CHAPTER 5

Statement of Financial Position and Statement of Cash Flows

ASSIGNMENT CLASSIFICATION TABLE (BY TOPIC)

Topics		Questions	Brief Exercises	Exercises	Problems	Concepts for Analysis
1.	Disclosure principles, uses of the statement of financial position, financial flexibility.	1, 2, 3, 4, 5, 6, 7, 10, 18, 21, 29, 30				4, 5
2.	Classification of items in the statement of financial position and other financial statements.	11, 12, 13, 14, 15, 16, 18, 19	1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11	1, 2, 3, 8, 9, 10		1, 2, 3
3.	Preparation of statement of financial position; issues of format, terminology, and valuation.	4, 7, 8, 9, 16, 17, 20		4, 5, 6, 7, 11, 12, 17	1, 2, 3, 4, 5, 6, 7	3, 4, 5
4.	Statement of cash flows.	21, 22, 23, 24, 25, 26, 27, 28	12, 13, 14, 15, 16	13, 14, 15, 16, 17, 18	6, 7	6
5.	Convergence.	31, 32, 33				

ASSIGNMENT CLASSIFICATION TABLE (BY LEARNING OBJECTIVE)

Learning Objectives	Brief Exercises	Exercises	Problems
1. Explain the uses and limitations of a statement of financial position.			7
2. Identify the major classifications of the statement of financial position.		1, 2, 3, 4, 8, 9	
3. Prepare a classified statement of financial position using the report and account formats.	1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11	1, 2, 3, 4, 5, 6, 7, 9, 10, 11, 12, 17	1, 2, 3, 4, 5, 6, 7
4. Indicate the purpose of the statement of cash flows.			
5. Identify the content of the statement of cash flows.		13	
6. Prepare a basic statement of cash flows.	12, 13, 14, 15	14, 15, 16, 17, 18	6, 7
7. Understand the usefulness of the statement of cash flows.	16	15, 16, 18	6, 7
8. Determine additional information requiring note disclosure.			
9. Describe the major disclosure techniques for financial statements.			

ASSIGNMENT CHARACTERISTICS TABLE

Item	Description	Level of Difficulty	Time (minutes)
E5-1	Statement of financial position classifications.	Simple	15–20
E5-2	Classification of statement of financial position accounts.	Simple	15–20
E5-3	Classification of statement of financial position accounts.	Simple	15–20
E5-4	Preparation of a classified statement of financial position.	Simple	30–35
E5-5	Preparation of a corrected statement of financial position.	Simple	30–35
E5-6	Corrections of a statement of financial position.	Complex	30–35
E5-7	Current assets section of the statement of financial position.	Moderate	15–20
E5-8	Current vs. non-current liabilities.	Moderate	10–15
E5-9	Current assets and current liabilities.	Complex	30–35
E5-10	Current liabilities.	Moderate	15–20
E5-11	Statement of financial position preparation.	Moderate	25–30
E5-12	Preparation of a statement of financial position.	Moderate	30–35
E5-13	Statement of cash flows—classifications.	Moderate	15–20
E5-14	Preparation of a statement of cash flows.	Moderate	25–35
E5-15	Preparation of a statement of cash flows.	Moderate	25–35
E5-16	Preparation of a statement of cash flows.	Moderate	25–35
E5-17	Preparation of a statement of cash flows and a statement of financial position.	Moderate	30–35
E5-18	Preparation of a statement of cash flows, analysis.	Moderate	25–35
P5-1	Preparation of a classified statement of financial position, periodic inventory.	Moderate	30–35
P5-2	Statement of financial position preparation.	Moderate	35–40
P5-3	Statement of financial position adjustment and preparation.	Moderate	40–45
P5-4	Preparation of a corrected statement of financial position.	Complex	40–45
P5-5	Statement of financial position adjustment and preparation.	Complex	40–50
P5-6	Preparation of a statement of cash flows and a statement of financial position.	Complex	35–45
P5-7	Preparation of a statement of cash flows and a statement of financial position.	Complex	40–50
CA5-1	Reporting the financial effects of varied transactions.	Moderate	20–25
CA5-2	Current asset and liability classification.	Moderate	25–30
CA5-3	Identifying statement of financial position deficiencies.	Moderate	30–35
CA5-4	Critique of statement of financial position format and content.	Simple	20–25
CA5-5	Presentation of property, plant, and equipment.	Simple	20–25
CA5-6	Cash flow analysis.	Complex	40–50

ANSWERS TO QUESTIONS

1. The statement of financial position provides information about the nature and amounts of investments in enterprise resources, obligations to enterprise creditors, and the owners' equity in net enterprise resources. That information not only complements information about the components of income, but also contributes to financial reporting by providing a basis for (1) computing rates of return, (2) evaluating the capital structure of the enterprise, and (3) assessing the liquidity and financial flexibility of the enterprise.

2. Solvency refers to the ability of an enterprise to pay its debts as they mature. For example, when a company carries a high level of long-term debt relative to assets, it has lower solvency. Information on non-current obligations, such as long-term debt and notes payable, in comparison to total assets can be used to assess resources that will be needed to meet these fixed obligations (such as interest and principal payments).

3. Financial flexibility is the ability of an enterprise to take effective actions to alter the amounts and timing of cash flows so it can respond to unexpected needs and opportunities. An enterprise with a high degree of financial flexibility is better able to survive bad times, to recover from unexpected setbacks, and to take advantage of profitable and unexpected investment opportunities. Generally, the greater the financial flexibility, the lower the risk of enterprise failure.

4. Some situations in which estimates affect amounts reported in the statement of financial position include:
(a) allowance for doubtful accounts.
(b) depreciable lives and estimated salvage values for plant and equipment.
(c) warranty returns.
(d) determining the amount of revenues that should be recorded as unearned.

When estimates are required, there is subjectivity in determining the amounts. Such subjectivity can impact the usefulness of the information by reducing the reliability of the measures, either because of bias or lack of verifiability.

5. An increase in inventories increases current assets, which is in the numerator of the current ratio. Therefore, inventory increases will increase the current ratio. In general, an increase in the current ratio indicates a company has better liquidity, since there are more current assets relative to current liabilities.

Note to instructors—When inventories increase faster than sales, this may not be a good signal about liquidity. That is, inventory can only be used to meet current obligations when it is sold (and converted to cash). That is why some analysts use a liquidity ratio—the acid test ratio—that excludes inventories from current assets in the numerator.

6. Liquidity describes the amount of time that is expected to elapse until an asset is converted into cash or until a liability has to be paid. The ranking of the assets given in order of liquidity is:
(1) (d) Short-term investments.
(2) (e) Accounts receivable.
(3) (b) Inventories.
(4) (c) Buildings.
(5) (a) Goodwill.

7. The major limitations of the statement of financial position are:
(a) The values stated are generally historical and not at fair value.
(b) Estimates have to be used in many instances, such as in the determination of collectibility of receivables or finding the approximate useful life of long-term tangible and intangible assets.
(c) Many items, even though they have financial value to the business, presently are not recorded. One example is the value of a company's human resources.

8. Some items of value to companies such as Louis Vitton or Adidas are the value of research and development (new products that are being developed but which are not yet marketable), the value of the "intellectual capital" of its workforce (the ability of the companies' employees to come up with new ideas and products in the changing industries), and the value of the company reputation or name brand. In most cases, the reasons why the value of these items are not recorded in the statement of financial position concern the lack of reliability of the estimates of the future cash flows that will be generated by these "assets" (for all three types) and the ability to control the use of the asset (in the case of employees). Being able to reliably measure the expected future benefits and to control the use of an item are essential elements of the definition of an asset.

9. Classification in financial statements helps users by grouping items with similar characteristics and separating items with different characteristics. Current assets are expected to be converted to cash within one year or one operating cycle, whichever is longer—property, plant and equipment will provide cash inflows over a longer period of time. Thus, separating non-current assets from current assets facilitates computation of useful ratios such as the current ratio.

10. Separate amounts should be reported for accounts receivable and notes receivable. The amounts should be reported gross, and an amount for the allowance for doubtful accounts should be deducted. The amount and nature of any nontrade receivables, and any amounts designated or pledged as collateral, should be clearly identified.

11. No. Available-for-sale securities should be reported as a current asset only if management expects to convert them into cash as needed within one year or the operating cycle, whichever is longer. If available-for-sale securities are not held with this expectation, they should be reported as long-term investments.

12. The relationship between current assets and current liabilities is that current liabilities are those obligations that are reasonably expected to be liquidated either through the use of current assets or the creation of other current liabilities.

13. The total selling price of the season tickets is £20,000,000 (10,000 X £2,000). Of this amount, $8,000,000 has been earned by 12/31/10 (8/20 X £20,000,000). The remaining £12,000,000 should be reported as unearned revenue, a current liability in the 12/31/10 statement of financial position (12/20 X £20,000,000).

14. Working capital is the excess of total current assets over total current liabilities. This excess is sometimes called net working capital. Working capital represents the net amount of a company's relatively liquid resources. That is, it is the liquidity buffer available to meet the financial demands of the operating cycle.

15. (a) Equity. "Treasury shares (at cost)."
Note: This is a reduction of total equity.
(b) Current Assets. Included in "Cash."
(c) Investments. "Land held as an investment."
(d) Investments. "Sinking fund."
(e) Current Liabilities. "Provision for warranties."
(f) Intangible Assets. "Copyrights."
(g) Investments. "Employees' pension fund," with subcaptions of "Cash" and "Securities" if desired. (Assumes that the company still owns these assets.)
(h) Equity. "Share capital—ordinary."
(i) Investments. Nature of investments should be given together with parenthetical information as follows: "pledged to secure loans payable to banks."
(j) Equity. "Minority interest."

16. (a) Allowance for doubtful accounts receivable should be deducted from accounts receivable in current assets.
(b) Merchandise held on consignment should not appear on the consignee's statement of financial position except possibly as a note to the financial statements.
(c) Advances received on sales contract are normally a current liability and should be shown as such in the statement of financial position.
(d) Accumulated other comprehensive income should be shown as part of equity.
(e) Land should be reported in property, plant, and equipment unless held for investment.
(f) Merchandise out on consignment should be shown among current assets under the heading of inventories.
(g) Franchises should be itemized in a section for intangible assets.
(h) Accumulated depreciation of plant and equipment should be deducted from the plant and equipment accounts.
(i) Materials in transit should not be shown on the statement of financial position of the buyer, if purchased f.o.b. destination.

17. (a) Trade accounts receivable should be stated at their estimated amount collectible, often referred to as net realizable value. The method most generally followed is to deduct from the total accounts receivable the amount of the allowance for doubtful accounts.
(b) Land is generally stated in the statement of financial position at cost.
(c) Inventories are generally stated at the lower of cost or net realizable value.
(d) Trading securities (consisting of ordinary shares of other companies) are stated at fair value.
(e) Prepaid expenses should be stated at cost less the amount apportioned to the previous accounting periods.

18. Assets are defined as probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. If a building is leased under a finance or capital lease, the future economic benefits of using the building are controlled by the lessee (tenant) as the result of a past event (the signing of a lease agreement).

19. Battle is incorrect. Retained earnings is a **source** of assets, but is not an asset itself. For example, even though the funds obtained from issuing a note payable are invested in the business, the note payable is not reported as an asset. It is a **source** of assets, but it is reported as a liability because the company has an obligation to repay the note in the future. Similarly, even though the earnings are invested in the business, retained earnings is not reported as an asset. It is reported as part of equity because it is, in effect, an investment by owners which increases the ownership interest in the assets of an entity.

20. The notes should appear as non-current liabilities with full disclosure as to their terms. Each year, as the profit is determined, notes of an amount equal to two-thirds of the year's profits should be transferred from the non-current liabilities to current liabilities until all of the notes have been liquidated.

21. The purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an enterprise during a period. It differs from the statement of financial position and the income statement in that it reports the sources and uses of cash by operating, investing, and financing activity classifications. While the income statement and the statement of financial position are accrual basis statements, the statement of cash flows is a cash basis statement—noncash items are omitted.

22. The difference between these two amounts may be due to increases in current assets (e.g., an increase in accounts receivable from a sale on account would result in an increase in revenue and net income but have no effect yet on cash). Similarly a cash payment that results in a decrease in an existing current liability (e.g., accounts payable would decrease cash provided by operations without affecting net income.)

23. The difference between these two amounts could be due to noncash charges that appear in the income statement. Examples of noncash charges are depreciation, depletion, and amortization of intangibles. Expenses recorded but unpaid (e.g., increase in accounts payable) and collection of previously recorded sales on credit (i.e., now decreasing accounts receivable) also would cause cash provided by operating activities to exceed net income.

24. **Operating activities** involve the cash effects of transactions that enter into the determination of net income. **Investing activities** include making and collecting loans and acquiring and disposing of debt and equity instruments; property, plant, and equipment and intangibles. **Financing activities** involve liability and equity items and include obtaining capital from owners and providing them with a return on (dividends) and a return of their investment and borrowing money from creditors and repaying the amounts borrowed.

25. (a) Net income is adjusted downward by deducting ¥5,000 from ¥90,000 and reporting cash provided by operating activities as ¥85,000.

(b) The issuance of the share capital is a financing activity. The issuance is reported as follows:

Cash flows from financing activities	
Issuance of share capital	¥1,150,000

(c) Net income is adjusted as follows:

Cash flows from operating activities	
Net income	¥ 90,000
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation expense	14,000
Amortization	5,000
Net cash provided by operating activities	¥ 109,000

(d) The increase of ¥20,000 reflects a noncash investing and financing activity. The increase in Land is reported in a footnote to the statement of cash flows as follows:
Noncash investing and financing activities were the purchase of land through issuance of ¥20,000 of long-term debt.

26. The company appears to have good liquidity and reasonable financial flexibility. Its current cash debt coverage ratio is 1.20 $\left(\frac{€1,200,000}{€1,000,000}\right)$, which indicates that it can pay off its current liabilities in a given year from its operations. In addition, its cash debt coverage ratio is also good at 0.80 $\left(\frac{€1,200,000}{€1,500,000}\right)$, which indicates that it can pay off approximately 80% of its debt out of current operations.

27. Free cash flow = $860,000 – $75,000 – $30,000 = $755,000.

28. Free cash flow is net cash provided by operating activities less capital expenditures and dividends. The purpose of free cash flow analysis is to determine the amount of discretionary cash flow a company has for purchasing additional investments, retiring its debt, purchasing treasury stock, or simply adding to its liquidity and financial flexibility.

29. A Summary of Significant Accounting Policies is usually the first note to the financial statements. It discloses all significant accounting principles and methods that involve selection from among alternatives (e.g., average cost and FIFO) or those that are peculiar to a given industry.

30. Companies use two methods to disclose pertinent information in the statement of financial position:
(1) Parenthetical explanations and
(2) cross-reference and contra items.

31. Among the similarities between IFRS and U.S. GAAP related to statement of financial position presentation are as follows:

- IAS 1 specifies minimum note disclosures. These must include information about (1) accounting policies followed, (2) judgments that management has made in the process of applying the entity's accounting policies, and (3) and the key assumptions and estimation uncertainty that could result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.
- Comparative prior-period information must be presented and financial statements must be prepared annually.
- Current/non-current classification for assets and liabilities is normally required. In general, post-financial statement events are not considered in classifying items as current or non-current.

Differences include (1) IFRS statements may report property, plant, and equipment first in the statement of financial position. Some companies report the sub-total "net assets", which equals total assets minus total liabilities. (2) While the use of the term "reserve" is discouraged in U.S. GAAP, there is no such prohibition in IFRS.

32. The IASB and the FASB are working on a project to converge their standards related to financial statement presentation. This joint project will establish a common, high-quality standard for presentation of information in the financial statements, including the classification and display of line items. A key feature of the proposed framework for financial statement presentation is that each of the statements will be organized in the same format to separate an entity's financing activities from its operating and other activities (investing) and further separates financing activities into transactions with owners and creditors. Thus, the same classifications used in the statement of financial position would also be used in the income statement and the statement of cash flows. The project has three phases.

33. Rainmaker would present current assets first in its statement of financial position instead of last under IFRS. It would report cash instead of inventory first under current assets. Rainmaker would also present current liabilities before non-current liabilities rather than as is done with IFRS.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 5-1

Current assets		
Inventories		$290,000
Accounts receivable	$110,000	
Less: Allowance for doubtful accounts	8,000	102,000
Prepaid insurance		9,500
Cash		30,000
Total current assets		$431,500

BRIEF EXERCISE 5-2

Current assets		
Inventory		€30,000
Accounts receivable	€90,000	
Less: Allowance for doubtful accounts	4,000	86,000
Prepaid insurance		5,200
Trading securities		11,000
Cash		7,000
Total current assets		€139,200

BRIEF EXERCISE 5-3

Long-term investments	
Held-to-maturity securities	$ 56,000
Long-term note receivables	42,000
Land held for investment	39,000
Total investments	$137,000

BRIEF EXERCISE 5-4

Property, plant, and equipment		
Land		$ 71,000
Buildings	$207,000	
Less: Accumulated depreciation	45,000	162,000
Equipment	190,000	
Less: Accumulated depreciation	(19,000)	171,000
Total property, plant, and equipment		$404,000

BRIEF EXERCISE 5-5

Intangible assets	
Goodwill	£150,000
Patents	220,000
Franchises	130,000
Total intangibles	£500,000

BRIEF EXERCISE 5-6

Intangible assets	
Capitalized development costs	$ 18,000
Goodwill	50,000
Franchises	47,000
Patents	33,000
Trademarks	10,000
Total intangible assets	$158,000

BRIEF EXERCISE 5-7

Current liabilities	
Notes payable	$ 22,500
Accounts payable	72,000
Accrued salaries	4,000
Income taxes payable	7,000
Total current liabilities	$105,500

BRIEF EXERCISE 5-8

Current liabilities	
Accounts payable	$220,000
Advances from customers	41,000
Wages payable	27,000
Interest payable	12,000
Provision for warranties	3,000
Income taxes payable	29,000
Total current liabilities	$332,000

BRIEF EXERCISE 5-9

Non-current liabilities	
Bonds payable	$371,000
Pension liability	375,000
Provision for warranties	6,000
Total non-current liabilities	$752,000

BRIEF EXERCISE 5-10

Equity	
Share capital—ordinary shares	$ 750,000
Share premium—ordinary shares	200,000
Retained earnings	120,000
Accumulated other comprehensive income	(150,000)
Minority interest	80,000
Total equity	$1,000,000

BRIEF EXERCISE 5-11

Equity	
Share capital—preference	$152,000
Share capital—ordinary	70,000
Share premium—ordinary	174,000
Retained earnings	114,000
Minority interest	18,000
Total equity	$528,000

BRIEF EXERCISE 5-12

Cash Flow Statement

Operating Activities		
Net income		$40,000
Depreciation expense	$ 4,000	
Increase in accounts receivable	(10,000)	
Increase in accounts payable	7,000	1,000
Net cash provided by operating activities		41,000

BRIEF EXERCISE 5-12 (Continued)

Investing Activities		
Purchase of equipment		(8,000)
Financing Activities		
Issue notes payable	$20,000	
Dividends	(5,000)	
Net cash flow from financing activities		15,000
Net change in cash ($41,000 – $8,000 + $15,000)		$48,000

Free Cash Flow = $41,000 (Net cash provided by operating activities) – $8,000 (Purchase of equipment) – $5,000 (Dividends) = $28,000.

BRIEF EXERCISE 5-13

Cash flows from operating activities		
Net income		HK$151,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	HK$44,000	
Increase in accounts receivable	(13,000)	
Increase in accounts payable	9,500	40,500
Net cash provided by operating activities		HK$191,500

BRIEF EXERCISE 5-14

Sale of land and building	$191,000
Purchase of land	(37,000)
Purchase of equipment	(53,000)
Net cash provided by investing activities	$101,000

BRIEF EXERCISE 5-15

Issuance of ordinary shares	$147,000
Purchase of treasury shares	(40,000)
Payment of cash dividend	(95,000)
Retirement of bonds	(100,000)
Net cash used by financing activities	$ (88,000)

BRIEF EXERCISE 5-16

Free Cash Flow Analysis

Net cash provided by operating activities	$400,000
Less: Purchase of equipment	(53,000)
Purchase of land*	(37,000)
Dividends	(95,000)
Free cash flow	$215,000

*If the land were purchased as an investment, it would be excluded in the computation of free cash flow.

SOLUTIONS TO EXERCISES

EXERCISE 5-1 (15–20 minutes)

(a) If the investment in preference shares is readily marketable and held primarily for sale in the near term to generate income on short-term price differences, then the account should appear as a current asset and be included with trading securities. If, on the other hand, the preference shares are not a trading security, they should be classified as available-for-sale.

(b) Treasury shares should be shown as a reduction of total equity.

(c) Equity.

(d) Current liability.

(e) Property, plant, and equipment (as a deduction).

(f) If the warehouse in process of construction is being constructed for another party, it is properly classified as an inventory account in the current asset section. This account will be shown net of any billings on the contract. On the other hand, if the warehouse is being constructed for the use of this particular company, it should be classified as a separate item in the property, plant, and equipment section.

(g) Current asset.

(h) Current liability.

(i) Retained earnings.

EXERCISE 5-1 (Continued)

(j) Current asset.

(k) Current liability.

(l) Current liability.

(m) Current asset (inventory).

(n) Current liability.

EXERCISE 5-2 (15–20 minutes)

1.	(c)	11.	(c)
2.	(a) (3)	12.	(e)
3.	(e)	13.	(b)
4.	(e)	14.	(c)
5	(a) (2)	15.	(a) (2)
6.	(b)	16.	(a) (1)
7.	(e)	17.	(b)
8.	(a) (3)	18.	(b)
9.	(b)	19.	(d)
10.	(b)	20.	(e)

EXERCISE 5-3 (15–20 minutes)

1. (e)
2. (a)
3. (g)
4. (e)
5 (g)
6. (h)
7. (i)
8. (c)
9. (e)
10. (g)
11. (e)
12. (g)
13. (e)
14. (k)
15. (g)
16. (X)
17. (b)

EXERCISE 5-4 (30–35 minutes)

GULISTAN INC.
Statement of Financial Position
December 31

Assets			
Non-current assets			
Long-term investments			
Long-term investment in preference shares		$XXX	
Land held for future plant site		XXX	
Cash restricted for plant expansion		XXX	
Total long-term investments			$XXX
Property, plant, and equipment			
Buildings		XXX	
Less: Accum. depreciation—buildings		XXX	XXX
Intangible assets			
Copyrights			XXX
Current assets			
Inventories			
Finished goods	$XXX		
Work in process	XXX		
Raw materials	XXX	XXX	
Accounts receivable	XXX		
Less: Allowance for doubtful accounts	XXX	XXX	
Notes receivable		XXX	
Receivables—officers		XXX	
Cash	XXX		
Less: Cash restricted for plant expansion	XXX	XXX	
Total current assets			XXX
Total assets			$XXX

EXERCISE 5-4 (Continued)

Equity and Liabilities

Equity		
Share capital—ordinary	XXX	
Share premium—ordinary shares	XXX	
Retained earnings	XXX	
Less: Treasury shares, at cost	(XXX)	
Total shareholders' equity		XXX
Total equity and liabilities		$XXX
Non-current liabilities		
Bonds payable, due in four years	$XXX	
Long-term note payable	XXX	
Total non-current liabilities		$XXX
Current liabilities		
Notes payable, short-term	XXX	
Accrued salaries payable	XXX	
Unearned subscriptions revenue	XXX	
Unearned rent revenue	XXX	
Total current liabilities	XXX	XXX
Total liabilities		XXX

Note to instructor: An assumption made here is that cash included the cash restricted for plant expansion. If it did not, then a subtraction from cash would not be necessary or the cash balance would be "grossed up" and then the cash restricted for plant expansion deducted.

EXERCISE 5-5 (30–35 minutes)

BRUNO COMPANY
Statement of Financial Position
December 31, 2010

Assets			
Non-current assets			
Long-term investments			
Land held for future use			$ 175,000
Property, plant, and equipment			
Building	$730,000		
Less: Accum. depr.—building	160,000	$570,000	
Office equipment	265,000		
Less: Accum. depr.—office equipment	105,000	160,000	730,000
Intangible assets			
Goodwill		80,000	
Other identifiable assets		90,000	170,000
Total non-current assets			1,075,000
Current assets			
Inventories, at lower of average cost or net realizable value		401,000	
Accounts receivable	357,000		
Less: Allowance for doubtful accounts	17,000	340,000	
Prepaid expenses		12,000	
Trading securities—at fair value		120,000	
Cash		260,000	
Total current assets			1,133,000
Total assets			$2,208,000

EXERCISE 5-5 (Continued)

Equity and Liabilities

Equity			
Share capital—ordinary, $1 par, authorized 400,000 shares, issued 290,000 shares	$290,000		
Share premium—ordinary	180,000	$470,000	
Retained earnings		794,000*	
Total equity			$1,264,000
Non-current liabilities			
Bonds payable	500,000		
Add: Premium on bonds payable	53,000	553,000	
Pension obligation		82,000	
Total non-current liabilities			$635,000
Current liabilities			
Notes payable (due next year)		125,000	
Accounts payable		135,000	
Rent payable		49,000	
Total current liabilities			309,000
Total liabilities			944,000
Total equity and liabilities			$2,208,000

*$2,208,000 – $944,000 – $470,000

EXERCISE 5-6 (30–35 minutes)

GARFIELD COMPANY
Statement of Financial Position
July 31, 2010

Assets			
Non-current asset			
Long-term investments			
Bond sinking fund		$ 12,000	
Property, plant, and equipment			
Equipment	$112,000		
Less: Accumulated depreciation—equipment	28,000	84,000	
Intangible assets			
Patents		21,000	
Total non-current assets			$117,000
Current assets			
Inventories		65,300*	
Accounts receivable	46,700**		
Less: Allowance for doubtful accounts	3,500	43,200	
Cash		66,000***	
Total current assets			174,500
Total assets			$291,500

*($60,000 + $5,300)
**($52,000 – $5,300)
***($69,000 – $12,000 + $9,000)

EXERCISE 5-6 (Continued)

Equity and Liabilities

Equity			$155,500
Non–current liabilities		$75,000	
Current liabilities			
Notes and accounts payable	$52,000****		
Taxes payable	9,000		
Total current liabilities		61,000	
Total liabilities			136,000
Total equity and liabilities			$291,500

****($44,000 + $8,000)

EXERCISE 5-7 (15–20 minutes)

Current assets

Inventories at lower-of-cost (determined using FIFO) or net-realizable-value		
Finished goods	€ 52,000	
Work-in-process	34,000	
Raw materials	187,000	€273,000
Accounts receivable (of which €50,000 is pledged as collateral on a bank loan)	161,000	
Less: Allowance for doubtful accounts	12,000	149,000
Interest receivable [(€40,000 X 6%) X 8/12]		1,600
Trading securities at fair value (cost, €31,000)		29,000
Cash	92,000*	
Less: Cash restricted for plant expansion	(50,000)	42,000
Total current assets		€494,600

*An acceptable alternative is to report cash at €42,000 and simply report the cash restricted for plant expansion in the investments section.

EXERCISE 5-8 (10–15 minutes)

1. **Dividends payable of $1,900,000 will be reported as a current liability [(1,000,000 – 50,000) X $2.00].**

2. **Bonds payable of $25,000,000 and interest payable of $2,000,000 ($100,000,000 X 8% X 3/12) will be reported as a current liability. Bonds payable of $75,000,000 will be reported as a non-current liability.**

3. **Customer advances of $17,000,000 will be reported as a current liability ($12,000,000 + $30,000,000 – $25,000,000).**

EXERCISE 5-9 (30–35 minutes)

(a)

AGINCOURT COMPANY
Statement of Financial Position (Partial)
December 31, 2010

Current assets			
Inventories		$161,000*	
Accounts receivable	$91,300**		
Less: Allowance for doubtful accounts	7,000	84,300	
Prepaid expenses		9,000	
Cash		30,476***	
Total current assets			$284,776

*Inventories	$171,000	
Less: Inventory received on consignment	10,000	
Adjusted inventory		$161,000

**Accounts receivable balance	$ 89,000	
Add: Accounts reduced from January collection ($23,324 ÷ 98%)	23,800	
	112,800	
Deduct: Accounts receivable in January	21,500	
Adjusted accounts receivable		$ 91,300

***Cash balance	$ 40,000	
Add: Cash disbursement after discount [$35,000 X 98%)]	34,300	
	74,300	
Less: Cash sales in January ($30,000 – $21,500)	8,500	
Cash collected on account	23,324	
Bank loan proceeds ($35,324 – $23,324)	12,000	
Adjusted cash		$ 30,476

EXERCISE 5-9 (Continued)

Current liabilities		
Notes payable		$ 55,000[a]
Accounts payable		113,000[b]
Total current liabilities		$168,000

[a]Notes payable balance		$ 67,000
Less: Proceeds of bank loan		12,000
Adjusted notes payable		$ 55,000

[b]Accounts payable balance		$ 61,000
Add: Cash disbursements	$35,000	
Purchase invoice omitted		
($27,000 – $10,000)	17,000	52,000
Adjusted accounts payable		$113,000

(b) Adjustment to retained earnings balance:

Add: January sales discounts		
[($23,324 ÷ 98%) X .02]		$ 476
Deduct: January sales	$30,000	
January purchase discounts		
($35,000 X 2%)	700	
December purchases..............................	17,000	
Consignment inventory	10,000	(57,700)
Change (decrease) to retained earnings		$ (57,224)

EXERCISE 5-10 (15–20 minutes)

(a) A current liability of $150,000 should be recorded.

(b) A current liability for accrued interest of $6,000 ($900,000 X 8% X 1/12) should be reported. Also, the $900,000 note payable should be a current liability if payable in one year. Otherwise, the $900,000 note payable would be a non-current liability.

(c) Although bad debts expense of $200,000 should be debited and the allowance for doubtful accounts credited for $200,000, this does not result in a liability. The allowance for doubtful accounts is a valuation account (contra asset) and is deducted from accounts receivable on the statement of financial position.

(d) A current liability of $80,000 should be reported. The liability is recorded on the date of declaration.

(e) Customer advances of $110,000 ($160,000 – $50,000) will be reported as a current liability.

EXERCISE 5-11 (25–30 minutes)

ABBEY CORPORATION
Statement of Financial Position
December 31, 2010

Assets				
Property, plant, and equipment				
Equipment		£48,000		
Less: Accumulated depreciation		9,000		
Total property, plant, and equipment				£39,000
Intangible assets				
Trademark				950
Current assets				
Office supplies		1,200		
Prepaid insurance		1,000		
Cash		6,850*		
Total current assets				9,050
Total assets				£49,000
Equity and Liabilities				
Equity				
Share capital—ordinary			£10,000	
Retained earnings (£20,000 – £2,500)			17,500	
Total shareholders' equity				£27,500
Non-current liabilities				
Bonds payable			£ 9,000	
Current liabilities				
Accounts payable	£10,000			
Wages payable	500			
Unearned service revenue	2,000			
Total current liabilities			12,500	
Total liabilities			21,500	
Total equity and liabilities				£49,000

*[£49,000 – £39,000 – £950 – £1,200 – £1,000]
**[£10,000 – (£9,000 + £1,400 + £1,200 + £900)]

EXERCISE 5-12 (30–35 minutes)

VIVALDI CORPORATION
Statement of Financial Position
December 31, 2010

Assets

Non-current assets			
Long-term investments			
Investments in bonds		$299,000	
Investments in capital shares		277,000	
Total long-term investments			$ 576,000
Property, plant, and equipment			
Land		260,000	
Buildings	$1,040,000		
Less: Accum. depreciation	352,000	688,000	
Equipment	600,000		
Less: Accum. depreciation	60,000	540,000	
Total property, plant, and equipment			1,488,000
Intangible assets			
Franchise		160,000	
Patent		195,000	
Total intangible assets			355,000
Total non-current assets			2,419,000
Current assets			
Inventories		597,000	
Accounts receivable	435,000		
Less: Allowance for doubtful accounts	25,000	410,000	
Trading securities		153,000	
Cash		197,000	
Total current assets			1,357,000
Total assets			$3,776,000

EXERCISE 5-12 (Continued)

Equity and Liabilities

Equity			
Share capital—ordinary ($5 par)		$1,000,000	
Retained earnings*		130,000	
Accumulated other comprehensive income		80,000	
Less: Treasury shares		191,000	
Total equity			$1,019,000
Non-current liabilities			
Bonds payable	$1,000,000		
Long-term notes payable	900,000		
Provision for pensions	80,000		
Total non-current liabilities		1,980,000	
Current liabilities			
Short-term notes payable	$ 90,000		
Accounts payable	455,000		
Dividends payable	136,000		
Accrued liabilities	96,000		
Total current liabilities		777,000	
Total liabilities			2,757,000
Total equity and liabilities			$3,776,000

EXERCISE 5-12 (Continued)

***Computation of Retained Earnings:**

Sales	$7,900,000
Investment revenue	63,000
Cost of goods sold	(4,800,000)
Selling expenses	(2,000,000)
Administrative expenses	(900,000)
Interest expense	(211,000)
Net income	$ 52,000

Beginning retained earnings	$ 78,000
Net income	52,000
Ending retained earnings	$ 130,000

Or ending retained earnings can be computed as follows:

Total equity ($3,776,000 – $2,757,000)	$1,019,000
Add: Treasury shares	191,000
Less: Share capital and Accum. other comprehensive income	1,080,000
Ending retained earnings	$ 130,000

Note to instructor: There is no dividends account. Thus, the 12/31/10 retained earnings balance already reflects any dividends declared.

EXERCISE 5-13 (15–20 minutes)

(a) 4.
(b) 3.
(c) 4.
(d) 3.
(e) 1.
(f) 1.
(g) 5.
(h) 4.
(i) 5.
(j) 4.
(k) 1.
(l) 2.
(m) 2.

EXERCISE 5-14 (25–35 minutes)

CONNECTICUT INC.
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities		
Net income		$34,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	$ 6,000	
Increase in accounts receivable	(3,000)	
Increase in accounts payable	5,000	8,000
Net cash provided by operating activities		42,000
Cash flows from investing activities		
Purchase of equipment		(17,000)
Cash flows from financing activities		
Issuance of common stock	20,000	
Payment of cash dividends	(13,000)	
Net cash provided by financing activities		7,000
Net increase in cash		32,000
Cash at beginning of year		13,000
Cash at end of year		$45,000

EXERCISE 5-15 (25–35 minutes)

(a)

YOON CORPORATION
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities		
Net income		₩160,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	₩ 17,000	
Loss on sale of investments	7,000	
Decrease in accounts receivable	5,000	
Decrease in current liabilities	(17,000)	12,000
Net cash provided by operating activities		172,000
Cash flows from investing activities		
Sale of investments [(₩74,000 – ₩52,000) – ₩7,000]	15,000	
Purchase of equipment	(58,000)	
Net cash used by investing activities		(43,000)
Cash flows from financing activities		
Payment of cash dividends		(50,000)
Net increase in cash		79,000
Cash at beginning of year		78,000
Cash at end of year		₩157,000

(b)

Free Cash Flow Analysis

Net cash provided by operating activities	₩172,000
Less: Purchase of equipment	(58,000)
Dividends	(50,000)
Free cash flow	₩ 64,000

EXERCISE 5-16 (25–35 minutes)

(a) **OROZCO CORPORATION**
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities		
Net income		$105,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	$27,000	
Decrease in inventory	9,000	
Increase in accounts receivable	(16,000)	
Decrease in accounts payable	(13,000)	7,000
Net cash provided by operating activities		$112,000
Cash flows from investing activities		
Sale of land	39,000	
Purchase of equipment	(70,000)	
Net cash used by investing activities		(31,000)
Cash flows from financing activities		
Payment of cash dividends		(40,000)
Net increase in cash		41,000
Cash at beginning of year		22,000
Cash at end of year		$ 63,000

Noncash investing and financing activities were issue of ordinary shares to retire $50,000 of bonds outstanding.

EXERCISE 5-16 (Continued)

(b) Current cash debt coverage ratio =

$$= \frac{\text{Net cash provided by operating activities}}{\text{Average current liabilities}}$$

$$= \frac{\$112{,}000}{(\$34{,}000 + \$47{,}000)/2}$$

$$= 2.77 \text{ to } 1$$

Cash debt coverage ratio =

$$= \frac{\text{Net cash provided by operating activities}}{\text{Average total liabilities}}$$

$$= \$112{,}000 \div \frac{\$184{,}000 + \$247{,}000}{2}$$

$$= 0.52 \text{ to } 1$$

Free Cash Flow Analysis

Net cash provided by operating activities	$112,000
Less: Purchase of equipment	(70,000)
Dividends	(40,000)
Free cash flow	$ 2,000

Orozco has acceptable liquidity. Its financial flexibility is good. It might be noted that it substantially reduced its long-term debt in 2010 which will help its financial flexibility.

EXERCISE 5-17 (30–35 minutes)

(a)

CHEKOV CORPORATION
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities		
Net income		$55,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	$13,000	
Patent amortization	2,500	
Loss on sale of equipment	3,000*	
Increase in current liabilities	13,000	
Increase in current assets (other than cash)	(25,000)	6,500
Net cash provided by operating activities		61,500
Cash flows from investing activities		
Sale of equipment	9,000	
Addition to building	(27,000)	
Investment in debt securities	(16,000)	
Net cash used by investing activities		(34,000)
Cash flows from financing activities		
Issuance of bonds	50,000	
Payment of dividends	(25,000)	
Purchase of treasury shares	(11,000)	
Net cash provided by financing activities		14,000
Net increase in cash		$41,500[a]

*[$9,000 – ($20,000 – $8,000)]

[a]An additional proof to arrive at the increase in cash is provided as follows:

Total current assets—end of period	$301,500	[from part (b)]
Total current assets—beginning of period	(235,000)	
Increase in current assets during the period	66,500	
Increase in current assets other than cash	(25,000)	
Increase in cash during year	$ 41,500	

EXERCISE 5-17 (Continued)

(b)

CHEKOV CORPORATION
Statement of Financial Position
December 31, 2010

Assets

Non-currents assets			
Long-term investments			$ 16,000
Property, plant, and equipment			
Land		$ 30,000	
Building ($120,000 + $27,000)	$147,000		
Less: Accum. depreciation ($30,000 + $4,000)	34,000	113,000	
Equipment ($90,000 – $20,000)	70,000		
Less: Accum. depreciation ($11,000 – $8,000 + $9,000)	12,000	58,000	
Total property, plant, and equipment			201,000
Intangible assets			
Patents ($40,000 – $2,500)			37,500
Total non-current assets			254,500
Current assets			301,500[b]
Total assets			$556,000

EXERCISE 5-17 (Continued)

Equity and Liabilities

Equity		
Share capital—ordinary	$180,000	
Retained earnings ($44,000 + $55,000 – $25,000)	74,000	
Less: Treasury shares	11,000	
Total shareholders' equity		$243,000
Non-current liabilities		
Bonds payable ($100,000 + $50,000)	$150,000	
Current liabilities ($150,000 + $13,000)	163,000	
Total liabilities		313,000
Total equity and liabilities		$556,000

Au: Is it correct. Pls confirm

[b] The amount determined for current assets could be computed last and then is a "plug" figure. That is, total liabilities and equity is computed because information is available to determine this amount. Because the total assets amount is the same as total liabilities and equity amount, the amount of total assets is determined. Information is available to compute all the asset amounts except current assets and therefore current assets can be determined by deducting the total of all the other asset balances from the total asset balance (i.e., $556,000 – $37,500 – $201,000 – $16,000). Another way to compute this amount, given the information, is that beginning current assets plus the $25,000 increase in current assets other than cash plus the $41,500 increase in cash equals $301,500.

EXERCISE 5-18 (25–35 minutes)

(a)

MENACHEM CORPORATION
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities		
Net income		€34,000
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	€ 6,000	
Increase in accounts payable	5,000	
Increase in accounts receivable	(18,000)	(7,000)
Net cash provided by operating activities		27,000
Cash flows from Investing activities		
Purchase of equipment		(15,000)
Cash flows from financing activities		
Issuance of shares	20,000	
Payment of dividends	(23,000)	
Net cash used by financing activities		(3,000)
Net increase in cash		9,000
Cash at beginning of year		13,000
Cash at end of year		€22,000

(b) Current ratio

	2010	2009
Current ratio	€128,000 / € 20,000 = 6.4	€101,000 / € 15,000 = 6.73

Free Cash Flow Analysis

Net cash provided by operating activities	€ 27,000
Less: Purchase of equipment	(15,000)
Pay dividends	(23,000)
Free cash flow	€(11,000)

(c) Although, Menachem's current ratio has declined from 2009 to 2010, it is still in excess of 6. It appears the company has good liquidity. Financial flexibility is poor due to negative free cash flow.

TIME AND PURPOSE OF PROBLEMS

Problem 5-1 (Time 30–35 minutes)
Purpose—to provide the student with the opportunity to prepare a statement of financial position, given a set of accounts. No monetary amounts are to be reported.

Problem 5-2 (Time 35–40 minutes)
Purpose—to provide the student with the opportunity to prepare a complete statement of financial position, involving dollar amounts. A unique feature of this problem is that the student must solve for the retained earnings balance.

Problem 5-3 (Time 40–45 minutes)
Purpose—to provide an opportunity for the student to prepare a statement of financial position in good form. Emphasis is given in this problem to additional important information that should be disclosed. For example, an inventory valuation method, bank loans secured by long-term investments, and information related to the capital stock accounts must be disclosed.

Problem 5-4 (Time 40–45 minutes)
Purpose—to provide the student with the opportunity to analyze a statement of financial position and correct it where appropriate. The statement of financial position as reported is incomplete, uses poor terminology, and is in error. A challenging problem.

Problem 5-5 (Time 40–50 minutes)
Purpose—to provide the student with the opportunity to prepare a statement of financial position in good form. Additional information is provided on each asset and liability category for purposes of preparing the statement of financial position. A challenging problem.

Problem 5-6 (Time 35–45 minutes)
Purpose—to provide the student with an opportunity to prepare a complete statement of cash flows. A condensed statement of financial position is also required. The student is also required to explain the usefulness of the statement of cash flows. Because the textbook does not explain in Chapter 5 all of the steps involved in preparing the statement of cash flows, assignment of this problem is dependent upon additional instruction by the teacher or knowledge gained in elementary financial accounting.

Problem 5-7 (Time 40–50 minutes)
Purpose—to provide the student with an opportunity to prepare a statement of financial position in good form and a more complex cash flow statement.

SOLUTIONS TO PROBLEMS

PROBLEM 5-1

COMPANY NAME
Statement of Financial Position
December 31, 20XX

Assets			
Non-current assets			
Long-term investments			
Bond sinking fund			$XXX
Land for future plant site			XXX
Property, plant, and equipment			
Land		$XXX	
Buildings	$XXX		
Less: Accum. depreciation—buildings	XXX	XXX	
Equipment	XXX		
Less: Accum. depreciation—equipment	XXX	XXX	
Total property, plant, and equipment			XXX
Intangible assets			
Copyright		XXX	
Patent		XXX	
Total intangible assets			XXX
Current assets			
Inventory (ending)		XXX	
Accounts receivable	XXX		
Less: Allowance for doubtful accounts	XXX	XXX	
Interest receivable		XXX	
Advances to employees		XXX	
Prepaid rent		XXX	
Trading securities		XXX	
Cash on hand (including petty cash)	XXX		
Cash in bank	XXX	XXX	
Total current assets			XXX
Total assets			$XXX

PROBLEM 5-1 (Continued)

Equity and Liabilities

Equity			
Share capital			
Preference shares (description)		$XXX	
Ordinary shares (description)		XXX	
Share premium—ordinary		XXX	
Retained earnings		XXX	
Less: Treasury shares		XXX	
Total shareholders' equity			$XXX
Minority interest			XXX
Non-current liabilities			
Bonds payable	$XXX		
Provision for pension benefits	XXX		
Total non-current liabilities		XXX	
Current liabilities			
Notes payable	XXX		
Payroll taxes payable	XXX		
Accrued wages	XXX		
Dividends payable	XXX		
Unearned subscriptions revenue	XXX		
Total current liabilities		XXX	
Total liabilities		XXX	
Total equity and liabilities			$XXX

PROBLEM 5-2

MONTOYA, INC.
Statement of Financial Position
December 31, 2010

Assets

Non-current assets			
Property, plant, and equipment			
Land		€ 480,000	
Building	€1,640,000		
Less: Accum. depreciation—building	270,200	1,369,800	
Equipment	1,470,000		
Less: Accum. depreciation—equipment	292,000	1,178,000	3,027,800
Intangible assets			
Goodwill			125,000
Current assets			
Inventories		239,800	
Notes receivable		445,700	
Income taxes receivable		97,630	
Prepaid expenses		87,920	
Trading securities		121,000	
Cash		360,000	
Total current assets			1,352,050
Total assets			€4,504,850

PROBLEM 5-2 (Continued)

Equity and Liabilities

Equity			
Share capital			
Share capital—Preference €10 par; 20,000 shares authorized, 15,000 shares issued	€ 150,000		
Share capital—ordinary, €1 par; 400,000 shares authorized, 200,000 issued	200,000	€350,000	
Retained earnings (€1,063,897 – €350,000)		713,897	
Total shareholders' equity (€4,504,850 – €3,440,953)			€1,063,897
Non-current liabilities			
Unsecured notes payable (long-term)	1,600,000		
Bonds payable	285,000		
Long-term rental obligations	480,000		
Total non-current liabilities		2,365,000	
Current liabilities			
Notes payable to banks	265,000		
Accounts payable	490,000		
Payroll taxes payable	177,591		
Taxes payable	98,362		
Rent payable	45,000		
Total current liabilities		1,075,953	
Total liabilities			€3,440,953
Total equity and liabilities			€4,504,850

Au: Is it correct. Pls confirm

PROBLEM 5-3

EASTWOOD COMPANY
Statement of Financial Position
December 31, 2010

Assets			
Non-current assets			
Long-term investments			
Investments in capital shares and, bonds ($120,000 have been pledged as security for notes payable)—at fair value			$339,000
Property, plant, and equipment			
Cost of uncompleted plant facilities			
Land	$85,000		
Building in process of construction	124,000	$209,000	
Equipment	400,000		
Less: Accum. depreciation	240,000	160,000	369,000
Intangible assets			
Patents (at cost less amortization)			36,000
Current assets			
Inventory (Average cost)		208,500	
Accounts receivable	163,500		
Less: Allowance for doubtful accounts	8,700	154,800	
Prepaid insurance		5,900	
Cash		41,000	
Total current assets			410,200
Total assets			$1,154,200

PROBLEM 5-3 (Continued)

<u>Equity and Liabilities</u>			
<u>Equity</u>			
Share capital—ordinary			
Authorized 600,000 shares of $1 par value; issued and outstanding, 500,000 shares		$500,000	
Share premium—ordinary		45,000	
Retained earnings		138,000	
Total shareholders' equity			683,000
<u>Non-current liabilities</u>			
8% bonds payable, due January 1, 2021		180,000	
<u>Current liabilities</u>			
Notes payable, secured by investments of $120,000	$ 94,000		
Accounts payable	148,000		
Accrued expenses	49,200		
Total current liabilities		291,200	
Total liabilities			471,200
Total equity and liabilities			$1,154,200

Au: Is it correct. Pls confirm

PROBLEM 5-4

KISHWAUKEE CORPORATION
Statement of Financial Position
December 31, 2010

Assets

Non-current assets			
Long-term investments			
Assets allocated to trustee for expansion:			
Cash in bank		£ 70,000	
Treasury notes, at fair value		138,000	£ 208,000
Property, plant, and equipment			
Land		950,000	
Buildings	£1,640,000		
Less: Accum. depreciation—buildings	410,000	1,230,000	
Total property, plant, and equipment			2,180,000
Current assets			
Inventories		312,100	
Accounts receivable		170,000	
Cash		175,900	
Total current assets			658,000
Total assets			£3,046,000

PROBLEM 5-4 (Continued)

Equity and Liabilities

Equity			
Share capital—ordinary, no par; 1,000,000 shares authorized and issued; 950,000 shares outstanding....		£1,150,000	
Retained earnings		738,000[b]	
Less: Treasury shares, at cost (50,000 shares)................................		87,000	
Total shareholders' equity			£1,801,000
Minority interest...................................			570,000
Non-current liabilities			
Notes payable...			500,000[a]
Current liabilities			
Notes payable—current installment........	£100,000		
Federal income taxes payable	75,000		
Total current liabilities........................		175,000	
Total liabilities			675,000
Total equity and liabilities			£3,046,000

Au: Is it correct. Pls confirm

[a]£600,000 – £100,000 (to reclassify the currently maturing portion of the notes payable as a current liability.)

[b]£858,000 – £120,000 (to remove the value of goodwill from retained earnings. Note 2 indicates that retained earnings was credited. Note that the goodwill account is also deleted.)

Note: As an alternate presentation, the cash restricted for plant expansion would be added to the general cash account and then subtracted. The amount reported in the investments section would not change.

PROBLEM 5-5

SARGENT CORPORATION
Statement of Financial Position
December 31, 2010

Assets

Non-current assets			
Long-term investments			
Investments in share capital (at fair value)		$270,000	
Bond sinking fund		250,000	
Land held for speculation		40,000	
Land held for future use		270,000	$ 830,000
Property, plant, and equipment			
Land		500,000	
Buildings	$1,040,000		
Less: Accum. depreciation—building	360,000	680,000	
Equipment	450,000		
Less: Accum. depreciation—equipment	180,000	270,000	
Total property, plant, and equipment			1,450,000
Intangible assets			
Franchise		165,000	
Goodwill		100,000	265,000
Current assets			
Inventories, at lower of cost (determined using FIFO) or NRV		180,000	
Accounts receivable	170,000		
Less: Allowance for doubtful accounts	10,000	160,000	
Trading securities (at fair value)		80,000	
Cash		150,000	
Total current assets			570,000
Total assets			$3,115,000

PROBLEM 5-5 (Continued)

Equity and Liabilities

Equity			
Share capital			
Preference shares, $5 par value; 200,000 shares authorized, 90,000 issued and outstanding		$450,000	
Ordinary shares, $1 par value; 400,000 shares authorized, 100,000 issued and outstanding		100,000	
Share premium—ordinary (100,000 X [$10 – $1)]		900,000	
Retained earnings		320,000	
Total shareholders' equity			$1,770,000
Non-current liabilities			
Notes payable	120,000		
7% bonds payable, due 2018	960,000		
Total non-current liabilities		1,080,000	
Current liabilities			
Notes payable	80,000		
Accounts payable	140,000		
Taxes payable	40,000		
Unearned revenue	5,000		
Total current liabilities		265,000	
Total liabilities			1,345,000
Total equity and liabilities			$3,115,000

PROBLEM 5-6

(a)

LANSBURY INC.
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities		
Net income		$32,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$11,000	
Gain on sale of investments	(3,400)	
Increase in account receivable ($41,600 – $21,200)	(20,400)	(12,800)
Net cash provided by operating activities		19,200
Cash flows from investing activities		
Sale of investments	15,000	
Purchase of land	(18,000)	
Net cash used by investing activities		(3,000)
Cash flows from financing activities		
Issuance of ordinary shares	20,000	
Retirement of notes payable	(16,000)	
Payment of cash dividends	(8,200)	
Net cash used by financing activities		(4,200)
Net increase in cash		12,000
Cash at beginning of year		20,000
Cash at end of year		$32,000

Noncash investing and financing activities were the purchase of land through issuance of $30,000 of bonds.

PROBLEM 5-6 (Continued)

(b)

LANSBURY INC.
Statement of Financial Position
December 31, 2010

Assets			Equity and Liabilities		
Investments	$ 20,400	(1)	Share capital—ordinary	$120,000	(6)
Plant assets (net)	70,000	(2)	Retained earnings	47,000	(7)
Land	88,000	(3)	Long-term notes payable	25,000	(4)
Accounts receivable	41,600		Bonds payable	30,000	(5)
Cash	32,000		Accounts payable	30,000	
	$252,000			$252,000	

(1) $32,000 – ($15,000 – $3,400)
(2) $81,000 – $11,000
(3) $40,000 + $18,000 + $30,000
(4) $41,000 – $16,000
(5) $0 + $30,000
(6) $100,000 + $20,000
(7) $23,200 + $32,000 – $8,200

(c) Cash flow information is useful for assessing the amount, timing, and uncertainty of future cash flows. For example, by showing the specific inflows and outflows from operating activities, investing activities, and financing activities, the user has a better understanding of the liquidity and financial flexibility of the enterprise. Similarly, these reports are useful in providing feedback about the flow of enterprise resources. This information should help users make more accurate predictions of future cash flow. In addition, some individuals have expressed concern about the quality of the earnings because the measurement of the income depends on a number of accruals and estimates which may be somewhat subjective. As a result, the higher the ratio of cash provided by operating activities to net income, the more comfort some users have in the reliability of the earnings. In this problem the ratio of cash provided by operating activities to net income is 60% ($19,200 ÷ $32,000).

An analysis of Lansbury free cash flow indicates it is negative as shown below:

Free Cash Flow Analysis

Net cash provided by operating activities	**$19,200**
Less: Purchase of land	**(18,000)**
Dividends	**(8,200)**
Free cash flow	**$ (7,000)**

Its current cash debt coverage ratio is 0.64 to 1 $\left(\frac{\$19,200}{\$30,000}\right)$ **and its cash debt coverage ratio is 0.25 to 1** $\left(\$19,200 \div \frac{\$71,000 + \$85,000}{2}\right)$**, which are reasonable. Overall, it appears that its liquidity position is average and overall financial flexibility and solvency should be improved.**

PROBLEM 5-7

(a)

LUO INC.
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities		
Net income		¥35,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	¥12,000	
Loss on sale of investments	5,000	
Increase in accounts payable (¥40,000 – ¥30,000)	10,000	
Increase in accounts receivable (¥42,000 – ¥21,200)	(20,800)	6,200
Net cash provided by operating activities		41,200
Cash flows from investing activities		
Sale of investments	27,000	
Purchase of land	(38,000)	
Net cash used by investing activities		(11,000)
Cash flows from financing activities		
Issuance of ordinary shares	30,000	
Payment of cash dividends	(10,000)	
Net cash provided by financing activities		20,000
Net increase in cash		50,200
Cash at beginning of year		20,000
Cash at end of year		¥70,200

Noncash investing and financing activities were the purchase of land through issuance of ¥30,000 of bonds.

PROBLEM 5-7 (Continued)

(b)

LUO INC.
Statement of Financial Position
December 31, 2010

Assets			Equity and Liabilities		
Plant assets (net)	¥ 69,000	(1)	Share capital—ordinary	¥130,000	(4)
Land	108,000	(2)	Retained earnings	48,200	(5)
Accounts receivable	42,000		Bonds payable	71,000	(3)
Cash	70,200		Accounts payable	40,000	
	¥289,200			¥289,200	

(1) ¥81,000 – ¥12,000
(2) ¥40,000 + ¥38,000 + ¥30,000
(3) ¥41,000 + ¥30,000
(4) ¥100,000 + ¥30,000
(5) ¥23,200 + ¥35,000 – ¥10,000

(c) An analysis of Luo's free cash flow indicates it is negative as shown below:

Free Cash Flow Analysis

Net cash provided by operating activities	¥ 41,200
Less: Purchase of land	(38,000)
Dividends	(10,000)
Free cash flow	¥ (6,800)

PROBLEM 5-7 (Continued)

Its current cash debt coverage is 1.18 to 1 $\left(\frac{¥41,200}{¥35,000^*}\right)$. Overall, it appears that its liquidity position is not very strong and overall financial flexibility is strained.

***(¥30,000 + ¥40,000) ÷ 2**

(d) This type of information is useful for assessing the amount, timing, and uncertainty of future cash flows. For example, by showing the specific inflows and outflows from operating activities, investing activities, and financing activities, the user has a better understanding of the liquidity and financial flexibility of the enterprise. Similarly, these reports are useful in providing feedback about the flow of enterprise resources. This information should help users make more accurate predictions of future cash flow. In addition, some individuals have expressed concern about the quality of the earnings because the measurement of the income depends on a number of accruals and estimates which may be somewhat subjective. As a result, the higher the ratio of cash provided by operating activities to net income, the more comfort some users have in the reliability of the earnings.

TIME AND PURPOSE OF CONCEPTS FOR ANALYSIS

CA 5-1 (Time 20–25 minutes)
Purpose—to provide a varied number of financial transactions and then determine how each of these items should be reported in the financial statements. Accounting changes, additional assessments of income taxes, prior period adjustments, and changes in estimates are some of the financial transactions presented.

CA 5-2 (Time 25–30 minutes)
Purpose—to present the student with the opportunity to determine whether certain accounts should be classified as current asset and current liability items. Borderline cases are included in which the student is required to state the reasons for the questionable classifications. The number of items to be classified is substantial and provides a good review to assess whether students understand what items should be classified in the current section of the statement of financial position.

CA 5-3 (Time 30–35 minutes)
Purpose—to present the asset section of a partial statement of financial position that must be analyzed to assess its deficiencies. Items such as improper classifications, terminology, and disclosure must be considered.

CA 5-4 (Time 20–25 minutes)
Purpose—to present a statement of financial position that must be analyzed to assess its deficiencies. Items such as improper classification, terminology, and disclosure must be considered.

CA 5-5 (Time 20–25 minutes)
Purpose—to present the student an ethical issue related to the presentation of statement of financial position information. The reporting involves "net presentation" of property, plant and equipment.

CA 5-6 (Time 40–50 minutes)
Purpose—to present a cash flow statement that must be analyzed to explain differences in cash flow and net income, and sources and uses of cash flow and ways to improve cash flow.

SOLUTIONS TO CONCEPTS FOR ANALYSIS

CA 5-1

1. The new estimate would be used in computing depreciation expense for 2010. No adjustment of the balance in accumulated depreciation at the beginning of the year would be made. Instead, the remaining depreciable cost would be divided by the estimated remaining life. This is a change in an estimate and is accounted for prospectively (in the current and future years). Disclosure in the notes to the financial statements is appropriate, if material.

2. The effect of the error at December 31, 2009, should be shown as an adjustment of the beginning balance of retained earnings on the statement of changes in equity. The current year's expense should be adjusted (if necessary) for the possible carryforward of the error into the 2010 expense computation.

3. Generally, an entry is made for a cash dividend on the date of declaration. The appropriate entry would be a debit to Retained Earnings (or Dividends) for the amount to be paid, with a corresponding credit to Dividends Payable. Dividends payable is reported as a current liability.

CA 5-2

Current Assets	**Current Liabilities**
Interest accrued on government securities.	Preference dividend, payable Nov. 1, 2010.
Notes receivable.	Income taxes payable.
Petty cash fund.	Customers' advances (on contracts to be completed next year).
Government securities.	Provision for warranties.
Cash in bank.	Officers' 2010 bonus accrued.
Inventory of operating parts and supplies.	Accrued payroll.
Inventory of raw materials.	Notes payable.
Accounts receivable.	Accrued interest on bonds.
Government contracts.	Accounts payable.
Regular (less allowance for doubtful accounts).	Accrued interest on notes payable.
Installments—due next year.	$6^1/_2$% First mortgage bonds due in 2010.
Inventory of finished goods.	
Inventory of work in process.	

CA 5-2 (Continued)

Borderline cases that have been classified on the basis of assumptions are:

1. Notes receivable are assumed to be collectible within the longer of one year or the operating cycle.

2. Government securities are assumed to be a temporary investment of current funds.

3. Accounts receivable—government contracts are assumed to be collectible within the longer of one year or the operating cycle.

4. Notes payable are assumed to be due within the longer of one year or the operating cycle.

(**Note to instructor:** Allowance for doubtful accounts receivable is not a current asset. It, however, would appear in the current asset section.)

CA 5-3

1. Minority interests should be shown under equity as an addition to total shareholders' equity.
2. Trading securities should be reported at fair value, not cost.
3. Bad Debt Reserve is generally viewed an improper terminology; Allowance for Doubtful Accounts is considered more appropriate. The amount of estimated uncollectibles should be disclosed.
4. Currents assets should be listed last and long-term investments should be reported first followed by "Tangible assets."
5. Heading "Tangible assets" should be changed to "Property, Plant and Equipment" also label for corresponding €630,000 should be changed to "net property, plant, and equipment."
6. Land should not be depreciated.
7. Buildings and equipment and their related accumulated depreciation balances should be separately disclosed.
8. The valuation basis for shares should be disclosed (fair value or equity) and the description should be Available for Sale Securities or Investment in X Company.
9. Treasury shares are not an asset and should be shown in the equity section as a deduction.
10. This land held for future factory site should be reported in the long-term investments section (not with other assets.)
11. Sinking fund should be reported in the long-term investments section.

CA 5-4

Criticisms of the statement of financial position of the Rasheed Brothers Corporation:

1. The basis for the valuation of short-term investments should be shown. Short-term investments are valued at fair value. In addition, they should be classified as either trading securities, available-for-sale securities, or held-to-maturity securities.

2. An allowance for doubtful accounts receivable is not indicated.

CA 5-4 (Continued)

3. The basis for the valuation and the method of pricing for Merchandise Inventory are not indicated.

4. An investment in an associated company is not ordinarily held to be sold within one year or the operating cycle, whichever is longer. As such, this account should not be classified as a current asset, but rather should be included under the heading "Investments." The basis of valuation of the investment should be shown.

5. Current assets should be reported last under Assets, with Short-term investments and Cash listed after Supplies inventory.

6. Treasury shares is not an asset. It should be presented as a deduction in the equity section of the statement of financial position. The class of stock, number of shares, and basis of valuation should be indicated.

7. Buildings and land should be segregated. Accumulated Depreciation should be shown as a subtraction from the Buildings account only.

8. Cash restricted for plant expansion would be more appropriately shown under the heading of "Investments."

9. Equity should be reported before liabilities and current liabilities should be reported after the non-current liabilities.

10. Unrealized Gains on Available-for-Sale Investments should be appropriately reported as accumulated other comprehensive income in the equity section. The use of the term deferred credits is inappropriate.

11. Bonds Payable are inadequately disclosed. The interest rate, interest payment dates, and maturity date should be indicated.

12. Additional disclosure relative to the Share Capital—Ordinary account is needed. This disclosure should include the number of shares authorized, issued, and outstanding.

13. Cash Dividends Declared should be disclosed on the retained earnings statement as a reduction of retained earnings. Dividends Payable, in the amount of $8,000, should be shown on the statement of financial position among the current liabilities, assuming payment has not occurred.

CA 5-5

1. The ethical issues involved are integrity and honesty in financial reporting, full disclosure, and the accountant's professionalism.

2. While presenting property, plant, and equipment net of depreciation on the statement of financial position may be acceptable, it is inappropriate to attempt to hide information from financial statement users. Information must be <u>useful</u>, and the presentation Keene is considering would not be. Users would not grasp the age of plant assets and the company's need to concentrate its future cash outflows on replacement of these assets. This information could be provided in a note disclosure.

CA 5-5 (Continued)

Because of the significant impact on the financial statements of the depreciation method(s) used, the following disclosures should be made.

a. Balances of major classes of depreciable assets, by nature and function.
b. Accumulated depreciation, either by major classes of depreciable assets or in total.
c. A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

CA 5-6

Date

President Kappeler, CEO
Kappeler Corporation
125 Wall Street
Middleton, Kansas 67458

Dear Mr. Kappeler:

I have good news and bad news about the financial statements for the year ended December 31, 2010. The good news is that net income of $100,000 is close to what you predicted in the strategic plan last year, indicating strong performance this year. The bad news is that the cash balance is seriously low. Enclosed is the Statement of Cash Flows, which best illustrates how both of these situations occurred simultaneously.

If you look at the operating activities, you can see that no cash was generated by operations due to the increase in accounts receivable and inventory and reduction in accounts payable. In effect, these events caused net cash flow provided by operating activities to be lower than net income; they reduced your cash balance by $116,000.

The corporation made significant investments in equipment and land. These were paid from cash reserves. These purchases used 75% of the company's cash. In addition, the redemption of the bonds improved the equity of the corporation and reduced interest expense. However, it also used 25% of the corporation's cash. It is normal to use cash for investing and financing activities. But when cash is used, it must also be replenished.

Operations normally provide the cash for investing and financing activities. Since there is a finite amount of assets to sell and funds to borrow or raise from the sale of capital stock, operating activities are the only renewable source of cash. That is why it is important to keep the operating cash flows positive. Cash management requires careful and continuous planning.

There are several possible remedies for the current cash problem. First, prepare a detailed analysis of monthly cash requirements for the next year. Second, investigate the changes in accounts receivable and inventory and work to return them to more normal levels. Third, look for more favorable terms with suppliers to allow the accounts payable to increase without loss of discounts or other costs. Finally, since the land represents a long-term commitment without immediate plans for use, consider shopping for a low interest loan to finance the acquisition for a few years and return the cash balance to a more normal level.

If you have additional questions or need one of our staff to address this problem, please contact me at your convenience.

Sincerely yours,

Partner in Charge

FINANCIAL REPORTING PROBLEM

(a) M&S could have adopted the account form or report form. M&S uses the report form.

(b) The techniques of disclosing pertinent information include (1) parenthetical explanations, and (2) cross-reference and contra items. M&S uses parenthetical explanations.

(c) Investments are reported on M&S's statement of financial position as non-current assets. Note 1 (Accounting Policies) states that Investments are classified as either available-for-sale, fair value through profit or loss, or held to maturity. These securities are valued at fair value. On 29 March 2008, M&S had negative working capital (current assets less than current liabilities) of £807.2 million. On 31 March 2007, M&S's negative working capital was £759.8 million.

(d) The following table summarizes M&S's cash flows from operating, investing, and financing activities in 2007 and 2008 (in millions).

	2008	2007
Net cash provided by operating activities	£ 1,069.8	£1,292.5
Net cash used in investing activities	(966.2)	(650.8)
Net cash used in financing activities	(34.2)	(875.6)

M&S's net cash provided by operating activities decreased by 17% from 2007 to 2008. Changes in accounts payable and in accrued and other liabilities is added to net income because these changes reduce income but not cash flow.

(e) 1. Net Cash Provided by Operating Activities ÷ Average Current Liabilities = Current Cash Debt Ratio

$$£1,069.8 \div \frac{(£1,988.9 + £1,606.2)}{2} = \underline{\underline{0.60:1}}$$

2. Net Cash Provided by Operating Activities ÷ Average Total Liabilities = Cash Debt Coverage Ratio

$$£1,069.8 \div \frac{(£5,197.0 + £3,732.8)}{2} = \underline{\underline{0.24:1}}$$

3. Net cash provided by operating activities less capital expenditures and dividends

Net cash provided by operating activities		£1,069.8
Less: Capital expenditures	£924.6	
Dividends	343.6	1,268.2
Free cash flow		£ (198.4)

M&S's financial position appears adequate. Over 20% of its total liabilities can be covered by the current year's operating cash flow and its free cash flow position indicates it is easily meeting its capital investment demands from current free cash flow. However, free cash flow is not sufficient to pay the current level of dividends.

COMPARATIVE ANALYSIS CASE

(a) Both Cadbury and Nestlé use the report form.

(b) Cadbury had a negative working capital of £753 million (£2,635 million – £3,888 million); Nestlé had a negative working capital of CHF175 million CHF33,048 million – CHF33,223 million).

(c) The most significant difference relates to intangible assets. Nestlé has Goodwill and Other Intangible Assets of CHF37,504 million (35% of assets); Cadbury has Goodwill and Intangible Assets of £3,973 million (or 45% of assets). Nestlé carries much higher levels of property, plant, and equipment. Nestlé also has higher Trade and Other Receivables.

(d) Cadbury has decreased net cash provided by operating activities from 2007 to 2008 by £343 million or 42%. Nestlé has decreased net cash provided by operating activities by CHF2,676 million or 20%. Both companies have unfavorable trends in the generation of internal funds from operations.

(e) Cadbury

Current Cash Debt Ratio

$$\text{£}469 \div \frac{\text{£}3{,}388 + \text{£}4{,}614}{2} = \underline{\underline{0.12:1}}$$

Cash Debt Coverage Ratio

$$\text{£}469 \div \frac{\text{£}5{,}361 + \text{£}7{,}165}{2} = \underline{\underline{0.07:1}}$$

COMPARATIVE ANALYSIS CASE (Continued)

(£ millions)

Free cash flow

Net cash provided by operating activities	£ 469
Capital expenditures	(500)
Dividends	(295)
Free cash flow	£(326)

Cadbury's free cash flow is £(326).

Nestlé

Current Cash Debt Ratio

$$\text{CHF10,763} \div \frac{\text{CHF33,223} + \text{CHF43,326}}{2} = \underline{\underline{0.28:1}}$$

Cash Debt Coverage Ratio

$$\text{CHF10,763} \div \frac{\text{CHF51,299} + \text{CHF60,585}}{2} = \underline{\underline{0.19:1}}$$

Free cash flow

Net cash provided by operating activities	CHF10,763
Less: Capital spending	(4,869)
Dividends	(4,573)
Free cash flow	CHF 1,321

Nestlé also is using significant cash balances to purchase treasury shares CHF8,696 million).

Both companies have strong liquidity and financial flexibility.

FINANCIAL STATEMENT ANALYSIS CASE 1

(a) These accounts are shown in the order in which Cathay Pacific actually presented the accounts. The order shown may be modified somewhat.

NON-CURRENT ASSETS AND LIABILITIES
Fixed assets
Intangible assets
Investments in associates
Other long-term receivables and investments

LONG-TERM LIABILITIES
Deferred taxation
Retirement benefit obligations

NET NON-CURRENT ASSETS

CURRENT ASSETS AND LIABILITIES
Trade and other receivables
Liquid funds

Current portion of long-term liabilities
Trade and other payables
Unearned transportation revenue
Taxation

CAPITAL AND RESERVES
Share capital—ordinary shares
Reserves
Funds attributable to owners of Cathay Pacific
Minority interests

(b) When Cathay passengers purchase tickets for future flights, Cash and Unearned Transportation Revenue are affected. Both of these accounts balances would increase when passengers purchase tickets prior to their flight.

FINANCIAL STATEMENT ANALYSIS CASE 2

(a) **The raw materials price increase is not a required disclosure. However, the company might well want to inform shareholders in the management discussion and analysis section, especially as a means for company management to point out an area of success. If the company had not been able to successfully meet the challenge, then the reporting in the discussion and analysis section would be for the purpose of explaining poorer than expected operating results.**

(b) **The information in item (2) should be reported as follows: The $4,000,000 outstanding should, of course, be included in the statement of financial position as a part of liabilities (current or non-current, depending on the terms of the loan). The fact that an additional $11,000,000 or so is available for borrowing should be disclosed in the notes to the financial statements, as also should the fact that the loan is based on the accounts receivable.**

FINANCIAL STATEMENT ANALYSIS CASE 3

(a) Working Capital, Current Ratio

Without off-balance sheet commitments

Working Capital	**Current Ratio**
€10,850 – €7,461 = €3,389	**€10,850 ÷ €7,461 = 1.45**

With off-balance sheet commitments

Off-balance sheet current obligations = €1,466 (€642 + €824)

Working Capital	**Current Ratio**
€10,850 – (€7,461 + €1,466) = €1,923	**€10,850 ÷ (€7,461 + €1,466) = 1.21**

Without information on off-balance sheet commitments, an analyst would overstate Dior's liquidity, as measured by working capital and the current ratio.

(b) 1. Based on the analysis in Part (a), Dior has a pretty good liquidity cushion. It would be able to pay a loan of up to €1,923 million, if due in one year.

2. Additional off-balance sheet commitments of €2,862 (€785 + €2,077) in years 2 through 5 are relevant in assessing whether Dior can repay a loan maturing in 5 years. In evaluating a longer term loan, an analyst would need to develop a prediction of Dior's cash flows over the next 5 years that would be used to repay a longer term loan.

In summary, the note provides information about off-balance sheet obligations—both the amounts and when due. This helps the analyst assess both liquidity and solvency of a company.

FINANCIAL STATEMENT ANALYSIS CASE 4

(a)

(₩ in billions)	2008		2007	
Cash provided by operations		₩10,217		₩8,807
Capital expenditures	₩8,190		₩5,071	
Dividends paid	659		423	
Free cash flow		8,849		5,494
		₩ 1,368		₩3,313

As indicated above, LG Korea's free cash flow in 2008 and 2007 was ₩1,368 billion and ₩3,313 billion respectively. LG Korea shows a significant declining trend in profitability and cash provided by operations. Depending on the investment required to build the warehouses, it appears they might not be able to finance the warehouses with internal funds.

(b) Cash provided by operations increased in 2008 relative to 2007 by ₩1,410 billion. This is due to a net decrease in working capital and other non-cash income adjustments. This increase helped LG Korea increase its capital expenditures by ₩3,119 during 2008.

INTERNATIONAL REPORTING CASE

(a) Some of the differences are:

1. ***Report form and subtotals*—Nordstrom uses a modified report form but does not report "Total non-current assets." It also does not report "Total liabilities." Nordstrom also uses "Total liabilities and shareholders' equity" instead of just "Total liabilities and equity."**
2. ***Classifications*—the classifications are arranged according to decreasing liquidity. For example, "Current assets" are listed first, then "Property, plant, and equipment". Current liabilities are presented before non-current liabilities. Inventory is not listed as the first current asset. Equity is reported before liabilities under IFRS.**
3. ***Terminology*—For example, "Common stock" is used instead of "Share capital". The term "Long-term debt" is used instead of "Non-current liabilities.**
4. ***Units of currency*—Nordstrom reports in U.S. dollars instead of euros or yen.**

(b) Since Nordstrom reports total current assets and current liabilities, both working capital and the current ratio (Appendix 5A) can be computed. In addition, the debt to total assets and book value per share (Appendix 5A) can be computed also.

ACCOUNTING, ANALYSIS, AND PRINCIPLES

ACCOUNTING

HOPKINS COMPANY
Statement of Financial Position
December 31, 2010

Assets			
Non-current assets			
Long-term investments			
Bond sinking fund			$ 15,000
Property, plant, and equipment			
Equipment		$112,000	
Less: Accumulated depreciation—equipment		28,000	84,000
Intangible assets			
Patents			15,000
Current Assets			
Inventories		65,300	
Accounts receivable ($52,000 – $9,000)	$43,000		
Less: Allowance for doubtful accounts ($13,500 – $9,000)	4,500	38,500	
Cash ($75,000 – $15,000)		60,000	
Total current assets			163,800
Total assets			$277,800
Equity and Liabilities			
Equity			
Share capital-ordinary		$100,000	
Retained earnings		50,800	
Total shareholders' equity			$150,800
Non-current liabilities			
Notes payable (due 2012)		75,000	
Current liabilities			
Notes and accounts payable		52,000	
Total liabilities			127,000
Total equity and liabilities			$277,800

Au: Is it correct. Pls confirm

ANALYSIS

The classified statement of financial position provides subtotals for current assets and current liabilities, which are assets expected to be converted to cash (or liabilities expected to be paid from cash) in the next year or operating cycle (also referred to as liquidity). Thus, an analysis of current assets relative to current liabilities provides information relevant to assessing Hopkins' ability to repay a loan within the next year. Specifically, current assets in excess of current liabilities (working capital) is $111,800 ($163,800 – $52,000.) This seems to be a safe liquidity cushion relative to an additional loan of $45,000. Of course, the loan officer also would evaluate Hopkins' earnings and cash flows in the analysis.

PRINCIPLES

The primary objection that the bank is likely to raise about this supplemental information is the reliability of the estimates of fair values for the long-lived assets and the internally generated intangibles. In addition, the loan officer might not consider information about these long-term assets to be that relevant to the loan decision, because the loan is short-term.

PROFESSIONAL RESEARCH

(a) International Accounting Standard 8 covers the disclosure of accounting policies

(b) Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements (para. 5)

(c) An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an IFRS specifically requires or permits categorisation of items for which different policies may be appropriate. If an IFRS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category. (para. 13)

An entity shall change an accounting policy only if the change:
a. is required by an IFRS; or
b. results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. (para. 14)

(d) Disclosure

When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
a. the title of the IFRS;
b. when applicable, that the change in accounting policy is made in accordance with its transitional provisions;
c. the nature of the change in accounting policy;
d. when applicable, a description of the transitional provisions;
e. when applicable, the transitional provisions that might have an effect on future periods;

f. for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
   (i) for each financial statement line item affected; and
   (ii) if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;
g. the amount of the adjustment relating to periods before those presented, to the extent practicable; and
h. if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures. (para. 28)

When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

a. the nature of the change in accounting policy;
b. the reasons why applying the new accounting policy provides reliable and more relevant information;
c. for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
   (i) for each financial statement line item affected; and
   (ii) if IAS 33 applies to the entity, for basic and diluted earnings per share;
d. the amount of the adjustment relating to periods before those presented, to the extent practicable; and
e. if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures (para. 29).

PROFESSIONAL SIMULATION

FINANCIAL STATEMENT

LANCE LIVESTRONG COMPANY
Statement of Financial Position
December 31, 2010

Assets

Non-current assets			
Long-term investments			
Plant expansion fund			€ 20,000
Property, plant, and equipment			
Equipment		€132,000	
Less: Accumulated depreciation—equipment		28,000	104,000
Intangible assets			
Patents			25,000
Current assets			
Inventories		65,300	
Accounts receivable (€38,500 + €13,500)	€ 52,000		
Less: Allowance for doubtful accounts	13,500	38,500	
Cash (€50,000 – €20,000)		30,000	
Total current assets			133,800
Total assets			€282,800

PROFESSIONAL SIMULATION (Continued)

Equity and Liabilities

Equity			
Share capital—ordinary (€1 par)		€50,000	
Share premium		55,000	
Retained earnings		20,800	
Total shareholders' equity			€125,800
Non-current liabilities			
Bonds payable (9%, due June 30, 2018)		100,000	
Current liabilities			
Note payable	€17,000		
Accounts payable	32,000		
Taxes payable	8,000		
Total current liabilities		57,000	
Total liabilities			157,000
Total equity and liabilities			€282,800

Au: Is it correct. Pls confirm

ANALYSIS

$$Z = \frac{\text{Working capital}}{\text{Total assets}} \text{ X } 1.2 + \frac{\text{Retained earnings}}{\text{Total assets}} \text{ X } 1.4 + \frac{\text{EBIT}}{\text{Total assets}} \text{ X } 3.3$$

$$+ \frac{\text{Sales}}{\text{Total assets}} \text{ X } 0.99 + \frac{\text{MV equity}}{\text{Total liabilities}} \text{ X } 0.6$$

$$= \frac{(€133,800 - €57,000)}{€282,800} \text{ X } 1.2 + \frac{€20,800}{€282,800} \text{ X } 1.4 + \frac{€14,000}{€282,800} \text{ X } 3.3$$

$$+ \frac{€210,000}{€282,800} \text{ X } 0.99 + \frac{€225,000}{€157,000} \text{ X } 0.6$$

$$= .3259 + .1030 + .1634 + .7351 + .8599 = 2.1873$$

PROFESSIONAL SIMULATION (Continued)

Livestrong's Z-Score is above the "likely-to-fail" level of 1.81 but also below the unlikely-to-fail value of 3.0. Livestrong should be concerned about his company's situation.

RESEARCH

Search string: "current and non-current assets and liabilities."

IAS 1: Presentation of Financial Statements

This Standard does not prescribe the order or format in which an entity presents items. Paragraph 54 simply lists items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

(a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and

(b) the descriptions used and the ordering of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position. For example, a financial institution may amend the above descriptions to provide information that is relevant to the operations of a financial institution (para. 57).

An entity makes the judgement about whether to present additional items separately on the basis of an assessment of:

(a) the nature and liquidity of assets;

(b) the function of assets within the entity; and

(c) the amounts, nature and timing of liabilities (para. 58).

The use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that an entity presents them as separate line items. For example, different classes of property, plant and equipment can be carried at cost or at revalued amounts in accordance with IAS 16 (para. 59).