

# **Solutions Manual for Financial Accounting for Managers 1st Kimmel**

# CHAPTER 2

## A Further Look at the Balance Sheet

### Learning Objectives

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

# ANSWERS TO QUESTIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

8. (a) Liquidity ratios: Working capital and current ratio.  
(b) Solvency ratio: Debt to assets.

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

## Questions Chapter 2 (Continued)

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

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

10. (a) Liquidity ratios measure the short-term ability of the company to pay its maturing obligations and to meet unexpected needs for cash.
- (b) Profitability ratios measure the income or operating success of a company for a given period of time.
- (c) Solvency ratios measure the company's ability to survive over a long period of time.

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

11. (a) An increase in the current ratio signals good news because the company improved its ability to meet maturing short-term obligations.
- (b) The increase in the debt to assets ratio is bad news because it means that the company has increased its obligations to creditors and has lowered its equity "buffer."

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

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

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

# SOLUTIONS TO BRIEF EXERCISES

## BRIEF EXERCISE 2.1

|            |                          |            |                               |
|------------|--------------------------|------------|-------------------------------|
| <u>CL</u>  | Accounts payable         | <u>CL</u>  | Income taxes payable          |
| <u>CA</u>  | Accounts receivable      | <u>LTl</u> | Investment in long-term bonds |
| <u>PPE</u> | Accumulated depreciation | <u>PPE</u> | Land                          |
| <u>PPE</u> | Buildings                | <u>CA</u>  | Inventory                     |
| <u>CA</u>  | Cash                     | <u>IA</u>  | Patent                        |
| <u>IA</u>  | Goodwill                 | <u>CA</u>  | Supplies                      |

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

## BRIEF EXERCISE 2.2

### CHIN COMPANY Partial Balance Sheet

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|                            |                 |
|----------------------------|-----------------|
| <b>Current assets</b>      |                 |
| Cash.....                  | \$10,400        |
| Debt investments.....      | 8,200           |
| Accounts receivable .....  | 14,000          |
| Supplies.....              | 3,800           |
| Prepaid insurance.....     | <u>2,600</u>    |
| Total current assets ..... | <u>\$39,000</u> |

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

## BRIEF EXERCISE 2.3

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

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

## BRIEF EXERCISE 2.4

### ALBERTA COMPANY Partial Balance Sheet December 31, 2027

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

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

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

## BRIEF EXERCISE 2.5

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

| <b>Assets</b>                                                                  |    |              |                        |
|--------------------------------------------------------------------------------|----|--------------|------------------------|
| <b>Current assets</b>                                                          |    |              |                        |
| Cash .....                                                                     | \$ | 1,182        |                        |
| Debt investments .....                                                         |    | 1,743        |                        |
| Accounts receivable .....                                                      |    | 1,823        |                        |
| Inventory .....                                                                |    | 1,202        |                        |
| Prepaid rent.....                                                              |    | <u>164</u>   |                        |
| Total current assets .....                                                     |    |              | \$ 6,114               |
| <b>Long-term investments</b>                                                   |    |              |                        |
| Stock investments .....                                                        |    |              | 637                    |
| <b>Property, plant, and equipment</b>                                          |    |              |                        |
| Equipment .....                                                                |    | 6,705        |                        |
| Less: Accumulated depreciation—equipment.....                                  |    | <u>3,547</u> | 3,158                  |
| <b>Intangible assets</b>                                                       |    |              |                        |
| Patents.....                                                                   |    |              | <u>2,210</u>           |
| Total assets.....                                                              |    |              | <u><u>\$12,119</u></u> |
| (Tot. current assets + L-T invest. + Prop., plant and equip. + Intang. assets) |    |              |                        |

### **Liabilities and Stockholders' Equity**

|                                                        |              |            |                        |
|--------------------------------------------------------|--------------|------------|------------------------|
| <b>Current liabilities</b>                             |              |            |                        |
| Accounts payable .....                                 | \$1,459      |            |                        |
| Income taxes payable .....                             | <u>128</u>   |            |                        |
| Total current liabilities .....                        |              |            | \$ 1,587               |
| <b>Long-term liabilities</b>                           |              |            |                        |
| Notes payable .....                                    |              | <u>810</u> |                        |
| Total liabilities.....                                 |              |            | 2,397                  |
| <b>Stockholders' equity</b>                            |              |            |                        |
| Common stock.....                                      | 2,826        |            |                        |
| Retained earnings.....                                 | <u>6,896</u> |            |                        |
| Total stockholders' equity .....                       |              |            | <u>9,722</u>           |
| Total liabilities and stockholders' equity .....       |              |            | <u><u>\$12,119</u></u> |
| (Tot. current liab. + Notes pay. + Tot. stock. equity) |              |            |                        |

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

## BRIEF EXERCISE 2.6

**Working capital = Current assets – Current liabilities**

|                     |                          |
|---------------------|--------------------------|
| Current assets      | \$ 102.5 million         |
| Current liabilities | <u>(201.2) million</u>   |
| Working capital     | <u>(\$ 98.7) million</u> |

(Current assets – Current liab.)

**Current ratio:**

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

$$= 0.51:1$$

(Current assets ÷ Current liab.)

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

## BRIEF EXERCISE 2.7

(a) Current ratio

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

(Current assets ÷ Current liab.)

(b) Debt to assets ratio

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

(Tot. liab. ÷ Tot. assets)

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



# SOLUTIONS TO DO IT! EXERCISES

## DO IT! 2.1a

### MYLAR CORPORATION Balance Sheet (partial) December 31, 2027

| Assets                                            |               |                         |
|---------------------------------------------------|---------------|-------------------------|
| <b>Current assets</b>                             |               |                         |
| Cash .....                                        | \$ 13,000     |                         |
| Accounts receivable.....                          | 22,000        |                         |
| Inventory .....                                   | 58,000        |                         |
| Supplies .....                                    | <u>7,000</u>  |                         |
| <b>Total current assets .....</b>                 |               | <b>\$100,000</b>        |
| <b>Property, plant, and equipment</b>             |               |                         |
| Equipment.....                                    | 180,000       |                         |
| Less: Accumulated depreciation—<br>equipment..... | <u>50,000</u> | <u>130,000</u>          |
| <b>Total assets.....</b>                          |               | <b><u>\$230,000</u></b> |

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

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

## DO IT! 2.1b

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

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

## DO IT! 2.2

|     |                      |      |                                       |
|-----|----------------------|------|---------------------------------------|
| (a) | Current assets:      | 2027 | \$6,700 (1,700 + 900 + 3,700 + 400)   |
|     |                      | 2026 | \$8,500 (2,400 + 1,200 + 4,200 + 700) |
|     | Current liabilities: | 2027 | \$6,100 (3,900 + 2,200)               |
|     |                      | 2026 | \$4,600 (3,000 + 1,600)               |

|     |                 |      |                             |
|-----|-----------------|------|-----------------------------|
| (b) | Working capital | 2027 | \$6,700 – \$6,100 = \$600   |
|     |                 | 2026 | \$8,500 – \$4,600 = \$3,900 |

|               |      |                            |
|---------------|------|----------------------------|
| Current ratio | 2027 | \$6,700 ÷ \$6,100 = 1.10:1 |
|               | 2026 | \$8,500 ÷ \$4,600 = 1.85:1 |

|     |                      |      |                              |
|-----|----------------------|------|------------------------------|
| (c) | Debt to assets ratio | 2027 | \$42,100 ÷ \$72,700 = 57.91% |
|     |                      | 2026 | \$34,600 ÷ \$80,500 = 42.98% |

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

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

# SOLUTIONS TO EXERCISES

## EXERCISE 2.1

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

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

## EXERCISE 2.2

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

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

## EXERCISE 2.3

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

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

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

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

## EXERCISE 2.4

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

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

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

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

## EXERCISE 2.5

### LONGHORN COMPANY Balance Sheet December 31, 2027

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

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

### Liabilities and Stockholders' Equity

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

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

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

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

**EXERCISE 2.6**

**CARMEN CO.  
Balance Sheet  
December 31, 2027**

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

## EXERCISE 2.6 (Continued)

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

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

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

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

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



## EXERCISE 2.7

(a) **FAIRVIEW CORPORATION**  
**Income Statement**  
**For the Year Ended July 31, 2027**

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|                                  |              |                          |
|----------------------------------|--------------|--------------------------|
| <b>Revenues</b>                  |              |                          |
| Service revenue.....             | \$66,100     |                          |
| Rent revenue .....               | <u>8,500</u> |                          |
| Total revenues .....             |              | \$74,600                 |
| <b>Expenses</b>                  |              |                          |
| Salaries and wages expense ..... | 57,500       |                          |
| Supplies expense .....           | 15,600       |                          |
| Depreciation expense .....       | <u>4,000</u> |                          |
| Total expenses.....              |              | <u>77,100</u>            |
| Net loss.....                    |              | <u><u>\$ (2,500)</u></u> |

(Tot. rev. – Tot. exp.)

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

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|                                        |              |                        |
|----------------------------------------|--------------|------------------------|
| Retained earnings, August 1, 2026..... |              | \$34,000               |
| Less: Net loss .....                   | \$2,500      |                        |
| Dividends .....                        | <u>4,000</u> | <u>6,500</u>           |
| Retained earnings, July 31, 2027 ..... |              | <u><u>\$27,500</u></u> |

(Beg. ret. earn. – Net loss – Div.)

**EXERCISE 2.7 (Continued)****(b)****FAIRVIEW CORPORATION  
Balance Sheet  
July 31, 2027**

| <b>Assets</b>                                          |               |               |                        |
|--------------------------------------------------------|---------------|---------------|------------------------|
| <b>Current assets</b>                                  |               |               |                        |
| Cash .....                                             | \$29,200      |               |                        |
| Accounts receivable .....                              | <u>9,780</u>  |               |                        |
| Total current assets .....                             |               |               | <b>\$38,980</b>        |
| <b>Property, plant, and equipment</b>                  |               |               |                        |
| Equipment .....                                        | 18,500        |               |                        |
| Less: Accumulated depreciation—<br>equipment .....     | <u>6,000</u>  | <u>12,500</u> |                        |
| Total assets .....                                     |               |               | <u><b>\$51,480</b></u> |
| (Tot. current assets + Tot. prop., plant and equip.)   |               |               |                        |
| <b>Liabilities and Stockholders' Equity</b>            |               |               |                        |
| <b>Current liabilities</b>                             |               |               |                        |
| Accounts payable .....                                 | \$ 4,100      |               |                        |
| Salaries and wages payable .....                       | <u>2,080</u>  |               |                        |
| Total current liabilities .....                        |               |               | <b>\$ 6,180</b>        |
| <b>Long-term liabilities</b>                           |               |               |                        |
| Notes payable .....                                    |               | <u>1,800</u>  |                        |
| Total liabilities .....                                |               |               | <u><b>7,980</b></u>    |
| <b>Stockholders' equity</b>                            |               |               |                        |
| Common stock .....                                     | 16,000        |               |                        |
| Retained earnings .....                                | <u>27,500</u> |               |                        |
| Total stockholders' equity .....                       |               |               | <u><b>43,500</b></u>   |
| Total liabilities and stockholders' equity .....       |               |               | <u><b>\$51,480</b></u> |
| (Tot. current liab. + Notes pay. + Tot. stock. equity) |               |               |                        |

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

## EXERCISE 2.8

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

## Liabilities and Stockholders' Equity

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

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**

$$\begin{aligned}\text{Retained earnings} &= \text{Beginning retained earnings} + \text{Net income} \\ &\quad - \text{Dividends declared} \\ &= \$116,520 + \$14,610 - \$0 \\ &= \$131,130\end{aligned}$$

## EXERCISE 2.9 (Continued)

b.

### SUMMIT LTD. Balance Sheet December 31, 2027

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

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

**EXERCISE 2.10**

**BATRA CORPORATION**  
**Income Statement**  
**Year Ended July 31, 2027**

---

**Revenues**

|                       |               |           |
|-----------------------|---------------|-----------|
| Service revenue ..... | \$113,600     |           |
| Rent revenue .....    | <u>18,500</u> |           |
| 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.....           | <u>900</u> |               |
| Total expenses .....            |            | <u>96,500</u> |

|                                |                 |
|--------------------------------|-----------------|
| Income before income tax ..... | 35,600          |
| Income tax expense .....       | <u>5,000</u>    |
| Net Income .....               | <u>\$30,600</u> |

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

**BATRA CORPORATION**  
**Retained Earnings Statement**  
**Year Ended July 31, 2027**

---

|                                         |                 |
|-----------------------------------------|-----------------|
| Retained earnings, August 1, 2026 ..... | \$17,940        |
| Add: Net income .....                   | <u>30,600</u>   |
|                                         | 48,540          |
| Less: Dividends .....                   | <u>12,000</u>   |
| Retained earnings, July 31, 2027.....   | <u>\$36,540</u> |

## EXERCISE 2.10 (Continued)

### BATRA CORPORATION Balance Sheet July 31, 2027

---

| Assets                                     |                  |
|--------------------------------------------|------------------|
| Current assets                             |                  |
| Cash.....                                  | \$ 5,060         |
| Debt investments (short-term).....         | 20,000           |
| Accounts receivable.....                   | 17,100           |
| Supplies .....                             | <u>1,500</u>     |
| Total current assets .....                 | \$ 43,660        |
| Property, plant, and equipment             |                  |
| Equipment.....                             | 62,900           |
| Less: Accumulated depreciation.....        | <u>6,000</u>     |
| Total property, plant, and equipment ..... | <u>56,900</u>    |
| Total assets .....                         | <u>\$100,560</u> |

### Liabilities and Stockholders' Equity

|                                                 |                  |
|-------------------------------------------------|------------------|
| Current liabilities                             |                  |
| Accounts payable.....                           | \$ 4,220         |
| Interest payable .....                          | 1,000            |
| Unearned sales revenue.....                     | 12,000           |
| Bank loan payable .....                         | <u>21,800</u>    |
| Total liabilities .....                         | \$ 39,020        |
| Stockholders' equity                            |                  |
| Common stock.....                               | 25,000           |
| Retained earnings.....                          | <u>36,540</u>    |
| Total stockholders' equity .....                | <u>61,540</u>    |
| Total liabilities and stockholders' equity..... | <u>\$100,560</u> |

(Assets = Liabilities + Stockholders' equity)

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

## EXERCISE 2.11

| (a)             | <u>Beginning of Year</u>           | <u>End of Year</u>                 |
|-----------------|------------------------------------|------------------------------------|
| Working capital | $\$3,361 - \$1,635 = \$1,726$      | $\$3,217 - \$1,601 = \$1,616$      |
| Current ratio   | $\frac{\$3,361}{\$1,635} = 2.06:1$ | $\frac{\$3,217}{\$1,601} = 2.01:1$ |

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

- (b) Nordstrom's liquidity decreased slightly during the year. Its current ratio decreased from 2.06:1 to 2.01:1. Also, Nordstrom's working capital decreased by \$110 million.
- (c) Nordstrom's current ratio at both the beginning and the end of the recent year exceeds Best Buy's current ratio for 2020 (and 2019). Nordstrom's end-of-year current ratio (2.01) exceeds Best Buy's 2020 current ratio (1.10\*). Nordstrom would be considered much more liquid than Best Buy for the recent year.

**\*Per Illustration 2.6**

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

## EXERCISE 2.12

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

(Current assets ÷ Current liabilities)

$$\text{Working capital} = \$60,000 - \$30,000 = \$30,000$$

(Current assets – Current liabilities)

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

(Current assets ÷ Current liabilities)

$$\text{Working capital} = \$40,000 - \$10,000 = \$30,000$$

(Current assets – Current liabilities)

$$*\$60,000 - \$20,000$$

$$**\$30,000 - \$20,000$$

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

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

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

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

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



## EXERCISE 2.13

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

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

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

# SOLUTIONS TO PROBLEMS

## PROBLEM 2.1

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

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

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

## PROBLEM 2.1 (Continued)

### Liabilities and Stockholders' Equity

#### Current liabilities

|                                 |            |        |
|---------------------------------|------------|--------|
| Accounts payable .....          | \$ 152     |        |
| Unearned sales revenue .....    | <u>413</u> |        |
| Total current liabilities ..... |            | \$ 565 |

#### Long-term liabilities

|                         |  |            |
|-------------------------|--|------------|
| Notes payable .....     |  | <u>734</u> |
| Total liabilities ..... |  | 1,299      |

#### Stockholders' equity

|                                  |              |               |
|----------------------------------|--------------|---------------|
| Common stock .....               | 6,283        |               |
| Retained earnings .....          | <u>6,108</u> |               |
| Total stockholders' equity ..... |              | <u>12,391</u> |

|                                                  |  |                        |
|--------------------------------------------------|--|------------------------|
| Total liabilities and stockholders' equity ..... |  | <u><u>\$13,690</u></u> |
|--------------------------------------------------|--|------------------------|

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

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

**PROBLEM 2.2**

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

---

|                                      |                     |                        |
|--------------------------------------|---------------------|------------------------|
| <b>Revenues</b>                      |                     |                        |
| Service revenue .....                |                     | <b>\$68,000</b>        |
| <b>Expenses</b>                      |                     |                        |
| Salaries and wages expense .....     | <b>\$37,000</b>     |                        |
| Depreciation expense.....            | <b>3,600</b>        |                        |
| Insurance expense .....              | <b>2,200</b>        |                        |
| Utilities expense .....              | <b>2,000</b>        |                        |
| Maintenance and repairs expense..... | <b><u>1,800</u></b> |                        |
| Total expenses .....                 |                     | <b><u>46,600</u></b>   |
| <b>Net income.....</b>               |                     | <b><u>\$21,400</u></b> |

(Serv. rev. – Tot. exp.)

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

---

|                                                   |                        |
|---------------------------------------------------|------------------------|
| <b>Retained earnings, January 1, 2027 .....</b>   | <b>\$31,000</b>        |
| <b>Add: Net income .....</b>                      | <b><u>21,400</u></b>   |
|                                                   | <b>52,400</b>          |
| <b>Less: Dividends.....</b>                       | <b><u>12,000</u></b>   |
| <b>Retained earnings, December 31, 2027 .....</b> | <b><u>\$40,400</u></b> |

(Beg. ret. earn. + Net inc. – Div.)

## PROBLEM 2.2 (Continued)

### MARTIN CORPORATION Balance Sheet December 31, 2027

---

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

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

### Liabilities and Stockholders' Equity

|                                                  |               |                 |
|--------------------------------------------------|---------------|-----------------|
| Current liabilities                              |               |                 |
| Accounts payable .....                           | \$18,300      |                 |
| Salaries and wages payable.....                  | <u>3,000</u>  |                 |
| Total current liabilities .....                  |               | \$21,300        |
| Stockholders' equity                             |               |                 |
| Common stock.....                                | 12,000        |                 |
| Retained earnings.....                           | <u>40,400</u> |                 |
| Total stockholders' equity .....                 |               | <u>52,400</u>   |
| Total liabilities and stockholders' equity ..... |               | <u>\$73,700</u> |

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

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

**PROBLEM 2.3**

(a)

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

|                                  |                |                              |
|----------------------------------|----------------|------------------------------|
| Sales revenue .....              |                | <b>\$5,100</b>               |
| Expenses                         |                |                              |
| Cost of goods sold .....         | <b>\$1,060</b> |                              |
| Salaries and wages expense ..... | <b>700</b>     |                              |
| Interest expense .....           | <b>400</b>     |                              |
| Depreciation expense.....        | <b>335</b>     |                              |
| Insurance expense .....          | <b>210</b>     |                              |
| Income tax expense.....          | <b>165</b>     |                              |
| Total expenses.....              |                | <b><u>2,870</u></b>          |
| Net income .....                 |                | <b><u><u>\$2,230</u></u></b> |

(Sales rev. – Tot. exp.)

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

|                                         |                              |
|-----------------------------------------|------------------------------|
| Retained earnings, May 1, 2026 .....    | <b>\$1,600</b>               |
| Add: Net income .....                   | <b><u>2,230</u></b>          |
|                                         | <b>3,830</b>                 |
| Less: Dividends .....                   | <b><u>325</u></b>            |
| Retained earnings, April 30, 2027 ..... | <b><u><u>\$3,505</u></u></b> |

(Beg. ret. earn. + Net inc. – Div.)

**PROBLEM 2.3 (Continued)**

**(b) LAZURIS ENTERPRISES**  
**Balance Sheet**  
**April 30, 2027**

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

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

**Liabilities and Stockholders' Equity**

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

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

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

## PROBLEM 2.4

- (a) Loeb appears to be more liquid. Loeb's 2027 working capital of \$340,875 ( $\$407,200 - \$66,325$ ) is more than twice as high as Bowsh's working capital of \$156,620 ( $\$190,336 - \$33,716$ ). In addition, Loeb's 2027 current ratio of 6.1:1 ( $\$407,200 \div \$66,325$ ) is higher than Bowsh's current ratio of 5.6:1 ( $\$190,336 \div \$33,716$ ).
- (b) Loeb appears to be slightly more solvent. Loeb's 2027 debt to assets ratio of 18.6% ( $\$174,825 \div \$939,200$ )<sup>a</sup> is lower than Bowsh's ratio of 22.5% ( $\$74,400 \div \$330,064$ )<sup>b</sup>. The lower the percentage of debt to assets, the lower the risk is that a company may be unable to pay its debts as they come due.

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

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

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



## PROBLEM 2.5

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

(Current assets – Current liab.)

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

(Current assets ÷ Current liab.)

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

(Tot. liab. ÷ Tot. assets)

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

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

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

**PROBLEM 2.6**

**2026**

**2027**

**(a) Working capital.**

$$(\$20,000 + \$62,000 + \$73,000) - \$70,000 = \$85,000$$

(Current assets – Current liab.)

$$(\$28,000 + \$70,000 + \$90,000) - \$75,000 = \$113,000$$

**(b) Current ratio.**

$$\frac{\$155,000}{\$70,000} = 2.2:1$$

(Current assets ÷ Current liab.)

$$\frac{\$188,000}{\$75,000} = 2.5:1$$

**(c) Debt to assets ratio.**

$$\frac{\$160,000}{\$685,000} = 23.4\%$$

(Tot. liab. ÷ Tot. assets)

$$\frac{\$155,000}{\$760,000} = 20.4\%$$

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

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

## PROBLEM 2.7

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

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

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

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

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

- (a) Total current assets were \$143,713 million at September 26, 2020, and \$162,819 million at September 28, 2019.
- (b) Current assets are properly listed in the order of liquidity. As you will learn in a later chapter, inventories are considered to be less liquid than receivables. Thus, they are listed below receivables and before prepaid expenses.
- (c) The asset classifications are similar to the text: (a) current assets, (b) long-term marketable securities, (c) property, plant, and equipment, and (d) other non-current assets.
- (d) Total current liabilities were \$105,392 million at September 26, 2020, and \$105,718 million at September 28, 2019.

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

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

**(b) Liquidity**

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

**Solvency**

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

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

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

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

The average decrease per year can be approximated as:

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

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

- (b) Gap's working capital and current ratio decreased (2024), increased (2025 and 2026) and then decreased (2027) during this period, indicating a decline, an improvement and then another decline in liquidity. The current ratio is a better measure of liquidity because it provides a relative measure; that is, current assets compared to current liabilities. Working capital only tells us the net amount of current assets less current liabilities. It is hard to say whether a given amount of working capital is adequate or inadequate without knowing the size of the company.
- (c) The debt to assets ratio suggests that Gap's solvency didn't change much during the period. Debt to assets was 0.39 in 2023, rose to 0.45 in 2024 and then bounced between 0.39 and 0.42 the next three years.

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

## REAL-WORLD FOCUS

### CT2.4

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

LO 2 BT: AN Difficulty: Hard TOT: 20 min. AACSB: Analytic and Technology AICPA AC: Reporting

### CT2.5

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

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

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

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

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

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

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



**To:** BPPalmer@FutureProducts.com

**From:** AStudent@StateUniversity.edu

**Subject:** Financial Statement Analysis

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

- 1. Liquidity ratios—These measure a company's ability to pay its current obligations.**
- 2. Solvency ratios—These measure a company's ability to pay its long-term obligations and survive over the long-term.**
- 3. Profitability ratios—These measure the ability of the company to generate a profit.**

**(b) 1. Examples of liquidity measures are:**

**Working capital = Current assets – Current liabilities**

**Indicates the absolute differences between a company's current assets and its current liabilities.**

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

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

**2. Example of solvency measures are:**

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

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

## CT2.7 (Continued)

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

**The bases of comparison are:**

- 1. Intracompany—This basis compares an item or financial relationship within a company in the current year with the same item or relationship in one or more prior years.**
- 2. Industry averages—This basis compares an item or financial relationship of a company with industry averages (or norms).**
- 3. Intercompany—This basis compares an item or financial relationship of one company with the same item or relationship in one or more competing companies.**

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

- (a) The stakeholders in this case are: Boeing's management; CEO, public relations manager, Boeing's stockholders, McDonnell Douglas stockholders, other users of the financial statements; especially potential investors of the new combined company.
- (b) The ethical issues center around full disclosure of financial information. Management attempted to "time" the release of bad news in order to complete a merger that would have been revoked if cost overruns had been disclosed as soon as management became aware of them.
- (c) It is not ethical to "time" the release of bad news. GAAP requires that all significant financial information be released to allow users to make informed decisions.
- (d) Answers will vary. One possibility: Release the information regarding cost overruns as it became available. Describe the causes of such overruns and explain how Boeing would address them (probably by improving production methods to eliminate the inefficiencies alluded to in the text).
- (e) Investors and analysts should be aware that Boeing's management will probably "manage" information in the future in ways that will interfere with full disclosure.

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

**Answers will vary.**

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

- (a) The existence of different forms of certification would most likely create confusion for coffee purchasers. It would be difficult to know what aspects of the coffee growing process each certification covered. Similarly, if there were multiple groups that certified financial statements, each with different criteria, it would be difficult for financial statement users to know what each certification promised.
- (b) The certifications have multiple objectives including organic farming as a means to protect bird species, biodiversity and wildlife habitat. Some included requirements are to improve workers' living conditions, ensure that farmers are paid a premium over costs that will allow them to make a profit, provide running water in worker housing, child labor regulations and education requirements. Certifications can also be financially beneficial because companies can benefit from the positive public relations effects of either producing or buying coffee produced using sustainable practices.

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