3,100	
Prepaid insurance	3,500	
Total current assets		$28,400
Long-term investments		
Debt investments		5,700
Property, plant, and equipment		
Equipment	66,000	
Less: Accumulated depreciation—equipment	17,600	48,400
Intangible assets		
Trademarks		2,000
Total assets		$84,500

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	22,800	
Retained earnings	40,400	
Total stockholders' equity		63,200
Total liabilities and stockholders' equity		$84,500

[(Current assets + L-T invest. + Prop., plant, & equip. + Intang. assets) = (Current liabl. + SE)]
[(($10,100 + $11,700 + $3,100 + $3,500) + $5,700 + ($66,000 – $17,600) + $2,000) = (($18,300 + $3,000) + ($22,800 + $40,400))]
LO 1 BT: AP Difficulty: Medium TOT: 25 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.3

(a)

LAZURIS ENTERPRISES
Income Statement
For the Year Ended April 30, 2025

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. = Net inc.)
[$5,100 – ($1,060 + $700 + $400 + $335 + $210 + $165) = $2,230]

LAZURIS ENTERPRISES
Retained Earnings Statement
For the Year Ended April 30, 2025

Retained earnings, May 1, 2024	$1,600
Add: Net income..	2,230
	3,830
Less: Dividends	325
Retained earnings, April 30, 2025	$3,505

(Beg. ret. earn. + net inc. – Div. = End. ret. earn.)
($1,600 + $2,230 – $325 = $3,505)

PROBLEM 2.3 (Continued)

(b)

LAZURIS ENTERPRISES
Balance Sheet
April 30, 2025

Assets

Current assets			
Cash		$1,270	
Stock investments		1,200	
Accounts receivable		810	
Inventory		967	
Prepaid insurance		60	
Total current assets			$ 4,307
Long-term investments			
Investment in land			14,200
Property, plant, and equipment			
Land		3,100	
Equipment	$2,420		
Less: Accumulated depreciation—equipment	670	1,750	4,850
Intangible assets			
Goodwill			1,800
Total assets			$25,157

PROBLEM 2.3 (Continued)

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	16,900	
Retained earnings	3,505	
Total stockholders' equity		20,405
Total liabilities and stockholders' equity		$25,157

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

[(($1,270 + $1,200 + $810 + $967 + $60) + $14,200 + ($3,100 + ($2,420 – $670)) + $1,800) = (($61 + $834 + $222 + $135) + $3,500 + ($16,900 + $3,505))

LO 1 BT: AP Difficulty: Medium TOT: 25 min. AACSB: Analytic AICPA FC: Reporting

PROBLEM 2.4

(a) **Loeb Company's net income for 2025 is $248,000 ($1,800,000 – $1,175,000 – $283,000 – $9,000 – $85,000). Its earnings per share is $3.10 ($248,000 ÷ 80,000 shares outstanding). Bowsh's net income for 2025 is $142,200 ($620,000 – $340,000 – $98,000 – $3,800 – $36,000). Its earnings per share is $2.84 ($142,200 ÷ 50,000 common shares outstanding).**

(b) **Loeb appears to be more liquid. Loeb's 2025 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 2025 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).**

(c) **Loeb appears to be slightly more solvent. Loeb's 2025 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 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 2025 total liabilities.
<u>$939,200</u> ($407,200 + $532,000) is Loeb's 2025 total assets.

[b]<u>$74,400</u> ($33,716 + $40,684) is Bowsh's 2025 total liabilities.
<u>$330,064</u> ($190,336 + $139,728) is Bowsh's 2025 total assets.

LO 2 BT: AN Difficulty: Hard TOT: 25 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation

PROBLEM 2.5

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

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

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

(iv) Earnings per share = $\frac{\$153,100}{\text{50,000 common shares outstanding}} = \$3.06$

(b) During 2025, 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 2025.

The company's debt to assets ratio increased from 31.0% in 2024 to 38.2% in 2025 indicating that the company is less solvent in 2025.

Earnings per share decreased from $3.15 in 2024 to $3.06 in 2025. This indicates a decline in profitability during 2025.

LO 2 BT: AP Difficulty: Medium TOT: 15 min. AACSB: Analytic AICPA FC: Measurement Analysis ad Interpretation

PROBLEM 2.6

	2024	2025
(a) Earnings per share.		
	$\frac{\$60{,}000}{30{,}000 \text{ common shares}} = \$2.00$	$\frac{\$70{,}000}{33{,}000 \text{ common shares}} = \$2.12$
(b) Working capital.		
	(\$20,000 + \$62,000 + \$73,000) – \$70,000 = \$85,000	(\$28,000 + \$70,000 + \$90,000) – \$75,000 = \$113,000
(c) Current ratio.		
	$\frac{\$155{,}000}{\$70{,}000} = 2.2{:}1$	$\frac{\$188{,}000}{\$75{,}000} = 2.5{:}1$
(d) Debt to assets ratio.		
	$\frac{\$160{,}000}{\$685{,}000} = 23.4\%$	$\frac{\$155{,}000}{\$760{,}000} = 20.4\%$

(e) Net income and earnings per share have increased, indicating that the underlying profitability of the corporation has improved. 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: Measurement Analysis and Interpretation

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)
(b)	Current ratio	1.66:1 (\$17,488 ÷ \$10,512)	.88:1 (\$48,949 ÷ \$55,390)
(c)	Debt to assets ratio	68.9% (\$30,394 ÷ \$44,106)	60.1% (\$98,144 ÷ \$163,429)
(d)	Earnings per share	$\$2.86 = \frac{\$2,214}{774}$	$\$3.39 = \frac{\$13,400}{3,951}$

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

Liquidity—Target's current ratio of 1.66:1 is much better than Walmart's .88:1 and Target has significantly higher working capital than Wal-Mart.

Solvency—Walmart's debt to assets ratio is about 13% less than Target's.

LO 2 BT: AP Difficulty: Medium TOT: 20 min. AACSB: Analytic AICPA FC: Measurement Analysis and interpretation

PROBLEM 2.8

(a) Accounting information is the compilation and presentation of financial information for a company. It provides information in the form of financial statements and additional disclosures that is useful for decision-making.

The accounting rules and practices that have substantial authoritative support and are recognized as a general guide for financial reporting purposes are referred to as generally accepted accounting principles (GAAP). The biotechnology company that employs Saira will follow GAAP to report its assets, liabilities, stockholders' equity, revenues, and expenses as it prepares financial statements.

(b) Saira is correct in her understanding that the low success rate for new biotech products will be a cause of concern for investors. Her suggestion that detailed scientific findings be reported to prospective investors might offset some of their concerns but it probably won't conform to the qualitative characteristics of accounting information.

These characteristics consist of relevance, faithful representation, comparability, consistency, verifiability, timeliness, and understandability. They apply to accounting information rather than the scientific findings that Saira wants to include.

LO 3 BT: E Difficulty: Medium TOT: 15 min. AACSB: Reflective Thinking AICPA FC: Measurement and Reporting

CCC2 CONTINUING COOKIE CREATIONS

(a) The balance sheet reports the assets, liabilities, and stockholders' equity of a company at a specific date. The income statement presents the revenues and expenses and resulting net income or net loss of a company for a specific period of time. The retained earnings statement summarizes the changes in retained earnings for a specific period of time. Finally, the cash flow statement provides information about the cash inflows and cash outflows for a specific period of time.

(b) By looking at the balance sheet and the cash flow statement and calculating liquidity ratios we can measure a company's short term ability to pay its obligations. Liquidity ratios include the calculation of working capital (current assets minus current liabilities) and current ratio (current assets divided by current liabilities).

(c) By looking at the balance sheet and the cash flow statement and calculating solvency ratios we are able to measure a company's ability to survive over a long period of time. These solvency ratios include debt to assets (total liabilities divided by total assets).

(d) By looking at the income statement we can determine if Biscuits is profitable. If revenues earned by Biscuits exceed expenses incurred, then Biscuits is profitable. Profitability ratios can measure a company's ability to generate earnings over a period of time. One profitability ratio is earnings per share (net income minus preferred dividends divided by average common shares outstanding).

(e) By looking at the balance sheet we can determine if Biscuits has any debt. By looking at the balance sheet and cash flow statement and calculating solvency ratios we are able to determine whether a company has the ability to repay its long-term debt. Profitability ratios will help in determining whether a company is able to pay its interest expense. The more profitable the company the better able it is to repay its long-term obligations as well as the amount of interest it is paying on its debt.

(f) By looking at the statement of cash flows we can determine whether Biscuits has paid any dividends to its shareholders.

(g) Be aware that financial statements of Biscuits provide a historical perspective of what has already taken place. The financial statements may prove to be a good indicator of what will happen in the future but remember that is not necessarily guaranteed. Consumer tastes change, and as a result, the demand for Biscuits' product may also change.

There are other issues that Natalie must consider as well. Does she have the ability to meet the demands of Biscuits? Will she be able to produce 1,500 dozen cookies a week? Does she have enough staff to enable her to do so? Does she have a large enough oven to do so? Does she have enough cash to pay her staff, purchase supplies, and cover operating expenses until she receives payment from Biscuits?

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 accounts receivable. 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: AN Difficulty: Medium TOT: 8 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation

CT2.2 COMPARATIVE ANALYSIS PROBLEM

(a)

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

(b) ***Liquidity***

Under Armour appears much 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: Measurement Analysis and Interpretation

CT2.3 COMPARATIVE ANALYSIS PROBLEM

(a)

	($ in millions)	Amazon	Walmart
1.	Working capital	\$132,733 – \$126,385 = \$6,348	\$90,067 – \$92,645 = \$(2,578)
2.	Current ratio	\$132,733 ÷ \$126,385 = 1.05:1	\$90,067 ÷ \$92,645 = .97:1
3.	Debt to assets ratio	$\frac{\$227,791^{*}}{\$321,195} = 70.9\%$	$\frac{\$164,965^{**}}{\$252,496} = 65.3\%$

*\$126,385 + \$52,573 + \$31,816 + \$17,017

**\$92,645 + \$41,194 +\$12,909 +\$3,847 + \$14,370

(b) ***Liquidity***

Amazon appears more liquid since it has \$8,926 million more working capital than Walmart. Also, Amazon's current ratio is slightly better than Walmart's.

Solvency

Based on the debt to assets ratio, Walmart is slightly more solvent. Walmart's debt to assets ratio is lower than Amazon's and, therefore, Walmart 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: Measurement Analysis and Interpretation

CT2.4 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:

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

(b) **Gap's working capital and current ratio decreased (2022), increased (2023 and 2024) and then decreased (2025) 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 .39 in 2021, rose to .45 in 2022 and then came back down to .42 in 2025.**

(d) **The earnings per share suggest that Gap's profitability improved significantly from 2021 to 2025, increasing from $0.94 to $1.89.**

LO 2 BT: AN Difficulty: Hard TOT: 15 min. AACSB: Analytic AICPA FC: Measurement Analysis and Interpretation

REAL-WORLD FOCUS

CT 2.5

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 FC: Reporting

CT 2.6

Answers will vary depending on the company chosen and the date.

LO 1, 2 BT: E Difficulty: Hard TOT: 25 min. AACSB: Analytic, Technology, and Reflective Thinking AICPA FC: Reporting AICPA BB: Decision Making

CT2.7 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.

The earnings per share increase is a favorable indicator for profitability. A 109% (from $1.15 to $2.40) increase indicates a significant increase in net income and provides a favorable sign regarding going-concern potential.

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

CT2.8	COMMUNICATION ACTIVITY

To: B. P. Palmer

From: Accounting Major

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

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

2. Example of solvency measures:

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

CT2.8 (Continued)

3. **Example of profitability measure:**

$$\textbf{Earnings per share} = \frac{\textbf{Net income} - \textbf{Preferred dividends}}{\textbf{Average common shares outstanding}}$$

(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: C Difficulty: Medium TOT: 18 min. AACSB: Communication AICPA PC: Communication

CT2.9	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) **The periodicity assumption requires that financial results be reported on specific, pre-determined dates.**

The full disclosure principle requires that all circumstances and events that make a difference to financial statement users must be disclosed.

(d) **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.**

(e) **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).**

(f) **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: Measurement Analysis ad Interpretation AICPA PC: Ethical Conduct

CT2.10 ALL ABOUT YOU

Answers will vary.

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

CT2.11 FASB CODIFICATION ACTIVITY

(a) 1. Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.

2. Current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities.

(b) Access FASB Codification 210-20-45

A right of set off exists when all of the following conditions are met:

1. Each of two parties owes the other determinable amounts.

2. The reporting party has the right to offset the amount owed with the amount owed by the other party.

3. The reporting party intends to offset.

4. The right of offset is enforceable at law. As a result, a company may not offset accounts payable against cash on its balance sheet.

LO 1 BT: C Difficulty: Medium TOT: 15 min. AACSB: Analytic and Technology AICPA FC: Research

CT2.12 PEOPLE, PLANET, AND PROFIT

(a) The existence of three 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 purchasing and using safety equipment, worker and environmental health conditions, child labor regulations, standard of living and income changes, and quality control. 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 Reflective Thinking AICPA FC: Measurement Analysis and Interpretation, Reporting AICPA BB: Global and Industry Perspectives

CHAPTER 2

SOLUTIONS TO EXERCISES—SET B

EXERCISE 2-1B

CL	Accounts payable
CA	Accounts receivable
PPE	Accumulated depreciation—buildings
PPE	Buildings
CA	Cash
CA	Interest receivable
IA	Goodwill
CL	Notes payable
CA	Inventory
LTI	Investments
PPE	Land
LTL	Mortgage payable
CA	Supplies
PPE	Equipment
CA	Prepaid rent

EXERCISE 2-2B

CA	Prepaid rent
PPE	Equipment
IA	Copyrights
CL	Salaries and wages payable
CL	Income taxes payable
RE	Retained earnings
CA	Accounts receivable
PPE	Land
IA	Patents
LTL	Bonds payable
CS	Common stock
PPE	Accumulated depreciation—equipment
CL	Unearned sales revenue
CA	Inventory

EXERCISE 2-3B

BOEING COMPANY
Partial Balance Sheet
December 31, 2014
(in millions)

Assets		
Current assets		
Cash	$ 7,042	
Debt investments	2,266	
Accounts receivable	5,740	
Notes receivable	328	
Inventory	9,563	
Total current assets		$24,939
Long term investments		
Notes receivable		6,777
Property, plant, and equipment		
Buildings	20,180	
Less: Accumulated depreciation—buildings	11,915	8,265
Intangible assets		
Patents		16,664
Total assets		$56,645

EXERCISE 2-4B

H. J. HEINZ COMPANY
Partial Balance Sheet
April 30, 2014
(in thousands)

Assets			
Current assets			
Cash		$ 617,687	
Accounts receivable		1,161,481	
Inventory		1,378,216	
Prepaid insurance		168,182	
Total current assets			$ 3,325,566
Property, plant, and equipment			
Land		56,007	
Buildings	$4,344,269		
Less: Accumulated depr-buildings	2,295,563	2,048,706	2,104,713
Intangible assets			
Goodwill		4,411,521	
Trademarks		723,243	5,134,764
Total assets			$10,565,043

EXERCISE 2-5B

TROTTER COMPANY
Balance Sheet
December 31, 2014

Assets			
Current assets			
Cash		$18,840	
Accounts receivable		10,600	
Prepaid insurance		3,200	
Total current assets			$ 32,640
Property, plant, and equipment			
Land		61,200	
Buildings	$115,800		
Less: Accumulated depreciation—buildings	45,600	70,200	
Equipment	82,400		
Less: Accumulated depreciation—equipment	18,720	63,680	195,080
Total assets			$227,720
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		75,000	
Retained earnings ($40,000 + $6,020*)		46,020	
Total stockholders' equity			121,020
Total liabilities and stockholders' equity			$227,720

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

EXERCISE 2-6B

TEXAS INSTRUMENTS, INC.
Balance Sheet
December 31, 2014
(in millions)

Assets

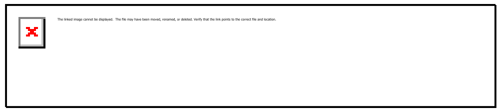
Current assets		
Cash	$ 1,328	
Debt investments	1,596	
Accounts receivable	1,742	
Inventory	1,418	
Prepaid rent	834	
Total current assets		$ 6,918
Long-term investments		
Stock investments		267
Property, plant, and equipment		
Equipment	7,568	
Less: Accumulated depreciation—equipment	3,959	3,609
Intangible assets		
Patents		1,873
Total assets		$12,667

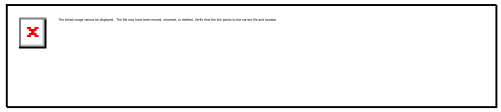
Liabilities and Stockholders' Equity

Current liabilities		
Accounts payable	$1,368	
Income taxes payable	657	
Total current liabilities		$ 2,025
Noncurrent liabilities		
Notes payable		667
Total liabilities		2,692
Stockholders' equity		
Common stock	2,671	
Retained earnings	7,304	
Total stockholders' equity		9,975
Total liabilities and stockholders' equity		$12,667

EXERCISE 2-7B

(a) **Earnings (loss) per share =** $\dfrac{\textbf{Net income – Preferred dividends}}{\textbf{Average common shares outstanding}}$

2014 :  **= $(0.29)**

2013 :  **= $(0.24)**

(b) **Using net loss as a basis to evaluate profitability, Callaway Company's net loss increased by 23% [($18,804 – $15,260) ÷ $15,260]. Its loss per share increased by 21% [($0.29 – $0.24) ÷ $0.24].**

(c) **To determine earnings (loss) per share, dividends on preferred stock are subtracted from net income (added to net loss), but dividends on common stock are not subtracted.**

EXERCISE 2-8B

(a)

WI-HAUL CORPORATION
Income Statement
For the Year Ended July 31, 2014

Revenues		
Service revenue	$66,100	
Rent revenue	8,500	
Total revenues		$74,600
Expenses		
Salaries and wages expense	57,500	
Supplies expense	17,600	
Depreciation expense	4,000	
Total expenses		79,100
Net loss		$ (4,500)

WI-HAUL CORPORATION
Retained Earnings Statement
For the Year Ended July 31, 2014

Retained earnings, August 1, 2013		$34,000
Less: Net loss	$4,500	
Dividends	4,000	8,500
Retained earnings, July 31, 2014		$25,500

(b)

WI-HAUL CORPORATION
Balance Sheet
July 31, 2014

Assets

Current assets		
Cash	$26,200	
Accounts receivable	11,780	
Total current assets		$37,980
Property, plant, and equipment		
Equipment	17,500	
Less: Accumulated depreciation—equipment	6,000	11,500
Total assets		$49,480

EXERCISE 2-8B (Continued)

(b)

WI-HAUL CORPORATION
Balance Sheet (Continued)
July 31, 2014

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	25,500	
Total stockholders' equity		41,500
Total liabilities and stockholders' equity		$49,480

(c) $\text{Current ratio} = \dfrac{\$37{,}980}{\$6{,}180} = 6.1:1$

$\text{Debt to assets ratio} = \dfrac{\$7{,}980}{\$49{,}480} = 16.1\%$

(d) The current ratio would not change because equipment is not a current asset and a 5-year note payable is a long-term liability rather than a current liability.

The debt to assets ratio would increase from 16.1% to 40.3%*.

Looking solely at the debt to assets ratio, I would favor making the sale because Wi-Haul's debt to assets ratio of 16.1% is very low. Looking at additional financial data, I would note that Wi-Haul reported a significant loss for the current year which would lead me to question its ability to make interest and loan payments (and even remain in business) in the future. I would not make the proposed sale unless Wi-Haul convinced me that it would be capable of earnings in the future rather than losses.

I would also consider making the sale but requiring a substantial down-payment and smaller note.

*($7,980 + $20,000) ÷ ($49,480 + $20,000)

EXERCISE 2-9B

(a)

	Beginning of Year	End of Year
Working capital	\$2,742 – \$1,433 = \$1,309	\$3,361 – \$1,635 = \$1,726
Current ratio	= 1.91:1	= 2.06:1

(b) Nordstrom’s liquidity increased during the year. Its current ratio increased from 1.91:1 to 2.06:1. Also, Nordstrom’s working capital increased by \$417,000,000.

(c) Nordstrom’s current ratio at both the beginning and the end of the recent year exceeds Best Buy’s current ratio for 2014 and 2013. Nordstrom’s end-of-year current ratio (2.06) exceeds Best Buy’s 2014 current ratio of 1.41. Nordstrom would be considered much more liquid than Best Buy for the recent year.

EXERCISE 2-10B

(a)

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

(b) $$\text{Current ratio} = \frac{\$42{,}000^{*}}{\$12{,}000^{**}} = 3.5:1$$

Working capital = \$42,000 – \$12,000 = \$30,000

*\$60,000 – \$18,000 **\$30,000 – \$18,000

(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.

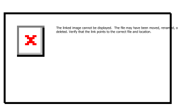
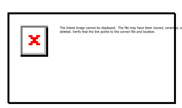
If a company has more current assets than current liabilities it is more likely that it will meet obligations as they become due. Since working capital and the current ratio compare current assets to current liabilities, both are measures of liquidity.

EXERCISE 2-10B (Continued)

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 Abrev's case, payment of $18,000 of accounts payable will leave only $17,000 cash. Since salaries payable will require $12,000, the company may need to borrow in order to make the required payment for salaries.

(d) The CFO's decision to use $18,000 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.

EXERCISE 2-11B

		2014	2013
(a)	Current ratio	$\frac{\$1,020,834}{\$376,178}$ = 2.71:1	$\frac{\$1,189,108}{\$464,618}$ = 2.56:1
(b)	Earnings per share	$\frac{\$400,019}{\$216,119}$ = $1.85	$\frac{\$387,359}{\$222,662}$ = $1.74
(c)	Debt to assets ratio	 = 28.2%	 = 28.4%

(d) Using the debt to assets ratio and free cash flow as measures of solvency produces negative results for American Eagle Outfitters. Its debt to assets ratio decreased slightly from 28.4% for 2013 to 28.2% for 2014 indicating a very small increase in solvency for 2014. Its free cash flow decreased by 71% indicating a significant decline in solvency.

EXERCISE 2-11B (Continued)

(e) In both 2014 and 2013 American Eagle Outfitters cash provided by operating activities was greater than the cash used for capital expenditures. It is generating plenty of cash from operations to cover its investing needs. This is not unusual for a company that has been operating successfully for more than ten years, as has been the case with American Eagle Outfitters. If it faced a deficiency, it could meet it by issuing stock or debt.

EXERCISE 2-12B

(a) __2__ Going concern assumption
(b) __6__ Economic entity assumption
(c) __3__ Monetary unit assumption
(d) __4__ Periodicity assumption
(e) __5__ Historical cost principle
(f) __1__ Full disclosure principle

EXERCISE 2-13B

1. **Incorrect. The *historical cost principle* requires that assets be recorded and reported at their cost.**

2. **Correct. The *monetary unit assumption* assumes the unit of measure remains sufficiently constant over time.**

3. **Incorrect. The *economic entity assumption* requires that the activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities.**

CHAPTER 2

PROBLEM 2-1B

STARBUCKS CORPORATION
Balance Sheet
September 30, 2014
(Amounts are in millions)

Assets		
Current assets		
Cash	$281	
Debt investments	157	
Accounts receivable	288	
Inventory	692	
Prepaid rent	278	
Total current assets		$1,696
Long-term investments		
Stock investments		280
Property, plant and equipment		
Equipment	3,036	
Less: Accumulated depreciation—equipment	145	2,891
Intangible assets		
Goodwill		477
Total assets		$5,344
Liabilities and Stockholders' Equity		
Current liabilities		
Notes payable	$ 1,468	
Accounts payable	391	
Unearned sales revenue	297	
Total current liabilities		$2,156
Long-term liabilities		
Notes payable	550	
Bonds payable	354	
Total long-term liabilities		904
Total liabilities		3,060
Stockholders' equity		
Common stock	40	
Retained earnings	2,244	

Total stockholders' equity	**2,284**
Total liabilities and stockholders' equity	**$5,344**

PROBLEM 2-2B

MUELLER, INC.
Income Statement
For the Year Ended December 31, 2014

Revenues		
Service revenue		$51,000
Expenses		
Salaries and wages expense	$34,000	
Depreciation expense	4,300	
Maintenance and repairs expense	2,600	
Utilities expense	2,100	
Insurance expense	1,800	
Total expenses		44,800
Net income		$ 6,200

MUELLER, INC.
Retained Earnings Statement
For the Year Ended December 31, 2014

Retained earnings, January 1	$14,000
Plus: Net income	6,200
	20,200
Less: Dividends	2,600
Retained earnings, December 31	$17,600

PROBLEM 2-2B (Continued)

MUELLER, INC.
Balance Sheet
December 31, 2014

Assets		
Current assets		
Cash	$ 6,100	
Accounts receivable	2,900	
Prepaid insurance	2,400	
Total current assets		$11,400
Property, plant, and equipment		
Equipment	30,000	
Less: Accumulated depreciation	7,600	22,400
Total assets		$33,800
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 7,200	
Salaries and wages payable	3,000	
Total current liabilities		$10,200
Stockholders' equity		
Common stock	6,000	
Retained earnings	17,600	
Total stockholders' equity		23,600
Total liabilities and stockholders' equity		$33,800

PROBLEM 2-3B

(a)

VERN CORPORATION
Income Statement
For the Year Ended April 30, 2014

Revenues		
Sales revenue		$20,450
Expenses		
Salaries and wages expense	$5,840	
Depreciation expense	3,200	
Income tax expense	700	
Rent expense	660	
Interest expense	350	
Total expenses		10,750
Net income		$ 9,700

VERN CORPORATION
Retained Earnings Statement
For the Year Ended April 30, 2014

Retained earnings, May 1, 2013	$13,960
Plus: Net income	9,700
	23,660
Less: Dividends	2,800
Retained earnings, April 30, 2014	$20,860

PROBLEM 2-3B (Continued)

(b)

VERN CORPORATION
Balance Sheet
April 30, 2014

Assets		
Current assets		
Cash	$20,955	
Accounts receivable	10,150	
Prepaid rent	380	
Total current assets		$31,485
Equipment	24,250	
Less: Accumulated depreciation—equipment	6,600	17,650
Total assets		$49,135
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 3,100	
Income taxes payable	300	
Interest payable	175	
Total current liabilities		$ 3,575
Notes payable		4,700
Total liabilities		8,275
Stockholders' equity		
Common stock	20,000	
Retained earnings	20,860	
Total stockholders' equity		40,860
Total liabilities and stockholders' equity		$49,135

PROBLEM 2-4B

(a) Wise's net income is $215,000 ($900,000 – $450,000 – $150,000 – $10,000 – $75,000).

Its earnings per share is $.43 ($215,000 ÷ 500,000 shares).

Omaz's net income is $74,000 ($450,000 – $225,000 – $130,000 – $6,000 – $15,000).

Its earnings per share is $.37 ($74,000 ÷ 200,000 shares).

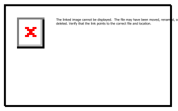
(b) Wise's 2014 working capital of $470,000 ($700,000 – $230,000) is over 4 times as high as Omaz's working capital of $105,000 ($180,000 – $75,000). And Wise's 2014 current ratio of 3.0:1 ($700,000 ÷ $230,000) is higher than Omaz's current ratio of 2.4:1 ($180,000 ÷ $75,000).

(c) Omaz appears to be less solvent. Omaz's 2014 debt to assets ratio of 34% ($265,000 ÷ $780,000)[a] is slightly higher than Wise's ratio of 29% ($430,000 ÷ $1,500,000)[b]. 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.

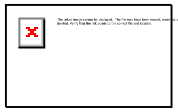
[a]<u>$265,000</u> ($75,000 + $190,000) is Omaz's 2014 total liabilities.
<u>$780,000</u> ($180,000 + $600,000) is Omaz's 2014 total assets.

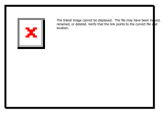
[b]<u>$430,000</u> ($230,000 + $200,000) is Wise's 2014 total liabilities.
<u>$1,500,000</u> ($700,000 + $800,000) is Wise's 2014 total assets.

PROBLEM 2-5B

(a) (i) Current ratio =  **= 2.0:1.**

(ii) Working capital = $302,600 – $148,700 = $153,900.

(iii) Debt to assets ratio =  **= 34%.**

(iv) Earnings per share =  **= $1.53.**

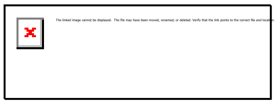
(b) During 2014, Divine's current ratio decreased from 2.4:1 to 2.0:1 and its working capital dropped from $178,000 to $153,900. Both measures indicate a slight decline in liquidity during 2014.

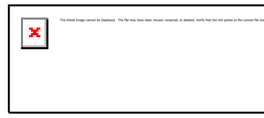
Divine's debt to assets ratio increased from 31% in 2013 to 34% in 2014 indicating that the company is less solvent in 2014. Using another measure of solvency, free cash flow, we see that Divine's solvency has not improved during 2014. Earnings per share increased from $1.35 to $1.53 in 2014. This 13% increase indicates better profitability in 2014.

PROBLEM 2-6B

	2013	2014

(a) Earnings per share.

 **= $.35**

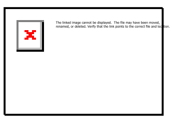
 **= $.27**

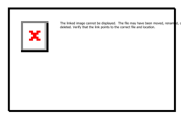
(b) Working capital.

($30,000 + $55,000 + $73,000) – $65,000 = $93,000

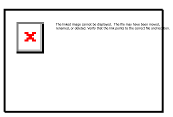
($50,000 + $80,000 + $74,000) – $88,000 = $116,000

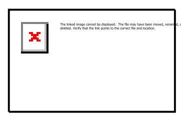
(c) Current ratio.

 **= 2.43:1**

 **= 2.32:1**

(d) Debt to assets ratio.

 **= 21.8%**

 **= 22.2%**

(e) The underlying profitability of the corporation as measured by earnings per share has declined. The overall liquidity of the corporation has dropped as shown by the slight decrease in the current ratio. Also, the corporation appears to be increasing its debt burden as its debt to assets ratio increased slightly indicating a decrease in solvency. Comparing free cash flow, we find a drop in this measure of solvency also.

PROBLEM 2-7B

	Ratio	Home Depot	Lowe's
		(All Dollars are in Millions)	
(a)	Working capital	$14,674 – $12,706 = $1,968	$8,686 – $7,751 = $935
(b)	Current ratio	1.2:1 ($14,674 ÷ $12,706)	1.1:1 ($8,686 ÷ $7,751)
(c)	Debt to assets ratio	60.0% ($26,610 ÷ $44,324)	47.9% ($14,771 ÷ $30,869)
(d)	Earnings per share	$2.38 =	$1.90 =

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

Liquidity—Home Depot's current ratio of 1.2:1 is slightly better than Lowes' 1.1:1 and Home Depot has significantly higher working capital than Lowe's.

Solvency—Home Depot's debt to assets ratio is about 25% more than Lowe's but its free cash flow is much larger.

Profitability—Home Depot's earnings per share is about 25% higher than Lowe's.

PROBLEM 2-8B

(a) The primary objective of financial reporting is to provide information useful for decision making. Since Yocum's shares appear to be actively traded, investors must be capable of using the information made available by Yocum to make decisions about the company.

(b) The investors must feel as if the company will show earnings in the future. They must recognize that information relevant to their investment choice is indicated by more than Yocum's net income.

(c) The change from Canadian dollars to U.S. dollars for reporting purposes should make Yocum's more comparable with companies traded on U.S. stock exchanges.

CHAPTER 2

A Further Look at Financial Statements

PROBLEM 2-1C

KELLOGG COMPANY
Balance Sheet
December 31, 2014
(in millions)

Assets		
Current assets		
Cash	$ 334	
Accounts receivable, net	1,093	
Inventory	910	
Prepaid insurance	221	
Total current assets		$ 2,558
Property, plant, and equipment		
Equipment	3,870	
Less: Accumulated depreciation—equipment	860	3,010
Intangible assets		
Goodwill		5,632
Total assets		$11,200
Liabilities and Stockholders' Equity		
Current liabilities		
Notes payable—current	$ 1,211	
Accounts payable	1,077	
Total current liabilities		$ 2,288
Long-term liabilities		
Notes payable—noncurrent	4,835	
Bonds payable	1,802	
Total long-term liabilities		6,637
Total liabilities		8,925
Stockholders' equity		
Common stock	577	
Retained earnings	1,698	
Total stockholders' equity		2,275
Total liabilities and stockholders' equity		$11,200

PROBLEM 2-2C

TILLEY, INC.
Income Statement
For the Year Ended December 31, 2014

Revenues		
Service revenue		$53,000
Expenses		
Salaries and wages expense	$36,000	
Depreciation expense	4,300	
Maintenance and repairs expense	2,600	
Utilities expense	2,100	
Insurance expense	1,800	
Total expenses		46,800
Net income		$ 6,200

TILLEY, INC.
Retained Earnings Statement
For the Year Ended December 31, 2014

Retained earnings, January 1	$14,000
Plus: Net income	6,200
	20,200
Less: Dividends	2,600
Retained earnings, December 31	$17,600

TILLEY, INC.
Balance Sheet
December 31, 2014

Assets

Current assets		
Cash	$ 5,100	
Accounts receivable	4,900	
Prepaid insurance	1,400	
Total current assets		$11,400
Property, plant, and equipment		
Equipment	31,000	
Less: Accumulated depreciation - equipment	8,600	22,400
Total assets		$33,800

Liabilities and Stockholders' Equity

Current liabilities		
Accounts payable	$8,200	
Salaries and wages payable	2,000	
Total current liabilities		$10,200
Stockholders' equity		
Common stock	6,000	
Retained earnings	17,600	
Total stockholders' equity		23,600
Total liabilities and stockholders' equity		$33,800

PROBLEM 2-3C

(a)

RAPP CORPORATION
Income Statement
For the Year Ended April 30, 2014

Revenues		
Sales revenue		$21,450
Expenses		
Salaries and wages expense	$6,840	
Depreciation expense	2,200	
Income tax expense	1,600	
Rent expense	760	
Interest expense	350	
Total expenses		11,750
Net income		$ 9,700

RAPP CORPORATION
Retained Earnings Statement
For the Year Ended April 30, 2014

Retained earnings, May 1, 2013	$13,960
Plus: Net income	9,700
	23,660
Less: Dividends	2,800
Retained earnings, April 30, 2014	$20,860

PROBLEM 2-3C (Continued)

(b)

RAPP CORPORATION
Balance Sheet
April 30, 2014

Assets

Current assets		
Cash	$21,955	
Accounts receivable	9,150	
Prepaid rent	380	
Total current assets		$31,485
Equipment	24,250	
Less: Accumulated depreciation—equipment	6,600	17,650
Total assets		$49,135

Liabilities and Stockholders' Equity

Current liabilities		
Accounts payable	$ 2,100	
Income taxes payable	300	
Interest payable	175	
Total current liabilities		$ 2,575
Notes payable		5,700
Total liabilities		8,275
Stockholders' equity		
Common stock	20,000	
Retained earnings	20,860	
Total stockholders' equity		40,860
Total liabilities and stockholders' equity		$49,135

(c) **Rapp Corporation reports its revenues and expenses on the income statement with net income being the result. Net income from the income statement is reported on the retained earnings statement as an item added to beginning retained earnings as part of the determination of retained earnings at year end. The year end retained earnings is then reported as part of stockholders' equity on the balance sheet.**

PROBLEM 2-4C

(a) **Weber's net income is $136,000 ($890,000 – $620,000 – $59,000 – $10,000 – $65,000).**

Its earnings per share is $.34 ($136,000 ÷ 400,000 shares).

Al Sharif's net income is $44,000 ($450,000 – $260,000 – $130,000 – $6,000 – $10,000).

Its earnings per share is $.22 ($44,000 ÷ 200,000 shares).

(b) **Weber's 2014 working capital of $400,000 ($700,000 – $300,000) is over 3 times as high as Al Sharif's working capital of $105,000 ($180,000 – $75,000). However, Weber's 2014 current ratio of 2.3:1 ($700,000 ÷ $300,000) is slightly lower than Al Sharif's current ratio of 2.4:1 ($180,000 ÷ $75,000).**

(c) **Al Sharif appears to be less solvent. Al Sharif's 2014 debt to assets ratio of 34% ($265,000 ÷ $780,000)[a] is slightly higher than Weber's ratio of 33% ($500,000 ÷ $1,500,000)[b]. 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]<u>$265,000</u> ($75,000 + $190,000) is Al Sharif's 2014 total liabilities.
<u>$780,000</u> ($180,000 + $600,000) is Al Sharif's 2014 total assets.

[b]<u>$500,000</u> ($300,000 + $200,000) is Weber's 2014 total liabilities.
<u>$1,500,000</u> ($700,000 + $800,000) is Weber's 2014 total assets.

PROBLEM 2-5C

(a) (i) Current ratio = $\frac{\$298,600}{\$148,700}$ = 2.0:1.

(ii) Working capital = $298,600 – $148,700 = $149,900.

(iii) Debt to assets ratio = $\frac{\$258,700}{\$763,900}$ = 34%.

(iv) Earnings per share = $\frac{\$99,200}{65,000}$ = $1.53.

(b) During 2014, DeVoe's current ratio decreased from 2.4:1 to 2.0:1 and its working capital dropped from $178,000 to $149,900. Both measures indicate a slight decline in liquidity during 2014.

DeVoe's debt to assets ratio increased from 31% in 2013 to 34% in 2014 indicating that the company is less solvent in 2014. Using another measure of solvency, free cash flow, we see that DeVoe's solvency has improved during 2014. Earnings per share increased from $1.35 to $1.53 in 2014. This 13% increase indicates better profitability in 2014.

PROBLEM 2-6C

	2013	2014

(a) Earnings per share.

2013: $\frac{\$163{,}000}{320{,}000 \text{ shares}} = \$.51$

2014: $\frac{\$150{,}000}{370{,}000 \text{ shares}} = \$.41$

(b) Working capital.

2013: ($24,000 + $55,000 + $73,000) – $65,000 = $87,000

2014: ($40,000 + $90,000 + $74,000) – $88,000 = $116,000

(c) Current ratio.

2013: $\frac{\$152{,}000}{\$65{,}000} = 2.34{:}1$

2014: $\frac{\$204{,}000}{\$88{,}000} = 2.32{:}1$

(d) Debt to assets.

2013: $\frac{\$135{,}000}{\$619{,}000} = 21.8\%$

2014: $\frac{\$178{,}000}{\$802{,}000} = 22.2\%$

(e) The underlying profitability of the corporation as measured by earnings per share has declined. The liquidity of the corporation dropped as shown by the increase in working capital and the slight decrease current ratio. Also, the corporation appears to be increasing its debt burden as its debt to assets increased slightly indicating a decrease in solvency. Comparing free cash flow, we find a drop in this measure of solvency also.

PROBLEM 2-7C

	Ratio	Blockbuster Inc	Movie Gallery, Inc.
		(All Dollars Are in Millions)	
(a)	Working capital	$171 ($1,566 – $1,395)	($29) ($239 – $268)
(b)	Current ratio	1.12:1 ($1,566 ÷ $1,395)	.89:1 ($239 ÷ $268)
(c)	Debt to assets ratio	71.6% ($2,246 ÷ $3,137)	120.6% ($1,390 ÷ $1,153)
(d)	Earnings (Loss) per share	$\$0.29 = \frac{\$55 - 0}{189.0}$	$(\$0.82) = \frac{(\$26) - 0}{31.8}$

(f) **The comparison of the two companies shows the following:**

Liquidity—Blockbuster's current ratio is 1.12:1 compared to Movie Gallery's .89:1. Its working capital is $171 compared to Movie Gallery's negative $29. Blockbuster is much more liquid than Movie Gallery using either indicator.

Solvency—Blockbuster is more solvent than Movie Gallery because its ratio of debt to assets is significantly lower and its free cash flow is much larger.

Profitability—Blockbuster reported a net income while Movie Gallery reported a net loss. Therefore, Blockbusters is more profitable.

PROBLEM 2-8C

(a) The primary objective of financial reporting is to provide information useful for decision making. Since Net Nanny's shares appear to be actively traded, investors must be capable of using the information made available by Net Nanny to make decisions about the company.

(b) The investors must feel as if the company will show earnings in the future. They must recognize that information relevant to their investment choice is indicated by more than Net Nanny's net income.

(c) The change from Canadian dollars to U.S. dollars for reporting purposes should make Net Nanny more comparable with companies traded on U.S. stock exchanges.