Q1-1 Both business and individuals need to establish a plan for the future in order to be successful. The planning process includes developing assumptions about the future, establishing goals, making decisions, putting plans into action, and evaluating actual results based on the plans.

Q1-2 Businesses need to manage cash from operating activities, cash from investing activities, and cash from financing activities. Operating cash flows include cash receipts and cash payments from transactions that relate to net income on the income statement. Investing cash flows include cash receipts and payments from buying and selling plant and investment assets. Financing cash flows include cash receipts and payments from transactions that relate to obtaining resources from owners and creditors.

Q1-3 Accounting is an information system. It generates financial information about an economic unit that is used for making decisions. In the accounting information system, we (1) collect financial and economic data, (2) process the data by organizing and storing it, and (3) summarize the data into reports that communicate information to users.

Q1-4 An internal user of accounting information is anyone who works inside the company and needs to make a decision about the company. The decision may be whether to purchase a new piece of equipment, to increase production by adding a third shift of workers, or what price to sell a product at. Accounting information shows the need for action and provides a basis for selecting a particular course of action.

An external user is anyone outside the company who needs information about the company in order to make a decision. Some examples are (1) a stockholder who is considering purchasing additional shares of the company's stock, (2) a banker who is evaluating a loan request from the company, (3) a union representative trying to negotiate a new contract with the company, (4) a potential customer who is trying to decide which company to purchase products from.
QI-5  The three types of business organizations are single proprietorship, partnership, and corporation. Single proprietorships and partnerships are not separate legal entities from their owners; the owners can be held liable for the debts incurred by the business. A corporation is a separate legal entity. The stockholders of the corporation cannot be held liable for the debts of the business.

QI-6  The three primary financial statements and their purpose are as follows:
   a. The balance sheet reports the assets, liabilities, and owners' equity of a business as of a point in time.
   b. The income statement compares revenues and expenses for a period of time to determine net income or net loss.
   c. The statement of cash flows reports the activities that result in cash inflows and outflows for a period of time. The cash flows are classified into three categories: operating, investing, and financing.

QI-7  The statement is true. The balance sheet shows the financial position of a business as of a moment in time such as the last day of a fiscal year. The income statements and cash flow statements show the results for a period of time such as a fiscal year.

QI-8  The basic accounting equation is:

   \[ \text{Assets} = \text{Liabilities} + \text{Owners' Equity} \]

   Assets are the economic resources owned by the business. Examples include cash, buildings, and land. Liabilities are the debts of a business. They represent creditors' claims against the assets. Owners' equity are the claims against assets by the owners of a business.

QI-9  In analyzing information about a business, we must view the financial statements as an integrated package of information. Although each statement provides separate information (the sales for the year are found on the income statement), we often need to relate information from different statements to reach conclusions. For example, if total assets on the balance sheet increased by 80% from last year and total revenues on the income statement decreased 40%, we could conclude that the company was operating less efficiently. This is because the business now has a higher asset investment and is generating less revenues.

QI-10 In this case, we could compute total asset turnover ratios for each company as follows:

   Company 1  \$20 million / \$10 million = 2 times
   Company 2  \$20 million / \$5 million = 4 times

Based only on this information, Company 2 has a higher asset turnover ratio. It is operating more efficiently because it is using a smaller investment in total assets to generate the same level of revenues. We would view Company 2 more favorably.
SOLUTIONS TO EXERCISES

EI-11 Users of Accounting Information
LG2

1. External user who needs to evaluate the financial position and overall success in operation to determine whether to grant the loan to Sunbelt Travel.
2. External user who is comparing prospective earnings from an investment in this company with other investment opportunities.
3. Internal user who needs information necessary to successfully operate the business.
4. External user who is concerned with the amount of income tax that should be paid by Sunbelt and its stockholders.
5. Internal user who needs information about various alternatives involving the purchase of plant assets.
6. Internal user who coordinates financial planning toward a target profit. These data are a part of the basis for future planning.
7. External user who has or desires to have a financial relationship with this company.
8. Internal user who needs financial and statistical information to perform her job as tour director: number of people, cost of tours, and so on.

EI-12 Entity Concept
LG3

There are three entities:
1. Irvin Stein (Personal)
2. Stein's Camera Repair Center
3. Capital City Audio Sales

EI-13 Balance Sheet Relationships for Real-Life Companies
LG 4

<table>
<thead>
<tr>
<th>Company</th>
<th>Total Assets</th>
<th>Total Liabilities</th>
<th>Owners' Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walt Disney</td>
<td>$62,497.0</td>
<td>$30,174.0</td>
<td>$32,323.0</td>
</tr>
<tr>
<td>Estée Lauder</td>
<td>5,011.2</td>
<td>3,358.0</td>
<td>1,653.2</td>
</tr>
<tr>
<td>Hershey Foods</td>
<td>3,634.7</td>
<td>3,316.5</td>
<td>318.2</td>
</tr>
<tr>
<td>H.J. Heinz</td>
<td>9,664.2</td>
<td>8,444.3</td>
<td>1,219.9</td>
</tr>
<tr>
<td>Nike</td>
<td>13,249.6</td>
<td>4,556.5</td>
<td>8,693.1</td>
</tr>
</tbody>
</table>
El-14 Income Statement Relationships for Real-Life Companies
LG 4

<table>
<thead>
<tr>
<th>Company</th>
<th>Total Revenues</th>
<th>Total Expenses</th>
<th>Net Income (Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walt Disney</td>
<td>$37,843.0</td>
<td>$33,416.0</td>
<td>$4,427.0</td>
</tr>
<tr>
<td>Estée Lauder</td>
<td>7,910.8</td>
<td>7,437.0</td>
<td>473.8</td>
</tr>
<tr>
<td>Hershey Foods</td>
<td>5,132.8</td>
<td>4,821.4</td>
<td>311.4</td>
</tr>
<tr>
<td>H.J. Heinz</td>
<td>10,148.1</td>
<td>9,225.0</td>
<td>923.1</td>
</tr>
<tr>
<td>Nike</td>
<td>19,176.1</td>
<td>17,689.4</td>
<td>1,486.7</td>
</tr>
</tbody>
</table>

El-15 Statement of Cash Flows Relationships for Real-Life Companies
LG 4

<table>
<thead>
<tr>
<th>Company</th>
<th>Net Cash Provided by Operating Activities</th>
<th>Net Cash Provided by Investing Activities</th>
<th>Net Cash Provided by Financing Activities</th>
<th>Increase (Decrease) in Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walt Disney</td>
<td>$5,446.0</td>
<td>$(2,162.0)</td>
<td>$(3,953.0)</td>
<td>$(669.0)</td>
</tr>
<tr>
<td>Estée Lauder</td>
<td>690.1</td>
<td>(478.5)</td>
<td>(63.6)</td>
<td>148.0</td>
</tr>
<tr>
<td>Hershey Foods</td>
<td>519.6</td>
<td>(198.2)</td>
<td>(413.5)</td>
<td>(92.1)</td>
</tr>
<tr>
<td>H.J. Heinz</td>
<td>1,166.9</td>
<td>(761.2)</td>
<td>(650.2)</td>
<td>(244.5)</td>
</tr>
<tr>
<td>Nike</td>
<td>1,736.1</td>
<td>(798.1)</td>
<td>(780.8)</td>
<td>157.2</td>
</tr>
</tbody>
</table>

El-16 Analyzing Balance Sheets for Real-Life Companies
LG 5

a. Company

<table>
<thead>
<tr>
<th>Company</th>
<th>Total Liabilities/ Total Liabilities + Owners' Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walt Disney</td>
<td>48.3% $30,174.0/62,497.0</td>
</tr>
<tr>
<td>Estée Lauder</td>
<td>67.0 $3,356.5/5,011.2</td>
</tr>
<tr>
<td>Hershey Foods</td>
<td>91.2 $3,316.5/3,634.7</td>
</tr>
<tr>
<td>H.J. Heinz</td>
<td>87.4 $8,444.3/9,664.2</td>
</tr>
<tr>
<td>Nike</td>
<td>34.4 $4,556.5/13,249.6</td>
</tr>
</tbody>
</table>

b. Hershey Foods has the highest (91.2%) percent of liabilities to liabilities + owners' equity.

c. Generally, a higher percent for liabilities is unfavorable since it implies more risk that the company may not be able to pay debts when they come due.
EI-17 Analyzing Income Statements for Real-Life Companies
LG 5

<table>
<thead>
<tr>
<th>Company</th>
<th>Total Expenses/ Total Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walt Disney</td>
<td>88.3% $33,416.0/37,843.0</td>
</tr>
<tr>
<td>Estée Lauder</td>
<td>94.0 $7,437.0/7,910.8</td>
</tr>
<tr>
<td>Hershey Foods</td>
<td>93.9 $4,821.4/5,132.8</td>
</tr>
<tr>
<td>H.J. Heinz</td>
<td>90.9 $9,225.0/10,148.1</td>
</tr>
<tr>
<td>Nike</td>
<td>92.2 $17,689.4/19,176.1</td>
</tr>
</tbody>
</table>

b. Estée Lauder has the highest (94.0%) percent of expenses to total revenues.

c. A higher percent for expenses is unfavorable since the company is making less profit on each dollar of total revenues.

LG 5

<table>
<thead>
<tr>
<th>Company</th>
<th>Operating Cash +/- Investing Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walt Disney</td>
<td>$3,284.0 $5,446.0 - 2,162.0</td>
</tr>
<tr>
<td>Estée Lauder</td>
<td>211.6 $690.1 - 478.5</td>
</tr>
<tr>
<td>Hershey Foods</td>
<td>321.4 $519.6 - 198.2</td>
</tr>
<tr>
<td>H.J. Heinz</td>
<td>405.7 $1,166.9 - 761.2</td>
</tr>
<tr>
<td>Nike</td>
<td>938.0 $1,736.1 - 798.1</td>
</tr>
</tbody>
</table>

b. Walt Disney has the largest amount of net cash inflow after covering investing expenditures with operating cash inflows.

c. All of the companies had positive cash flow after covering investing activities with cash from operations. This is favorable because it shows the strong operating cash flows generated by these companies with the ability to cover all investing outflows with cash from operations.
PI-19 Analyzing Home Depot
LG 4, 5

1. Total assets as of February 1, 2009 ($41,164.0 million) are lower than as of February 1, 2008 ($44,324.0 million).

2. \( (7.1\%) = 100 \times \frac{$(3,160.0)\ast}{44,324.0} \ast$41,164.0 - $44,324.0 = $(3,160.0) \)

3. The percent of liabilities to total liabilities + owners' equity is decreasing from fiscal 2007 (60.0%) to fiscal 2008 (56.8%). Based only on this information, we could say that Home Depot has less risk of not being able to pay its debts.

4. Total revenues for 2008 ($71,288.0 million) are lower than for 2007 ($77,349.0).

5. \( (7.8\%) = 100 \times \frac{$(6,061.0)\ast}{77,349.0} \ast$71,288.0 - $77,349.0 = $(6,061.0) \)

6. The percent of total expenses to revenues is increasing from 2007 (94.3%) to 2008 (96.8%). This is an unfavorable trend.

7. 2008: \( 1.67 \text{ times} = \frac{$71,288.0}{42,744.0} \ast$41,164.0 + $44,324.0)/2 = $42,744.0 \)

    2007: \( 1.60 \text{ times} = \frac{$77,349.0}{48,293.5} \ast$44,324.0 + $52,263.0)/2 = $48,293.5 \)

Total asset turnover is higher in 2008. In 2008, Home Depot is operating more efficiently by using a lower proportionate investment in assets to generate total revenues.

PI-20 Analyzing Google Inc.
LG 4, 5

1. Total assets as of December 31, 2008 ($31,767.6 million) are higher than as of December 31, 2007 ($25,335.8 million).

2. \( 25.4\% = 100 \times \frac{$6,431.8\ast}{25,335.8} \ast$31,767.6 - $25,335.8 = $6,431.8 \)

3. The percent of liabilities to total liabilities + owners' equity is increasing slightly from 2007 (10.4%) to 2008 (11.1%). We note that the debt percentages in both years are very low. Google has very little liabilities.

4. Total revenues for 2008 ($21,795.6 million) are higher than for 2007 ($16,594.0).
5. 31.3% = 100 × \( \frac{5,201.6^*}{16,594.0} \)  
   \*\( 21,795.6 - 16,594.0 = 5,201.6 \)

6. The percent of total expenses to revenues is increasing from (74.7)% to (80.6)%. This is an unfavorable trend.

7. 2008: 0.76 times = \( \frac{21,795.6}{28,551.7^*} \)  
   \*\( (31,767.6 + 25,335.8)/2 = 28,551.7 \)

   2007: 0.76 times = \( \frac{16,594.0}{21,904.6^*} \)  
   \*\( (25,335.8 + 18,473.4)/2 = 21,904.6 \)

Total asset turnover is the same in both years.

PI-21 Comparing GAP, Inc. and Polo Ralph Lauren Corp.
LG 5

1. GAP is larger than Polo in terms of total assets ($7,564.0 million for GAP versus $4,356.5 million for Polo).

2. GAP: (3.5)% = 100 × \( \frac{(274.0)^*}{7,838.0} \)  
   \*\( 7,564.0 - 7,838.0 = 274.0 \)

   Polo: (0.2)% = 100 × \( \frac{(9.0)^*}{4,365.5} \)  
   \*\( 4,356.5 - 4,365.5 = 9.0 \)

GAP has a much larger decrease in growth percent in total assets from 2007 to 2008. Polo’s assets have declined much less.

3. In 2008, GAP has a higher amount of risk in terms of a percent of liabilities. The percent of liabilities to total liabilities + owner’s equity is 42.0% for GAP and 37.2% for Polo. Based on this information, we could say that GAP has more risk of not being able to pay its debts.

4. GAP ($14,526.0) million is larger than ($7,953.9) million for Polo.

5. GAP had the lowest expense percent (93.3%) versus 94.9% for Polo. As a result, GAP had the highest net income percent, 6.7% versus 5.1% for Polo.

6. The percent of total expenses to revenues is increasing in 2008 for Polo. Polo increased total expenses as a percent of revenues from 93.6% in 2007 to 94.9% in 2008 while GAP expense percent decreased from 94.7% to 93.3%.
7. GAP:  1.89 times  =  \frac{14,526.0}{7,701.0^*}  \quad *(\frac{7,564.0 + 7,838.0}{2}) = 7,701.0 \\

Polo:  1.82 times  =  \frac{7,953.9}{4,361.0^*}  \quad *(\frac{4,356.5 + 4,365.5}{2}) = 4,381.0 \\

GAP total asset turnover is higher. GAP is operating more efficiently by using a smaller proportionate investment in assets to generate total revenues.

PI-22 Comparing Safeway, Inc. and Whole Foods Market
LG 5

1. Safeway is much larger than Whole Foods in terms of total assets ($17,484.0 million for Safeway versus $3,380.7 million for Whole Foods).

2. Whole Foods: 5.2%  =  100 \times \frac{167.6^*}{3,213.1}  \quad * (3,380.7 - 3,213.1 = 167.6

Safeway:  (0.9)%  =  100 \times \frac{(167.0)^*}{17,651.0}  \quad * (17,484.0 - 17,651.0 = (167.0)

Whole Foods has a larger growth percent in total assets from 2007 to 2008.

3. Safeway has more risk in terms of percent of liabilities (Safeway liabilities are 61.2% of total liabilities + owners' equities as of December 31, 2008, versus 55.5% for Whole Foods as of September 30, 2008).

4. Safeway ($44,104.0 million for Safeway versus $7,953.9 million for Whole Foods).

5. Safeway had the slightly lower expense percent (98.6% for Whole Foods versus 97.8% for Safeway). Both companies have a high expense percentage.

6. The cost percent for Safeway decreased slightly from 97.9% in 2007 to 97.8% in 2008.

7. Safeway:  2.51 times  =  \frac{44,104.0}{17,567.5^*}  \quad *(\frac{17,484.0 + 17,651.0}{2}) = 17,567.5 \\

Whole Foods: 2.41 times  =  \frac{7,953.9}{3,296.9^*}  \quad *(\frac{3,380.7 + 3,213.1}{2}) = 3,296.9 \\

Safeway total asset turnover is higher. Safeway is operating more efficiently by using a smaller proportionate investment in assets to generate total revenues.
1. Coca-Cola ($40,519.0 million for Coca-Cola versus $35,994.0 million for Pepsico).

2. Coca-Cola \( (6.4\%) = 100 \times \frac{\$2,750.0*}{\$43,269.0} \quad ^*\$40,519.0 - \$43,269.0 \)

    Pepsico: \( 3.9\% = 100 \times \frac{\$1,366.0*}{\$34,628.0} \quad ^*\$35,994.0 - \$34,628.0 \)

    Pepsico has the largest growth percent in total assets from 2007 to 2008.

3. Pepsico (Pepsico liabilities are 66.1\% of total liabilities + owners’ equities as of December 31, 2008, versus 49.5\% for Coca-Cola).

4. Pepsico ($43,251.0 million for Pepsico versus $31,944.0 million for Coca-Cola).

5. Coca-Cola had the lower expense percent (81.8\% for Coca-Cola versus 88.1\% for Pepsico). As a result, Coca-Cola had the highest net income percent of 18.2\%.

6. Both companies increased the percent of expenses to total revenues in 2008. Coca-Cola has the lowest expense percent in 2008.

7. Coca-Cola: \( 0.76 \text{ times} = \frac{\$31,944.0}{\$41,894.0^*} \quad ^*\$40,519.0 + \$43,269.0)/2 \)

    Pepsico: \( 1.22 \text{ times} = \frac{\$43,251.0}{\$35,311.0^*} \quad ^*\$35,994.0 + \$34,628.0)/2 \)

    Pepsico’s total asset turnover is higher. Pepsico is operating more efficiently by using a smaller proportionate investment in assets to generate total revenues.