SOLUTIONS TO ANALYZE, THINK, COMMUNICATE – CHAPTER 2

ATC 2-1 (All dollar amounts are in millions.)

**a. Target’s accrual accounts are: Accounts payable, Accrued and other current liabilities. The “Other current assets” accounts includes two “Vendor income receivables” and “Income tax and other receivables.” See Note 13. As Note 18 shows, all of the individual accounts included in “Accrued and other current liabilities” are accrual accounts.**

**The “Deferred income taxes” account shown under Liabilities is probably best classified as an accrual account, but students will probably not recognize it as such.**

**b. Net income for 2016 was $2,737**

**Cash provided by operating activities for 2016 was $5,436**

**Thus, cash flow from operating activities exceeded net income by $2,699.**

**c. Net income decreased by $626 from 2015 to 2016 ($2,737 - $3,363). Cash provided by operating activities decreased by $522 from 2015 to 2016 ($5,436- $5,958). Therefore, the change in net earnings was the greatest.**

**ATC 2-2**

|  |  |  |
| --- | --- | --- |
| **Income Statments** | **Year 1** | **Year 2** |
| **Revenue** | **$50,000** | **$40,000** |
| **Expense** | **(30,000)** | **(25,000)** |
| **Net Income** | **$(20,000)** | **$(15,000)** |

|  |  |  |
| --- | --- | --- |
| **Accounts Receivable** | **Year 1** | **Year 2** |
| **Beginning accounts receivable balance** | **$0** | **$10,000** |
| **Plus: Increases due to sales on account** | **50,000** | **40,000** |
| **Minus: Decreases due to receivables collections** | **(40,000)** | **(50,000)** |
| **Yields: Ending accounts receivable balance** | **$10,000** | **$0** |

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| --- | --- | --- |
| **Operating Activities Section of Statement of Cash Flows** | **Year 1** | **Year 2** |
| **Cash collections from customers** | **$40,000** | **$50,000** |
| **Cash payments for expense** | **(25,000)** | **(30,000)** |
| **Net cash flow from operating activities** | **$15,000** | **$20,000** |

|  |  |  |
| --- | --- | --- |
| **Accounts Payable** | **Year 1** | **Year 2** |
| **Beginning accounts payable balance** | **$0** | **$5,000** |
| **Plus: Increases due to expenses incurred on account** | **30,000** | **25,000** |
| **Minus: Decreases due to payments to reduce accounts payable** | **(25,000)** | **(30,000)** |
| **Yields: Ending accounts payable balance** | **$5,000** | **$0** |

**Class Discussion**

**The discussion should focus on how accrual accounting facilitates the matching of revenues with expenses.**

**ATC 2-3**

**Dollar amounts are in thousands.**

**a.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **2015** | **2016** |  |  |
| **Revenues** | **$2,842,284** | **$2,912,351** |  |  |
| **- Expenses** | **2,678,381** | **2,723,052** |  |  |
| **Net income** | **$ 163,903** | **$ 189,299** |  |  |
|  |  |  |  |  |
| **Beg. retained earnings** | **$ 483,167** | **$ 475,687** |  |  |
| **+ Net income** | **163,903** | **189,299** |  |  |
| **- Dividends** | **171,383** | **186,505** |  |  |
| **End. Retained earnings** | **$ 475,687** | **$ 478,481** |  |  |

**b. Revenue increased by 2.5%**

**($2,912,351 - $2,842,284) ÷ $2,842,284 = 2.5%**

**Net income increased by 15.5%**

**($189,299 - $163,903) ÷ $163,903 = 15.5%**

**c. 2015: $163,903 ÷ $2,842,284 = 5.8%**

**2016: $189,299 ÷ $2,912,351 = 6.5%**

**d. Both revenues and net income increased in 2016, and net income as a percentage of revenues was also higher in 2016, thus, 2016 appears to have been a better year than 2015.**

**ATC 2-4**

**Dollar amounts in thousands.**

**a. and b.**

|  |  |  |
| --- | --- | --- |
|  | **2015** | **2016** |
| **Cash from operating activities** | **$ 237,260** | **$ 282,589** |
| **Cash from investing activities** | **(365,191)** | **(144,844)** |
| **Cash from financing activities** | **45,499** | **(99,666)** |
| **Net change in cash** | **(82,432)** | **38,079** |
| **+ Beg. cash balance** | **93,329** | **10,897** |
| **= End. Cash balance** | **$ 10,897** | **$ 48,976** |
|  |  |  |

**c. Negative cash flow from investing activities is most likely an indication that the company is growing, which is not a negative situation.**

**Note to instructor: The ending cash balances shown above will not match exactly with those on the company’s balance sheet due to small adjustments for “exchange rate adjustments.” These were omitted to simplify this problem.**

ATC 2-5

**The memo provided by students should convey knowledge of the following relationships.**

**The amount of revenue recognized on account was greater than the amount of cash collected from customers. Accordingly, the amount of revenue recognized will be higher than the amount of cash collected thereby making net income higher than net cash flow from operating activities. At the end of the period, there will be a $9,000 balance in the accounts receivable account. This balance represents the amount of cash Corola expects to collect from customers in the next accounting period.**

ATC 2-6

**a.**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Income Statement** | |  | **Balance Sheet** | | | | |  |
|  |  |  |  | |  |  |  |  | |
|  | **Service Revenue** | **$120,000** |  | | **Assets:** |  | $167,000 |  | |
|  | **Operating Exp.** | **(40,000)** |  | |  |  |  |  | |
|  | **Net Income** | **$ 80,000** |  | | **Liabilities:** |  | **$ 5,000** |  | |
|  |  |  |  | | **Stockholders’ Equity:** |  |  |  | |
|  |  |  |  | | **Common Stock** |  | 82,000 |  | |
|  |  |  |  | | **Retained Earnings** |  | 80,000 |  | |
|  |  |  |  | | **Total Stk Eqty.** |  | **162,000** |  | |
|  |  |  |  | | **Total Liab. and**  **Stk. Equity** |  | $167,000 |  | |
|  |  |  |  | |  |  |  |  | |

**Computations for Income Statement Items:**

**Revenue: $38,000 + $82,000 = $120,000**

**Operating Expense: $70,000 − $30,000 = $40,000**

**Computations for Balance Sheet Items:**

**Assets: $85,000 + $82,000 = $167,000**

**Liabilities: $35,000 − $30,000 = $5,000**

**Retained Earnings: $(32,000) + $82,000 + $30,000 = $80,000**

**b. Willful deception is an act of fraud and punishable under the law. Good intentions are not sufficient justification for breaking the law. Students should learn to avoid operating under an ends justifies the means philosophy. Suppose the unexpected happens in this case. Glenn fails to obtain the contract and is forced to declare bankruptcy after having manipulated the statements. He would not only stand to lose the friend that he deceived, but also may be convicted of a felony on charges of fraudulent reporting.**

**ACT 2-6 (cont.)**

c. The auditing profession has identified three elements that are typically present when fraud occurs. They are: (1) the availability of an opportunity, (2) the existence of some form of pressure leading to an incentive, and (3) the capacity for rationalization. Glenn had the opportunity to record the questionable adjustments because he was the owner and could make whatever adjustments he deemed appropriate. Glenn’s existence of pressure is the fact that he needs the financial statements to look good in order to obtain the loan. Because Glenn was confident that the contracts would be approved, he was able to rationalize making the adjustments. All three of the factors of ethical misconduct are present in this case.

ATC 2-7

**This solution is based on Netflix’s 2016 financial report. If the instructor chooses to use a more current report it will be necessary to reconstruct the solution.**

**Dollar amounts are in thousands.**

**a. Netflix’s accrual accounts are:**

**Current content liabilities (though students will probably not list this account)**

**Accounts payable**

**Accrued expenses**

**b. Netflix’s net earnings for 2016 were $186,678.**

**c. Retained earnings on December 31, 2015 was $941,925. Retained earnings on December 31, 2016 was $1,128,603.**

**d. Retained earnings December 31, 2015 $ 941,925**

**Plus Net Income 186,678**

**Retained earnings December 31, 2016 $1,128,603**

**Netflix did not pay any dividends in 2016.**