Chapter 5

Communicating and Interpreting  
Accounting Information

ANSWERS TO QUESTIONS

1. The primary responsibility for the accuracy of the financial records and conformance with Generally Accepted Accounting Principles (GAAP) of the information in the financial statements rests with management, normally the CEO and CFO. Independent auditors or CPAs are responsible for conducting an examination of the statements in accordance with Generally Accepted Auditing Standards (for private companies) and PCAOB Auditing Standards (for public companies), and based on that examination, attesting to the fairness of the financial presentations in accordance with GAAP. Both management and the auditors assume a financial responsibility to users of the statements.

2. *Financial analysts*, who normally work for brokerage and investment banking houses, mutual funds, and investment advisory services, gather extensive financial and nonfinancial information about a company, on which they base forecasts and stock purchase and sale recommendations. *Private investors* include individuals who purchase shares in companies, often on the basis of recommendations from financial analysts. *Institutional investors* are managers of pension, mutual, endowment, and other funds that invest on behalf of others.

3. Information services provide a wide variety of financial and nonfinancial information to analysts and investors, often on-line or on CD-ROM. These services are normally the first source where important financial information such as quarterly earnings announcements are available.

4. Material amounts are amounts that are large enough to influence a user’s decision.

5. a. Income statement--Accrual basis required by GAAP.

b. Balance sheet--Accrual basis required by GAAP.

c. Statement of cash flows--Cash basis required by GAAP.

6. Private companies normally issue quarterly and annual reports, both of which are normally simple photocopied reports. The quarterly reports normally present unaudited summary income statement and balance sheet information. The annual reports include the four basic financial statements, related notes, and the auditor’s opinion if the statements are audited.

7. Public companies issue quarterly press releases, quarterly reports, and annual reports to shareholders and Forms 10-Q (quarterly reports), 10-K (annual reports), and 8-K (special events) reports to the SEC. Press releases include a summary of the quarterly report information and are the first announcement of quarterly financial information. The quarterly reports normally present unaudited summary income statement, cash flow statement, and balance sheet information along with abbreviated management discussion and analysis and notes. Annual reports are often elaborate reports including extensive discussions. The financial section includes: (1) summarized financial data for a 5-year period; (2) management’s discussion and analysis of financial condition and results of operations and disclosures about market risk; (3) the four basic financial statements; (4) notes (footnotes); (5) report of independent registered public accounting firm (auditor’s opinion) and the management certification; (6) recent stock price information; (7) summaries of the unaudited quarterly financial data; and (8) listings of directors and officers of the company and relevant addresses. The Form 10-Q and 10-K provide more detailed information than the quarterly and annual reports of private companies including additional disclosures not included in those reports. The 8-K is issued irregularly when special events, such as a change in auditors, occur.

8. The four major subtotals or totals on the income statement are: (a) gross profit, (b) income from operations, (c) income before income taxes, and (d) net income.

9. The six major classifications on the balance sheet are: (a) current assets, (b) noncurrent assets, (c) current liabilities, (d) long-term liabilities, (e) contributed capital and (f) retained earnings.

10. Property, plant, and equipment are reported on the balance sheet. Property, plant, and equipment are those assets held by the business not for resale but for use in operating the business, such as a delivery truck. (a) Property, plant, and equipment are reported at their acquisition cost which represents the amount of resources expended in acquiring them. (b) Over their period of use, they are "depreciated" because of being worn out (used up) or becoming obsolete in carrying out the function for which they were acquired. A portion of the cost of this effect is known as depreciation expense. A certain amount of depreciation is reported each period as an expense on the income statement and the total amount of depreciation on the asset from the date it was acquired up to the date of the financial statement is known as accumulated depreciation. (c) Cost minus accumulated depreciation equals net book value, as reported on the balance sheet. Net book value (sometimes also called book value or carrying value) does not represent the current market value of the asset but rather the original cost of it less the amount of that cost that has been measured as depreciation expense for all of the periods since the asset was acquired.

11. The major classifications of stockholders’ equity are: (1) contributed capital, which represents the stockholders' investments and (2) retained earnings, which represent the earnings of the company to date less any dividends paid to the owners. Contributed capital is often split between the account common stock (which consists of a nominal legal amount called par value) and additional paid-in capital.

12. The three major classifications on the Statement of Cash Flows are (a) cash from operating activities, (b) cash from investing activities, and (c) cash from financing activities.

13. The three major categories of notes to the financial statements are: (1) descriptions of accounting rules applied to the company’s statements, often called significant accounting policies (e.g., the depreciation method applied to property, plant, and equipment), (2) additional details about financial statement numbers (e.g., sales by geographic region), and (3) relevant financial information not listed on the statements (e.g., the existence of a bank line of credit).

14. *Return on assets (ROA)* is a ratio measure defined as net income divided by average total assets. It measures how much the firm earned for each dollar of assets available to management, regardless of the source of financing. A *return on assets analysis* provides an overall framework for evaluating company performance by breaking down ROA into its two determinants: net profit margin and total asset turnover. Together, these indicate why ROA differs from prior levels or that of competitors, and provide insights into strategies to improve ROA in future periods.

ANSWERS TO MULTIPLE CHOICE

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1. b) | 1. b) | 1. c) | 1. a) | 1. b) |
| 1. d) | 1. b) | 1. c) | 1. c) | 1. a) |

Authors' Recommended Solution Time

**(Time in minutes)**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *Mini-exercises* | | *Exercises* | | *Problems* | | *Alternate Problems* | | *Cases and Projects* | |
| *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* |
| 1 | 5 | 1 | 10 | 1 | 30 | 1 | 40 | 1 | 30 |
| 2 | 5 | 2 | 10 | 2 | 20 | 2 | 20 | 2 | 30 |
| 3 | 5 | 3 | 15 | 3 | 40 | 3 | 40 | 3 | 40 |
| 4 | 10 | 4 | 10 | 4 | 20 | 4 | 35 | 4 | 30 |
| 5 | 10 | 5 | 20 | 5 | 20 |  |  | 5 | 30 |
| 6 | 10 | 6 | 30 | 6 | 40 |  |  | 6 | 30 |
| 7 | 10 | 7 | 15 | 7 | 35 |  |  | 7 | 40 |
|  |  | 8 | 20 | 8 | 40 |  |  | 8 | \* |
|  |  | 9 | 25 | 9 | 20 |  |  |  |  |
|  |  | 10 | 25 |  |  |  |  |  |  |
|  |  | 11 | 25 |  |  |  |  | *Continuing Cases* | |
|  |  | 12 | 12 |  |  |  |  | 1 | 45 |
|  |  | 13 | 15 |  |  |  |  | 2 | 45 |
|  |  | 14 | 15 |  |  |  |  |  |  |
|  |  | 15 | 15 |  |  |  |  |  |  |
|  |  | 16 | 20 |  |  |  |  |  |  |
|  |  | 17 | 25 |  |  |  |  |  |  |
|  |  | 18 | 20 |  |  |  |  |  |  |
|  |  | 19 | 20 |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

\* Due to the nature of these cases and projects, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

MINI-EXERCISES

**M5-1.**

|  |  |  |
| --- | --- | --- |
| Players |  | Definitions |
| \_\_\_\_D\_\_\_\_ (1) Independent auditor  \_\_\_\_C\_\_\_\_ (2) CEO and CFO  \_\_\_\_B\_\_\_\_ (3) Users  \_\_\_\_A\_\_\_\_ (4) Financial analyst |  | A. Adviser who analyzes financial and other economic information to form forecasts and stock recommendations.  B. Institutional and private investors and creditors (among others).  C. Chief executive officer and chief financial officer who have primary responsibility for the information presented in financial statements.  D. Independent CPA who examines financial statements and attests to their fairness. |

**M5-2.**

|  |  |  |
| --- | --- | --- |
| No. |  | Title |
| \_\_\_\_3\_\_\_\_\_ |  | Form 10-K |
| \_\_\_\_1\_\_\_\_\_ |  | Earnings press release |
| \_\_\_\_2\_\_\_\_\_ |  | Annual report |

Note: Many companies now issue the annual report and the 10-K at the same time.

**M5-3.**

**Elements of**

**Financial Statements Financial Statements**

A (1) Expenses A. Income statement

C (2) Cash from operating activities B. Balance sheet

A (3) Losses C. Cash flow statement

B (4) Assets D. None of the above

A (5) Revenues

C (6) Cash from financing activities

A (7) Gains

B (8) Owners' equity

B (9) Liabilities

D (10) Assets personally owned by a stockholder

**M5-4.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Transaction** | **Current Assets** | **Gross Profit** | **Current Liabilities** |
| a. | + | + | NE |
| b. | NE | NE | + |

The effects of the transactions can be seen by making the related journal entries and using CA, CL, R, and E to denote current asset, current liability, revenue, and expense, respectively.

a. Accounts receivable (+CA) 300

Sales revenue (+R) 300

Cost of goods sold (+E) 200

Inventory (–CA) 200

Note that Gross Profit increases (by $100) since it is defined as Sales (increased by $300) less Cost of Goods Sold (increased by only $200).

b. Advertising expense (+E) 10

Accounts payable (+CL) 10

Note that Advertising Expense is not included in Cost of Goods Sold and, hence, has no effect on Gross Profit.

**M5-5.**

|  |  |  |
| --- | --- | --- |
| Assets | Liabilities | Stockholders’ Equity |
| a.) Accounts Receivable +1,800  Inventory -1,200 |  | Sales Revenue +1,800  Cost of Goods Sold -1,200 |
| b.) Cash +60,000 |  | \*Common stock +5,000  \*\*Additional paid-in   capital +55,000 |

\*$1 par value × 5,000 shares

\*\*$60,000 cash - $5,000 common stock

**M5-6.**

a. Accounts receivable (+A) 1,800

Sales revenue (+R, +SE) 1,800

Cost of goods sold (+E, –SE) 1,200

Inventory (–A) 1,200

b. Cash (+A) 60,000

Common stock ($1 par value × 5,000 shares) (+SE) 5,000

Additional paid-in capital (+SE) 55,000

($60,000 cash - $5,000 common stock)

**M5-7.**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Return on assets (ROA) | = | Net income | = | $100 | = | $100 | = | 0.111 (11.1%) |
|  |  | Avg total assets |  | ($1,000+$800)/2 |  | $900 |  |  |

Return on assets (ROA) measures how much the firm earned for each dollar of investment.

EXERCISES

**E5-1.**

**Players Definitions**

|  |  |
| --- | --- |
| F(1) Financial analyst  A (2) Creditor  H (3) Independent auditor  G (4) Private investor  D (5) SEC  E (6) Information service  C (7) Institutional investor  B(8) CEO and CFO | A. Financial institution or supplier that lends money to the company.  B. Chief Executive Officer and Chief Financial Officer who have primary responsibility for the information presented in financial statements.  C. Manager of pension, mutual, and endowment funds that invest on the behalf of others.  D. Securities and Exchange Commission which regulates financial disclosure requirements.  E. A company that gathers, combines, and transmits (paper and electronic) financial and related information from various sources.  F. Adviser who analyzes financial and other economic information to form forecasts and stock recommendations.  G. Individual who purchases shares in companies.  H. Independent CPA who examines financial statements and attests to their fairness. |

**E5-2.**

**Information Release Definitions**

|  |  |
| --- | --- |
| C (1) Form 10-Q  B (2) Quarterly report  D (3) Press release  F (4) Annual report  E (5) Form 10-K  A (6) Form 8-K | A. Report of special events (e.g., auditor changes, mergers) filed by public companies with the SEC.  B. Brief unaudited report for quarter normally containing summary income statement and balance sheet.  C. Quarterly report filed by public companies with the SEC that contains additional unaudited financial information.  D. Written public news announcement that is normally distributed to major news services.  E. Annual report filed by public companies with the SEC that contains additional detailed financial information.  F. Report containing the four basic financial statements for the year, related notes, and often statements by management and auditors. |

**E5-3.**

**Information Item Report**

|  |  |
| --- | --- |
| B,F (1) Summarized financial data for 5-year period.  B,F (2) Notes to financial statements.  B,F (3) The four basic financial statements for the year.  E (4) Summarized income statement information for the quarter.  F (5) Detailed discussion of the company’s competition.  D (6) Initial announcement of hiring of new vice president for sales.  D (7) Initial announcement of quarterly earnings.  B,F (8) A description of those responsible for the financial statements.  A (9) Complete quarterly income statement, balance sheet and cash flow statement.  C (10) Announcement of a change in auditors. | A. Form 10-Q  B. Annual report  C. Form 8-K  D. Press release  E. Quarterly report  F. Form 10-K  G. None of the above |

**E5-4.**

**No. Title**

7 Long-term liabilities

6 Current liabilities

2 Long-term investments

4 Intangible assets

8 Contributed capital

1 Current assets

9 Retained earnings

3 Property, plant, and equipment

5 Other noncurrent assets

**E5-5.**

**Campbell Soup Company**

**Consolidated Balance Sheet**

**July 31, Current Year**

**(in millions)**

|  |  |
| --- | --- |
| **Assets** |  |
| Current Assets |  |
| Cash and cash equivalents | $ 484 |
| Accounts receivable | 560 |
| Inventories | 767 |
| Other current assets | 152 |
| Total current assets | 1,963 |
| Property, plant, and equipment, net | 2,103 |
| Intangible assets | 2,660 |
| Other assets | 136 |
| Total assets | $6,862 |
| **Liabilities and Stockholders' Equity** |  |
| Current liabilities |  |
| Accounts payable | $ 585 |
| Accrued expenses | 619 |
| Other current debt | 785 |
| Total current liabilities | 1,989 |
| Other noncurrent liabilities | 3,777 |
| Total liabilities | 5,766 |
| Stockholders' Equity |  |
| Common stock, $0.0375 par value | 351 |
| Retained earnings | 745 |
| Total stockholders' equity | 1,096 |
| Total liabilities and stockholders' equity | $6,862 |

**E5-6.**

Req. 1.

**Snyder’s-Lance**

**Consolidated Balance Sheet**

**December 31, Current Year**

**(in millions)**

|  |  |
| --- | --- |
| **Assets** |  |
| Current Assets |  |
| Cash and cash equivalents | $ 20,841 |
| Accounts receivable, net | 143,238 |
| Inventories | 106,261 |
| Prepaid expenses and other | 20,705 |
| Other current assets | 96,983 |
| Total current assets | 388,028 |
| Property, plant and equipment, net | 313,043 |
| Goodwill | 367,853 |
| Other intangible assets, net | 376,062 |
| Other assets | 21,804 |
| Total assets | $1,466,790 |
| **Liabilities and Stockholders’ Equity** |  |
| Current Liabilities |  |
| Accounts payable | $ 52,930 |
| Accrued compensation | 29,248 |
| Other payables and accrued liabilities | 68,712 |
| Short-term debt | 4,256 |
| Total current liabilities | 155,146 |
| Long-term debt | 253,939 |
| Other long-term liabilities | 219,114 |
| Total liabilities | 628,199 |
| Stockholders' Equity |  |
| Common stock, 67,820,798 shares outstanding | 56,515 |
| Additional paid-in capital | 730,338 |
| Retained earnings | 51,738 |
| Total stockholders' equity | 838,591 |
| Total liabilities and stockholders' equity | $1,466,790 |

**E5-6.(continued)**

Req. 2.

In each case, the term “net” means that the account is reported after the balance in the related contra account has been subtracted. Accounts receivable, net means that the allowance for doubtful accounts contra account has been subtracted. Other intangible assets, net means that the accumulated amortization contra account has been subtracted. Property, plant and equipment, net means that the accumulated depreciation contra account has been subtracted.

**E5-7.**

**Terms Definitions**

|  |  |
| --- | --- |
| A (1) Net income  B (2) Income tax expense on operations  K (3) Income before extraordinary items  E (4) Cost of goods sold  F (5) Operating expenses  C (6) Gross margin on sales  J (7) EPS  H (8) Interest expense  D (9) Service revenue  G (10) Pretax income from operations | A. Revenues + Gains - Expenses - Losses including effects of discontinued operations and extraordinary items (if any).  B. Income tax on revenues minus operating expenses.  C. Sales revenue minus cost of goods sold.  D. Sales of services for cash or on credit.  E. Amount of resources used to purchase or produce the goods that were sold during the reporting period.  F. Total expenses directly related to operations.  G. Income before all income tax and before discontinued operations and extraordinary items (if any).  H. Cost of money (borrowing) over time.  I. Item that is both unusual and infrequent.  J. Net income divided by average shares outstanding.  K. Income before unusual and infrequent items and the related income tax.  L. None of the above. |

**E5-8.**

**TOWNSHIP CORPORATION**

**Income Statement**

**For the Year Ended December 31, 2015**

*Computations in Order*

Sales revenue Given $85,000

Cost of goods sold (a) $85,000 - $30,000 55,000

Gross profit Given 30,000

Operating expenses:

Selling expense Given $7,000

Administrative expense (c) $17,000 – $7,000 10,000

Total operating expenses (b) $30,000 – $13,000 17,000

Pretax income Given 13,000

Income tax expense (d) $13,000 x 35%\* 4,550

Net income (e) $13,000 – $4,550 $ 8,450

Earnings per share ($8,450 ÷ 2,500 shares\*) $3.38

\*Given

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Gross profit percentage | = | Gross profit | = | 30,000 | = | 0.353 (35.3%) |
|  |  | Net sales |  | 85,000 |  |  |

**E5-9.**

Req. 1.

|  |  |  |
| --- | --- | --- |
| **Hewlett Packard Company** | | |
| **Consolidated Statement of Income**  **For Year Ended October, Current Year (In millions)** | | |
| Net sales |  |  |
| Product sales | $84,799 |  |
| Service sales | 40,816 |  |
| Financing income | 418 |  |
| Total net revenue |  | $126,033 |
| Cost of sales: |  |  |
| Cost of products | 65,064 |  |
| Cost of services | 30,590 |  |
| Cost of financing | 302 |  |
| Total cost of sales |  | 95,956 |
| Gross profit |  | 30,077 |
| Operating expenses: |  |  |
| Research and development | 2,959 |  |
| Selling, general and administrative | 12,718 |  |
| Amortization of purchased intangible assets | 1,484 |  |
| Restructuring charges | 1,144 |  |
| Acquisition-related charges | 293 |  |
| Total operating expenses |  | 18,598 |
| Operating income |  | 11,479 |
| Interest expense |  | 505 |
| Income before income taxes |  | 10,974 |
| Provision for taxes |  | 2,213 |
| Net income |  | 8,761 |
|  |  |  |
| Net earnings per share |  | $3.78 |
| Weighted average shares outstanding |  | 2,319 |

Req. 2.

Product sales: $84,799 – $65,064 = $19,735

**E5-10.**

**Case A Case B Case C Case D Case E**

Sales revenue $800 $600 $500 $1,170\* $760\*

Cost of goods sold 425\* 150 280\* 500 320

Gross margin 375 450\* 220\* 670\* 440

Operating expenses:

Selling expense 50\* 50 80 350 240

Administrative expense 125 100\* 70 120 80

Total expenses 175\* 150\* 150\* 470\* 320\*

Pretax income 200 300 70\* 200 120\*

Income tax expense 50\* 30 20 50 20

Net income $150 $270\* $50 $150\* $100

*\*Amounts not given in the exercise.*

**E5-11.**

**Case A Case B Case C Case D Case E**

Sales revenue $770 $1,200\* $400\* $600 $1,050

Cost of goods sold 300\* 320 125 250 420\*

Gross margin 470\* 880 275\* 350\* 630

Operating expenses:

Selling expense 90 275 45 70 85\*

Administrative expense 200 120 80 150\* 175

Total expenses 290\* 395\* 125\* 220\* 260\*

Pretax income 180\* 485\* 150 130 370

Income tax expense 65 210 60 45 130\*

Net income $115 $275 $90\* $85\* $240

*\*Amounts not given in the exercise.*

**E5-12.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Common Stock** | | |  | **Additional**  **Paid-in** |  | **Retained** |  | **Total Stockholders'** |
|  | **Shares** |  | **Amount** |  | **Capital** |  | **Earnings** |  | **Equity** |
| Shares issued for employee stock option plan | 12,100 |  | 121 |  | 343,879 |  |  |  | 344,000 |

**E5-13.**

Req. 1.

Beginning RE + Net income - Dividends = Ending RE

Dividends = Beginning RE + Net income - Ending RE

Dividends = $8, 225 M + $602 M - $8,571 M = $256 M

Kroger declared dividends of $256,000,000 during the year.

Req. 2.

Cash (+A) 34,000,000

Common stock ($959 M – $958 M) (+SE) 1,000,000

Additional paid-in capital ($3,427 M – $3,394 M) (+SE) 33,000,000

**E5-14.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Transaction** | **Current Assets** | **Gross Profit** | **Current Liabilities** |
| a. | +$2,449.3 | +$2,449.3 | NE |
| b. | +$500.0 | NE | +$500.0 |
| c. | –$197.6 | NE | NE |

The effects of the transactions can be seen by making the related journal entries and using CA, CL, R, and E to denote current asset, current liability, revenue, and expense, respectively.

a. Accounts receivable (+CA) 4,285.6

Sales revenue (+R) 4,285.6

Cost of goods sold (+E) 1,836.3

Inventory (–CA) 1,836.3

Note that Gross Profit increases (by $2,449.3) since it is defined as Sales (increased by $4,285.6) less Cost of Goods Sold (increased by only $1,836.3).

b. Cash (+CA) 500.0

Notes payable (+CL) 500.0

c. Research and development expense (+E) 197.6

Cash (–CA) 197.6

Note that Research and Development Expense is not included in Cost of Goods Sold and, hence, has no effect on Gross Profit.

**E5-15.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Transaction** | **Current Assets** | **Gross Profit** | **Current Liabilities** | **Cash Flow from Operating Activities** |
| a. | NE | NE | NE | + 40.8 |
| b. | – 5.6 | NE | – 5.6 | NE |

The effects of the transactions can be seen by making the related journal entries and using CA and CL to denote current asset and current liability, respectively.

a. Cash (+CA) 40.8

Accounts receivable (–CA) 40.8

b. Notes payable (–CL) 5.6

Cash (–CA) 5.6

Note that repayment of debt is a financing activity.

**E5-16.**

**AVALOS CORPORATION**

**Statement of Cash Flows**

**For the Year Ended December 31, 2014**

From Operating Activities

Net income $25,000

Increase in accounts receivable (9,000)

Decrease in inventory 1,000

Decrease in accounts payable (3,000)

Cash flows from operating activities $ 14,000

From Investing Activities

Purchased a new delivery truck (7,000)

Purchased land (36,000)

Cash flows from investing activities (43,000)

From Financing Activities

Borrowed cash on three-year note 30,000

Issued stock for cash 24,000

Cash flows from financing activities 54,000

Net cash inflows for the year 25,000

Beginning cash balance 25,000

Ending cash balance $ 50,000

**E5-17.**

Req. 1.

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | Current  Year | Prior  Year |
| Net Income (given)  Average Total Assets (given) |  | $439,190 = 0.111  $3,947,331 | $368,403 = 0.102  $3,612,015 |

The increase in ROA from 0.102 in the prior year to 0.111 in the current year means that the firm earned $0.009 more for each $1 of investment.

Req. 2.

|  |  |  |
| --- | --- | --- |
| ROA Analysis | Current  Year | Prior  Year |
| Net Income Net Sales | $439,190 = 0.1206  $3,642,937 | $368,403 = 0.1194  $3,085,290 |
| x Net SalesAverage Total Assets | $3,642,937 = 0.9229  $3,947,331 | $3,085,290 = 0.8542  $3,612,015 |
| Return on Assets | 0.111 | 0.102 |

The increase in ROA is caused by increases in both net profit margin and asset turnover (from 0.119 to 0.121 and from 0.854 to 0.923, respectively). The company’s profit margin and efficiency appear to have increased with the economic recovery.

**E5-18.**

Req. 1.

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | Current  Year | Prior  Year |
| Net Income (given)  Average Total Assets (given) |  | $59,387 = 0.147  $403,162 | $55,425 = 0.141  $394,143 |

The increase in ROA from 0.141 in the prior year to 0.147 in the current year means that the firm earned $0.006 more for each $1 of investment.

Req. 2.

Security analysts would be more likely to *increase* their estimates of share value on the basis of this change. The company increased its earnings by $0.006 for each $1 of investment and, hence, increased the corresponding value of that investment.

**E5-19**

1. Notes payable (long-term) (–L) 2,000

Cash (–A) 2,000

1. Rent expense (+E, –SE) 100

Cash (–A) 100

|  |  |  |  |
| --- | --- | --- | --- |
| **Transaction** | **Net Profit Percentage** | **Return on Assets** | **Current Ratio** |
| *a.* | NE | + | – |
| *b.* | – | – | – |

PROBLEMS

**P5-1.**

1. E; (2) L; (3) D; (4) I; (5) M; (6) W; (7) B; (8) Q; (9) A; (10) H; (11) U; (12) J; (13) C; (14) G; (15) V; (16) R; (17) K; (18) N; (19) T; (20) S; (21) O; (22) P; (23) F.

**P5-2.**

P (1) Capital in excess of par B (11) Current liabilities

E (2) Assets C (12) Long-term liabilities

M (3) Retained earnings N (13) Fixed assets

O (4) Book value F (14) Liabilities

J (5) Other assets L (15) Contra-asset account

I (6) Shares outstanding K (16) Accumulated depreciation

D (7) Shareholders’ equity H (17) Intangible assets

A (8) Liquidity

Q (9) Normal operating cycle

G (10) Current assets

**P5-3.**

Req. 1

**EXQUISITE JEWELERS**

**Balance Sheet**

**December 31, 2015**

**Assets**

Current Assets

Cash $ 58,000

Accounts receivable 71,000

Prepaid insurance 1,500

Merchandise inventory 154,000

Total current assets $284,500

Investment in Z Corporation 36,000

Store equipment 67,000

Less accumulated depreciation 19,000 48,000

Used store equipment held for disposal 9,000

Total assets $377,500

**Liabilities**

Current Liabilities

Accounts payable $ 52,500

Income taxes payable 9,000

Total current liabilities $ 61,500

Note payable 42,000

Total liabilities 103,500

**Stockholders' Equity**

Contributed Capital

Common stock, par $1 per share, 100,000 shares 100,000

Additional paid-in capital 10,000

Total contributed capital 110,000

Retained Earnings 164,000

Total stockholders' equity 274,000

Total liabilities and stockholders' equity $377,500

**P5-3. *(continued)***

Req. 2

|  |  |  |
| --- | --- | --- |
| Store equipment | $67,000 - $19,000 = $48,000 | Acquisition cost less sum of all depreciation expense to date. |

Net book value (sometimes called book value or carrying value) is the amount of **cost** **less** any contra accounts (offsets).

**P5-4.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **BARNARD CORPORATION** | | | | | | | | | |
| **Statement of Stockholders' Equity** | | | | | | | | | |
|  | **Common Stock** | | |  | **Paid-in** |  | **Retained** |  | **Total Stockholders'** |
|  | **Shares** |  | **Amount** |  | **Capital** |  | **Earnings** |  | **Equity** |
| Balances as of December 31, 2014 | 5,500 |  | $82,500 |  | $13,000 |  | $44,000 |  | $139,500 |
| Net income |  |  |  |  |  |  | 37,000 |  | 37,000 |
| Dividends declared |  |  |  |  |  |  | (11,000) |  | (11,000) |
| Stock issued | 1,000 |  | 15,000 |  | 20,000 |  |  |  | 35,000 |
| **Balances as of December 31, 2015** | **6,500** |  | **$97,500** |  | **$33,000** |  | **$70,000** |  | **$200,500** |

**P5-5.**

|  |  |
| --- | --- |
| **AEROPOSTALE, Inc.** | |
| **Consolidated Statement of Income**  **For Year Ended March 31, Current Year (In Thousands Except Per Share Amounts)** | |
| Net revenue | $2,342,260 |
| Cost of goods sold | 1,733,916 |
| Gross profit | 608,344 |
| Other selling, general and administrative expenses | 494,829 |
| Total operating expenses | 494,829 |
| Operating income | 113,515 |
| Interest expense | 417 |
| Income before income taxes | 113,098 |
| Provision for income taxes | 43,583 |
| Net income | $69,515 |
|  |  |
| Earnings per share: |  |
| Basic earnings per share | $0.86 |
| Weighted average shares outstanding | 81,208 |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Gross profit percentage | = | Gross profit | = | 608,344 | = | 0.260 (26.0%) |
|  |  | Net sales |  | 2,342,260 |  |  |

It means that 26% of each sales dollar is gross profit. It measures the ability to sell goods for more than their cost.

**P5-6.**

(a) **JORDAN SALES COMPANY**

**Income Statement**

**For the Year Ended March 31, 2016**

Sales revenue $99,000

Cost of goods sold 33,000

Gross profit 66,000

Operating expenses:

Operating expenses $19,000

Depreciation expense 8,000

Total operating expenses 27,000

Income from operations 39,000

Interest expense 1,000

Income before income taxes 38,000

Income tax expense ($38,000 x 25%) 9,500

Net income $28,500

Earnings per share ($28,500 ÷ 33,000 shares) $ .86

**P5-6*.* (continued)**

(b)  **JORDAN SALES COMPANY**

**Balance Sheet**

**March 31, 2016**

**Assets**

Current Assets:

Cash $58,000

Accounts receivable 49,000

Office supplies inventory 1,000

Total current assets $108,000

Automobiles $34,000

Less accumulated depreciation 14,000 20,000

Office equipment 3,000

Less accumulated depreciation 1,000 2,000

Total assets $130,000

**Liabilities**

Current Liabilities:

Accounts payable $22,000

Income taxes payable 9,500

Salaries and commissions payable 2,000

Total current liabilities $33,500

Note payable 33,000

Total liabilities 66,500

**Stockholders' Equity**

Contributed capital:

Capital stock (33,000 shares, par $1) 33,000

Paid-in capital 5,000

Total contributed capital 38,000

Retained earnings (beginning balance, $7,500 + net income,

$28,500 - dividends declared and paid, $10,500) 25,500

Total stockholders' equity 63,500

Total liabilities and stockholders' equity $130,000

**P5-7.**

Req. 1.

|  |  |  |  |
| --- | --- | --- | --- |
| **Transaction** | **Gross Profit** | **Operating Income** | **Return on Assets** |
| a. | + | + | + |
| b. | NE | – | – |
| c. | NE | NE | – |
| d. | NE | NE | + |

The effects of the transactions can be seen by making the related journal entries and using A, L, SE, R, and E to denote asset, liability, shareholders’ equity, revenue, and expense, respectively.

a.\* Accounts receivable (+A) 400

Sales revenue (+R, +SE) 400

Cost of goods sold (+E, –SE) 300

Inventory (–A) 300

\*Note that net income goes up by $100 as does ending assets. As a consequence, average assets ((beginning + ending)/2) increases by only one-half of that amount or $50.

b. Research and development expense (+E, –SE) 100

Cash (–A) 100

c. Cash (+A) 260

Common stock and additional paid-in capital (+SE) 260

d. Retained earnings (–SE) 90

Cash (–A) 90

**P5-8.**

Req. 1.

|  |  |  |  |
| --- | --- | --- | --- |
| **Transaction** | **Total Asset Turnover** | **Return on Assets** | **Gross Profit Percentage** |
| a. | – | – | NE |
| b. | + | – | NE |
| c. | + | + | + |
| d. | – | – | NE |
| e. | + | + | – |

The effects of the transactions can be seen by making the related journal entries and using A, L, SE, R, and E to denote asset, liability, shareholders’ equity, revenue, and expense, respectively.

a. Cash (+A) 3,000

Notes payable (+L) 3,000

b. Salary expense (+E, –SE) 1,000

Cash (–A) 1,000

c. Accounts receivable (+A) 2,000

Sales revenue (+R, +SE) 2,000

d. Inventory (+A) 700

Accounts payable (+L) 700

e.\* Accounts receivable (+A) 500

Sales revenue (+R, +SE) 500

Cost of goods sold (+E, –SE) 300

Inventory (–A) 300

\*Note that net income goes up by $200 as does ending assets. As a consequence, average assets ((beginning + ending)/2) increases by only one-half of that amount or $100. So ROA increases. Also, since the gross margin percentage on this sale was 40% ((500 – 300) / 500), and the gross margin percentage before the sale was 45%, this transaction will lower the ratio.

**P5-9.**

**NEWELL RUBBERMAID**

**Consolidated Statement of Operations**

**For the Year Ended December 31, 2011  
(dollars in thousands)**

|  |  |  |
| --- | --- | --- |
| Net Sales |  | $ 5,864.6 |
| Cost of Products Sold |  | 3,659.4 |
| Gross Profit |  | 2,205.2 |
| Operating Expenses: |  |  |
| Selling, General, and Administrative Expenses | $1,515.3 |  |
| Other Expense | 432.7 |  |
| Total Operating Expenses |  | 1,948.0 |
| Operating Income (loss) |  | 257.2 |
| Interest and Other Non-Operating Expense |  | 104.7 |
| Income before Income Taxes |  | 152.5 |
| Income Tax Expense |  | 17.9 |
| Net (Loss) Income from Continuing Operations |  | 134.6 |
| Loss on Sale of Discontinued Operations, Net of Income Taxes |  | (9.4) |
| Net (Loss) Income |  | $ 125.2 |

**ALTERNATE PROBLEMS**

**AP5-1.**

Req. 1

**TANGOCO**

**Balance Sheet**

**December 31, 2015**

**Assets**

Current Assets

Cash $ 48,800

Accounts receivable 71,820

Prepaid rent 1,120

Inventory 154,000

Total current assets $275,740

Noncurrent assets

Investment in PIL Corporation 36,400

Store equipment 67,200

Less accumulated depreciation 13,440 53,760

Used store equipment held for disposal 9,800

Total assets $375,700

**Liabilities**

Current Liabilities

Accounts payable $ 58,800

Income taxes payable 9,800

Total current liabilities $ 68,600

Note payable 32,000

Total liabilities 100,600

**Stockholders' Equity**

Contributed Capital

Common stock, par $1 per share, 100,000 shares 100,000

Additional paid-in capital 10,000

Total contributed capital 110,000

Retained Earnings 165,100

Total stockholders' equity 275,100

Total liabilities and stockholders' equity $375,700

**AP5-1. (continued)**

Req. 2

|  |  |  |
| --- | --- | --- |
| Store equipment | $67,200 - $13,440 = $53,760 | Acquisition cost less sum of all depreciation expense to date. |

Net book value (sometimes called book value or carrying value) is the amount of **cost** **less** any contra accounts (offsets).

**AP5-2.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **MESA INDUSTRIES** | | | | | | | | | |
| **Statement of Stockholders' Equity** | | | | | | | | | |
|  | **Common Stock** | | |  | **Paid-in** |  | **Retained** |  | **Total Stockholders'** |
|  | **Shares** |  | **Amount** |  | **Capital** |  | **Earnings** |  | **Equity** |
| Balances as of December 31, 2014 | 7,000 |  | $105,000 |  | $9,000 |  | $48,000 |  | $162,000 |
| Net income |  |  |  |  |  |  | 46,000 |  | 46,000 |
| Dividends declared |  |  |  |  |  |  | (7,000) |  | (7,000) |
| Stock issued | 1,500 |  | 22,500 |  | 16,500 |  |  |  | 39,000 |
| **Balances as of December 31, 2015** | **8,500** |  | **$127,500** |  | **$25,500** |  | **$87,000** |  | **$240,000** |

**AP5-3.**

(a) **DYNAMITE SALES**

**Income Statement**

**For the Year Ended August 31, 2015**

Sales revenue $81,000

Cost of goods sold 27,000

Gross profit 54,000

Expenses:

Operating expenses $16,200

Depreciation expense 4,950

Total operating expenses 21,150

Income from operations 32,850

Interest expense 2,250

Income before income taxes 30,600

Income tax expense ($30,600 x 30%) 9,180

Net income $21,420

Earnings per share ($21,420 ÷ 29,000 shares) $ .74

**AP5-3*. (continued)***

(b) **DYNAMITE SALES**

**Balance Sheet**

**August 31, 2015**

**Assets**

Current Assets:

Cash $47,700

Accounts receivable 38,320

Office supplies 270

Total current assets $86,290

Company vehicles $27,000

Less accumulated depreciation 9,000 18,000

Equipment 2,700

Less accumulated depreciation 900 1,800

Total assets $106,090

**Liabilities**

Current Liabilities:

Accounts payable $16,225

Income taxes payable 9,180

Salaries payable 1,350

Total current liabilities $26,755

Long-term debt 25,000

Total liabilities 51,755

**Stockholders' Equity**

Contributed capital:

Capital stock (29,000 shares, par $1) 29,000

Paid-in capital 4,500

Total contributed capital 33,500

Retained earnings (beginning balance, $6,615 + net income,

$21,420 - dividends declared and paid, $7,200) 20,835

Total stockholders' equity 54,335

Total liabilities and stockholders' equity $106,090

**AP5-4.**

Req. 1.

|  |  |  |  |
| --- | --- | --- | --- |
| **Transaction** | **Operating Income (Loss)** | **Net Income** | **Return on Assets** |
| a. | NE | + | + |
| b. | NE | NE | – |
| c. | – | – | – |
| d. | NE | NE | – |

The effects of the transactions can be seen by making the related journal entries and using A, L, SE, R, and E to denote asset, liability, shareholders’ equity, revenue, and expense, respectively.

a. Cash (+A) 7

Interest income (+R) 7

b. Inventory (+A) 80

Accounts payable (+L) 80

c. Advertising expense (+E) 16

Cash (–A) 16

d. Cash (+A) 40

Common stock and additional paid-in capital (+SE) 40

Req. 2.

Assuming that next period Avon’s total assets increase by 5%, but Avon earns 20% more income as during the current period, Avon’s ROA will *increase* over that earned in the current period. Both the denominator and the numerator increase. In this case, net income is increasing at a faster rate than average total assets, causing ROA to be higher in the next period. (Students are encouraged to calculate ROA to verify this assertion.)

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | Current  Year | Next  Year |
| Net Income  Average Total Assets |  | $514 = 0.07  ($7,874+$7,735)/2 | $617 = 0.08  ($7,735+$8,122) |

**CASES AND PROJECTS**

## ANNUAL REPORT CASES

**CP5-1.**

1. The Balance Sheet lists “Property and equipment”, “Intangible assets”, “Goodwill”,   
   “Non-current deferred income taxes and “Other assets” as non-current assets.
2. The company owned $6,364,000 in land at the end of the year. This is disclosed in note 7, “Property and Equipment”.
3. Unredeemed stored value cards and gift certificates were $ 44,970,000, or 11.1% of current liabilities for the year. This is disclosed on the Balance Sheet.
4. Website sales are recorded “upon the estimated customer receipt date of the merchandise” (see note 2 under Revenue Recognition).
5. The company had negative cash from financing and made considerable capital expenditures. This resulted in a net outflow of $188,102,000 from financing and investing activities. The effect of exchange rates on cash was ($798,000), making up the difference between the $239,256,000 cash provided by operations and the overall change in cash of $51,952,000.
6. The highest stock price was $16.18, in the 1st quarter of fiscal 2011. This information is in Item 5 of the 10-K disclosed with the annual report.
7. ROA increased from fiscal 2010 to 2011. This does not seem to be reflected in the share price, which decreased from a high of $19.34 in the 1st quarter of 2010 to a low of $13.60 in the 3rd quarter of 2011.

|  |  |  |
| --- | --- | --- |
|  | Fiscal 2011 | Fiscal 2010 |
| Net Income \_ Average Total Assets | $151,705 \_  $(1,950,802+1,879,998)/2  = 0.079 | $140,647 \_  = 0.07  $(1,879,998+2,138,148)/2 |

**CP5-2.**

1. The company presents the subtotals “gross profit,” “income from operations,” and “income before income taxes”.
2. The cash flow statement indicates that operating activities provided $282,702,000 in cash, while financing activities used $ 523,347,000 in cash. Thus, the investing activities were financed primarily by operating activities.
3. The company’s largest asset (net) is “Property and Equipment, net” of $684,979,000 reported on the balance sheet.
4. The company “capitalizes applicable costs incurred during the application and infrastructure development stage and expenses costs incurred during the planning and operating stage”. This is disclosed in note 2.
5. Buildings are depreciated over useful lives of 39 years. This is disclosed in note 2.
6. Buildings are $118,050,000, which is 9% of the total balance of gross property and equipment. This is disclosed in note 5.

7.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **2012** | | | | | **2011** | | | | |
| Gross Profit | = | Gross Profit |  |  | $860,536 | = | 0.348 |  |  | $936,620 | = | 0.412 |  |
| Percentage |  | Net Sales |  |  | 2,473,801 |  |  |  |  | 2,274,102 |  |  |  |

The gross profit percentage decreased from 2011 to 2012. The decrease implies that the company has decreased its ability to charge premium prices or to purchase goods for resale at lower cost.

**CP5-3.**

Req. 1.

|  |  |  |
| --- | --- | --- |
|  | American Eagle Outfitters | Urban Outfitters |
| Net Income \_ Average Total Assets | $151,705 \_ = 0.079  $(1,950,802+1,879,998)/2 | $185,251 = 0.113  $(1,483,708 +1,794,321)/2 |

Urban Outfitters had a higher return on assets during the current year.

Req. 2.

|  |  |  |
| --- | --- | --- |
| ROA Analysis | American Eagle Outfitters | Urban Outfitters |
| Net Income Net Sales | 151,705 = 0.048  3,159,818 | 185,251\_ = 0.075  2,473,801 |
| Net SalesAverage Total Assets | 3,159,818 = 1.65  1,915,400 | 2,473,801 = 1.509  1,639,015 |
| Return on Assets | 0.079 | 0.113 |

Urban Outfitters has a higher ROA than American Eagle because it has a higher profit margin which more than compensates for its lower total asset turnover ratio. Ownership of property, plant, and equipment decreases the total asset turnover ratio relative to rentals. The owned assets would be included in “average total assets” while rented assets would not be included—thus, for the same level of sales, asset turnover would be lower.

**CP5-3. *(continued)***

Req. 3.

Industry Return on Assets (ROA) profit driver analysis:

ROA = Net Profit Margin × Total Asset Turnover

|  |  |  |  |
| --- | --- | --- | --- |
| ROA Analysis | Industry  Average | American Eagle Outfitters | Urban Outfitters |
| Net Profit Margin | .054 | .048 | .075 |
| Total Asset Turnover | 1.75 | 1.65 | 1.51 |
| Return on Assets | .091 | 0.079 | 0.113 |

Urban Outfitters has a higher ROA and American Eagle has a lower ROA than the industry average. This is being driven solely by Urban Outfitters’ higher net profit margins. This is expected, given that the Urban Outfitters competes by differentiating their product rather than competing more on price. Both firms have asset turnover lower than the industry average.

## FINANCIAL REPORTING AND ANALYSIS CASES

**CP5-4.**

1. Gross margin on sales, $105,000.

Computation:

Sales revenue $275,000

Less: Cost of goods sold 170,000

Gross margin on sales $105,000

2. EPS, $1.00.

Computation:

Net income, $10,000 ÷ ($100,000 ÷ $10 = 10,000 shares)

= $1.00 per share.

3. Pretax income, $13,333.

Computation (and proof):

Pretax income [$10,000 ÷ (100% - 25% = 75%)] $13,333

Proof:

Income tax ($13,333 x 25%) 3,333

Net income ($13,333 x 75%) (given) $10,000

4. Average sales price per share of stock, $11.60.

Computation:

($100,000 + $16,000 = $116,000) ÷ ($100,000 ÷ $10 = 10,000 shares)

= $11.60 per share.

5. Beginning balance, $70,000.

Computation: (work backwards)

Beginning balance (?) ($80,000 - $10,000) $70,000

Add: 2015 net income (given) 10,000

Deduct: 2015 dividends (given) (None)

Ending balance (given) $80,000

## CRITICAL THINKING CASES

**CP5-5.**

|  |  |  |  |
| --- | --- | --- | --- |
| **Strategy Change** | **Current**  **Period**  **ROA** | **Future**  **Periods’**  **ROA** | **Explanation** |
| a. | + | – | The decrease in R&D investments would lead to lower expense in the current year, increasing current period’s income and ROA. However, when fewer products are brought to market in future periods, income and ROA will decrease. |
| b. | – | + | The advertising expense would decrease income and ROA in the current year. Assuming that the movie earns a greater income in future periods because of the advertising, net income will increase, increasing ROA in future periods. |

**CP5-6.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Net Income | | Assets | | Liabilities | |
| Error | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 |
| (1) | O | NE | O | O | NE | NE |
|  | $950 |  | $950 | $950 |  |  |
| (2) | O | U | NE | NE | U | NE |
|  | 500 | $500 |  |  | $500 |  |
| (3) | U | O | U | NE | NE | NE |
|  | 600 | 600 | 600 |  |  |  |
| (4) | U | O | U | NE | NE | NE |
|  | 200 | 200 | 200 |  |  |  |
| (5) | O | U | NE | NE | U | NE |
|  | 900 | 900 |  |  | 900 |  |
| (6) | U | NE | U | U | NE | NE |
|  | 300 |  | 300 | 300 |  |  |
| (7) | NE | NE | U | NE | U | NE |
|  |  |  | 8,000 |  | 8,000 |  |

**CP5-6. (continued)**

Explanation of analysis if not corrected:

(1) Given in problem (example).

(2) Wage expense should be increased (debited) by $500 in 2013 because the wages were incurred in that year. This increase in expense was not recorded; therefore, income for 2013 was overstated by $500. The wages were not paid when earned in 2013. Therefore, there is a 2013 liability of $500; thus, liabilities were understated at the end of 2013. In 2014 when the wages are recorded, wage expense will be overstated and income will be understated.

(3) Revenues were understated by $600 in 2013, which caused 2013 income to be understated by $600. Also accounts receivable was understated because the amount of $600 will be collected in 2014; thus, assets were understated by $600 at the end of 2013. Also, if not corrected, the $600 of revenue would be recorded in 2014, which would cause 2014 revenues, and hence income, to be overstated.

(4) The $200 expense should be recorded as 2014 expense. It was recorded in 2013; therefore, 2013 expense was overstated which would cause 2013 income to be understated. If not corrected, 2014 expense would be understated, which would cause 2014 income to be overstated by $200. Assets at the end of 2013 would be understated by $200 because prepaid expense (an asset) should be debited at the end of 2013 for this expenditure, because it was paid in advance.

(5) The $900 revenue should be recorded as revenue in 2014 because it was earned in 2014. Therefore, if not corrected, 2013 revenue and income would be overstated by $900. Also, 2014 revenue and income would be understated by $900 because that is the year that the $900 revenue was earned but was not recorded. At the end of 2013 liabilities would be understated by $900 because revenue collected in advance (a liability to render future performance to earn the revenue) should be credited for $900 at the end of 2013.

(6) This transaction should have been recorded as a credit to revenue of $300 instead of a credit to accounts receivable. Therefore, revenue, and hence income, was understated by $300. The credit to accounts receivable caused assets to be understated by $300 for each year. Accounts receivable will continue to be understated until a correction is made.

(7) This transaction should have been recorded in 2013 as a debit to Land (an asset) and a credit to a liability, $8,000. Therefore, at the end of 2013 both assets and liabilities were understated by $8,000. The entry in 2014 corrected the accounts.

**CP5-7.**

1. At the time this solution was prepared, three former top managers had pleaded guilty to fraud charges and the chief marketing officer pleaded not guilty and was found guilty at trial. He received an 84 month prison sentence. Dutch authorities fined two Dutch executives at Ahold but imposed no prison terms. Ahold settled shareholder suits against it for $1.1 billion dollars and, in May of 2007, sold its U.S. Foodservice unit to two private-equity firms.

2. In October 2004, the SEC chose not to impose a monetary fine on the company because of its extensive cooperation with the investigation. The company promptly attended to SEC requests for information, granted access to current employees, waived attorney-client privilege in its internal investigations, revised its internal control procedures to prevent further frauds, and fired employees found responsible for the frauds. This move sends a strong signal to other companies that there is a benefit to cooperating with SEC investigations.

3. Bonuses tied to performance measures such as accounting earnings tend to align the managers' interests with those of the shareholders. However, when companies face a significant downturn, and bonuses will not be awarded, some dishonest managers attempt to meet performance goals by falsifying accounting numbers.

## FINANCIAL REPORTING AND ANALYSIS PROJECT

**CP5-8.**

The solutions to this case will depend on the company and/or accounting period selected for analysis.

**CONTINUING CASE**

**CC5-1.**

|  |  |  |  |
| --- | --- | --- | --- |
| *a.* | Retained earnings (−SE) | 10,000 |  |
|  | Cash (−A) |  | 10,000 |
|  |  |  |  |
| *b.* | Cash (+A) | 2,000 |  |
|  | Deferred revenue (+L) |  | 2,000 |
|  |  |  |  |
| *c.* | Rent expense (+E, −SE) | 500 |  |
|  | Cash (−A) |  | 500 |
|  |  |  |  |
| *d.* | Equipment (+A) | 14,000 |  |
|  | Note payable (+L) |  | 14,000 |
|  |  |  |  |
| *e.* | Depreciation expense (+E, −SE) | 600 |  |
|  | Accumulated depreciation (+XA, −A) |  | 600 |
|  |  |  |  |
| *f.* | Interest expense (+E, −SE) | 400 |  |
|  | Interest payable (+L) |  | 400 |
|  |  |  |  |

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| Transaction | Gross Profit | Operating  Income (Loss) | Current  Assets |
| *a.* | NE | NE | −10,000 |
| *b..* | NE | NE | +2,000 |
| *c.* | NE | −500 | -500 |
| *d.* | NE | NE | NE |
| *e.* | NE | −600 | NE |
| *f.* | NE | NE | NE |

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
| Transaction | Net Profit  Margin | Total Asset  Turnover | Return on  Assets |
| *a.* | NE | + | + |
| *b.* | NE | − | − |
| *c.* | − | + | − |
| *d.* | NE | − | − |
| *e.* | − | + | − |
| *f.* | − | NE | − |

**CC5-2.**

Req. 1

|  |  |
| --- | --- |
| **Pool Corporation** | |
| **Consolidated Statement of Income**  **For Year Ended December 31, Current Year (In Thousands Except Per Share Amounts)** | |
| Net sales | $1,793,318 |
| Cost of goods sold | 1,261,728 |
| Gross profit | 531,590 |
| Selling and administrative expenses | 406,523 |
| Operating income | 125,067 |
| Interest expense | 7,755 |
| Income before income taxes | 117,312 |
| Provision for income taxes | 45,319 |
| Net income | $71,993 |
|  |  |
| Earnings per share: |  |
| Basic earnings per share | $1.49 |
| Weighted average shares outstanding | 48,158 |

**CC5-2. (continued)**

**Pool Corporation**

**Consolidated Balance Sheet**

**December 31, Current Year**

**(in Thousands)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Assets** | |  | | |
| Current Assets | |  | | |
| Cash and cash equivalents | | $ 17,487 | | |
| Receivables, net | | 110,555 | | |
| Product inventories, net | | 386,924 | | |
| Prepaid expenses and other current assets | | 23,035 | | |
| Total current assets | | $538,001 | | |
| Noncurrent Assets | |  | | |
| Property and equipment, net | | 41,394 | | |
| Intangible assets | | 188,841 | | |
| Other non-current assets, net | | 30,386 |
| Total assets | | $798,622 | | |
| **Liabilities and Stockholders’ Equity** | |  | | |
| Current Liabilities | |  | | |
| Accounts payable | | $ 177,437 | | |
| Accrued expenses and other current liabilities | | 53,398 | | |
| Current portion of long-term debt | | 22 | | |
| Total current liabilities | | 230,857 | | |
| Noncurrent Liabilities | |  | | |
| Long-term debt | | 247,300 | | |
| Other long-term liabilities | | 40,719 | | |
| Total noncurrent liabilities | | 288,019 | | |
| Stockholders' Equity | |  | | |
| Common stock | | 47 | | |
| Additional paid-in capital | | 173,180 | | |
| Retained earnings | | 106,519 | | |
| Total stockholders' equity | | 279,746 | | |
| Total liabilities and stockholders' equity | | $798,622 | | |

Req. 2

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Gross profit percentage | = | Gross profit | = | 531,590 | = | 0.296 (29.6%) |
|  |  | Net sales |  | 1,793,318 |  |  |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Return on assets (ROA) | = | Net income | = | $71,993 | = | 0.094 (9.4%) |
|  |  | Avg total assets |  | ($798,622+728,545)/2 |  |  |