

# Chapter 2

## Exercises: Set B

**E2-1B** The following are the major balance sheet classifications.

*Classify accounts on balance sheet.*

Current assets (CA)	Current liabilities (CL)
Long-term investments (LTI)	Long-term liabilities (LTL)
Property, plant, and equipment (PPE)	Common stock (CS)
Intangible assets (IA)	Retained earnings (RE)

**(LO 1), AP**

### Instructions

Classify each of the following financial statement items taken from Inshore Corporation's balance sheet.

_____ Accounts payable	_____ Inventory
_____ Accounts receivable	_____ Stock investments (to be sold in 18 months)
_____ Accumulated depreciation—buildings	_____ Land
_____ Buildings	_____ Mortgage payable
_____ Cash	_____ Supplies
_____ Interest receivable	_____ Equipment
_____ Goodwill	_____ Prepaid rent
_____ Notes payable	

**E2-2B** The major balance sheet classifications are listed in E2-1B above.

*Classify financial statement items by balance sheet classification.*

### Instructions

Classify each of the following financial statement items based upon the major balance sheet classifications listed in E2-1B.

**(LO 1), AP**

_____ Prepaid rent	_____ Patents
_____ Equipment	_____ Bonds payable
_____ Copyrights	_____ Common stock
_____ Salaries and wages payable	_____ Accumulated depreciation—equipment
_____ Income taxes payable	_____ Unearned sales revenue
_____ Retained earnings	_____ Inventory
_____ Accounts receivable	
_____ Land	

**E2-3B** Suppose the following items were taken from the December 31, 2014, assets section of the Boeing Company balance sheet. (All dollars are in millions.)

*Classify items as current or noncurrent, and prepare assets section of balance sheet.*

Inventory	\$ 9,563	Patents	\$16,664
Notes receivable—due after December 31, 2015	6,777	Buildings	20,180
Notes receivable—due before December 31, 2015	328	Cash	7,042
Accumulated depreciation—buildings	11,915	Accounts receivable	5,740
		Debt investments (short-term)	2,266

**(LO 1)**

### Instructions

Prepare the assets section of a classified balance sheet, listing the current assets in order of their liquidity.

Prepare assets section of a classified balance sheet.

(LO 1)

**E2-4B** Suppose the following information (in thousands of dollars) is available for H. J. Heinz Company—famous for ketchup and other fine food products—for the year ended April 30, 2014.

Prepaid insurance	\$ 168,182	Buildings	\$4,344,269
Land	56,007	Cash	617,687
Goodwill	4,411,521	Accounts receivable	1,161,481
Trademarks	723,243	Accumulated depreciation—	
Inventory	1,378,216	buildings	2,295,563

### Instructions

Prepare the assets section of a classified balance sheet, listing the items in proper sequence and including a statement heading.

Prepare a classified balance sheet.

(LO 1), AP

**E2-5B** These items are taken from the financial statements of Trotter Co. at December 31, 2014.

Buildings	\$115,800
Accounts receivable	10,600
Prepaid insurance	3,200
Cash	18,840
Equipment	82,400
Land	61,200
Insurance expense	780
Depreciation expense	5,300
Interest expense	2,600
Common stock	75,000
Retained earnings (January 1, 2014)	40,000
Accumulated depreciation—buildings	45,600
Accounts payable	9,500
Notes payable	93,600
Accumulated depreciation—equipment	18,720
Interest payable	3,600
Service revenue	14,700

### Instructions

Prepare a classified balance sheet. Assume that \$13,600 of the note payable will be paid in 2015.

Prepare a classified balance sheet.

(LO 1), AP

**E2-6B** Suppose the following items were taken from the 2014 financial statements of Texas Instruments, Inc. (All dollars are in millions.)

Common stock	\$2,671	Accumulated depreciation—equipment	\$3,959
Prepaid rent	834	Accounts payable	1,368
Equipment	7,568	Patents	1,873
Income taxes payable	657	Notes payable (long-term)	667
Stock investments (long-term)	267	Retained earnings	7,304
Debt investments (short-term)	1,596	Accounts receivable	1,742
Cash	1,328	Inventory	1,418

### Instructions

Prepare a classified balance sheet in good form as of December 31, 2014.

Compute and interpret profitability ratio.

(LO 2), AP

**E2-7B** Suppose the following information is available for Callaway Golf Company for the years 2014 and 2013. (Dollars are in thousands, except share information.)

	<u>2014</u>	<u>2013</u>
Net sales	\$967,656	\$950,799
Net income (loss)	(18,804)	(15,260)

Total assets	884,979	875,930
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### **Share information**

Shares outstanding at year-end	64,406,000	64,473,000
Preferred dividends	—0—	—0—

There were 64,507,000 shares outstanding at the end of 2012.

### **Instructions**

- What was the company's earnings (loss) per share for each year?
- Based on your findings above, how did the company's profitability change from 2013 to 2014?
- Suppose the company had paid dividends on preferred stock and on common stock during the year. How would this affect your calculation in part (a)?

**E2-8B** These financial statement items are for Wi-HAUL Corporation at year-end, July 31, 2014. *Prepare financial statements.*

Salaries and wages payable	\$ 2,080	(LO 1, 2), AP
Salaries and wages expense	57,500	
Supplies expense	17,600	
Equipment	17,500	
Accounts payable	4,100	
Service revenue	66,100	
Rent revenue	8,500	
Notes payable (due in 2017)	1,800	
Common stock	16,000	
Cash	26,200	
Accounts receivable	11,780	
Accumulated depreciation—equipment	6,000	
Dividends	4,000	
Depreciation expense	4,000	
Retained earnings (beginning of the year)	34,000	

### **Instructions**

- Prepare an income statement and a retained earnings statement for the year. Wi-HAUL Corporation did not issue any new stock during the year.
- Prepare a classified balance sheet at July 31.
- Compute the current ratio and debt to assets ratio.
- Suppose that you are the president of Crescent Equipment. Your sales manager has approached you with a proposal to sell \$20,000 of equipment to Wi-HAUL. He would like to provide a loan to Wi-HAUL in the form of a 10%, 5-year note payable. Evaluate how this loan would change Wi-HAUL's current ratio and debt to assets ratio, and discuss whether you would make the sale.

**E2-9B** Nordstrom, Inc. operates department stores in numerous states. Selected financial statement data (in millions of dollars) for a recent year are as follows. *Compute liquidity ratios and compare results.*

	<b><u>End of Year</u></b>	<b><u>Beginning of Year</u></b>
Cash and cash equivalents	\$ 358	\$ 403
Receivables (net)	1,788	684
Merchandise inventory	956	997
Other current assets	259	658
Total current assets	\$3,361	\$2,742
Total current liabilities	\$1,635	\$1,433

### **Instructions**

- Compute working capital and the current ratio at the beginning of the year and at the end of the current year.
- Did Nordstrom's liquidity improve or worsen during the year?
- Using the data in the chapter, compare Nordstrom's liquidity with Best Buy's.

*Compute liquidity measures and discuss findings.*

**(LO 2), AP**

**E2-10B** The chief financial officer (CFO) of Abrev Corporation requested that the accounting department prepare a preliminary balance sheet on December 30, 2014, so that the CFO could get an idea of how the company stood. He knows that certain debt agreements with its creditors require the company to maintain a current ratio of at least 2:1. The preliminary balance sheet is as follows.

**ABREV CORP.  
Balance Sheet  
December 30, 2014**

Current assets		Current liabilities	
Cash	\$35,000	Accounts payable	\$ 18,000
Accounts receivable	20,000	Salaries and wages payable	<u>12,000</u> \$ 30,000
Prepaid insurance	<u>5,000</u>	Long-term liabilities	
Equipment (net)	<u>200,000</u>	Notes payable	<u>80,000</u>
Total assets	<u>\$260,000</u>	Total liabilities	110,000
		Stockholders' equity	
		Common stock	100,000
		Retained earnings	<u>50,000</u> <u>150,000</u>
		Total liabilities and stockholders' equity	<u>\$260,000</u>

**Instructions**

- Calculate the current ratio and working capital based on the preliminary balance sheet.
- Based on the results in (a), the CFO requested that \$18,000 of cash be used to pay off the balance of the accounts payable account on December 31, 2014. Calculate the new current ratio and working capital after the company takes these actions.
- Discuss the pros and cons of the current ratio and working capital as measures of liquidity.
- Was it unethical for the CFO to take these steps?

*Compute and interpret solvency ratios.*

**(LO 2), AP**

**E2-11B** Suppose the following data were taken from the 2014 and 2013 financial statements of American Eagle Outfitters. (All dollars are in thousands.)

	<u>2014</u>	<u>2013</u>
Current assets	\$1,020,834	\$1,189,108
Total assets	1,867,680	1,979,558
Current liabilities	376,178	464,618
Total liabilities	527,216	562,246
Net income	400,019	387,359
Net cash provided by operating activities	464,270	749,268
Capital expenditures	250,407	225,939
Dividends paid on common stock	80,796	61,521
Weighted-average shares outstanding	216,119	222,662

**Instructions**

Perform each of the following.

- Calculate the current ratio for each year.
- Calculate earnings per share for each year.
- Calculate the debt to assets ratio for each year.
- Calculate the free cash flow for each year.

- (e) Discuss American Eagle's solvency in 2014 versus 2013.
- (f) Discuss American Eagle's ability to finance its investment activities with cash provided by operating activities, and how any deficiency could be met.

**E2-12B** Presented below are the assumptions and principles discussed in this chapter.

*Identify accounting assumptions and principles.*

- |                               |                                |
|-------------------------------|--------------------------------|
| 1. Full disclosure principle. | 4. Periodicity assumption.     |
| 2. Going concern assumption.  | 5. Historical cost principle.  |
| 3. Monetary unit assumption.  | 6. Economic entity assumption. |

**(LO 3), K**

**Instructions**

Identify by number the accounting assumption or principle that is described below. Do not use a number more than once.

- (a) Is the rationale for why plant assets are not reported at liquidation value. (Note: Do not use the historical cost principle.)
- (b) Indicates that personal and business record-keeping should be separately maintained.
- (c) Assumes that the dollar is the “measuring stick” used to report on financial performance.
- (d) Separates financial information into time periods for reporting purposes.
- (e) Indicates that companies should not record in the accounts fair value changes subsequent to purchase.
- (f) Dictates that companies should disclose all circumstances and events that make a difference to financial statement users.

**E2-13B** The following situations involve accounting principles and assumptions.

*Identify the assumption or principle that has been violated.*

1. Donkey Company owns land that is worth substantially more than it originally cost. In an effort to provide more relevant information, Donkey reports the land at market value in its accounting reports.
2. Benjamin Company includes in its accounting records only transaction data that can be expressed in terms of money.
3. Josh Borke, owner of Josh’s MovieHouse, records his personal living costs as expenses of the MovieHouse.

**(LO 3), C**

**Instructions**

For each of the three situations, say if the accounting method used is correct or incorrect. If correct, identify which principle or assumption supports the method used. If incorrect, identify which principle or assumption has been violated.