Module 1 Class Exercises


<table>
<thead>
<tr>
<th>Component</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability (Net income/Sales)</td>
<td>14%</td>
<td>15%</td>
</tr>
<tr>
<td>Productivity (Sales/Average net assets)</td>
<td>1.4</td>
<td>1.5</td>
</tr>
</tbody>
</table>

a. Was the company profitable in 2010? What evidence do you have of this?  
   Yes, 14% return on sales or profit margin

b. Is the change in productivity (asset turnover) a positive development? Explain.  
   No, declined

c. Compute the company’s return on assets (ROA) for 2010 (show computations).
   \[ \frac{14\% \times 1.4}{1.4} = 19.6\% \]

P1-35. Computing Return on Equity and Return on Assets (LO3)
The following table contains financial statement information for Wal-Mart Stores, Inc.

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>Total Assets</th>
<th>Net Income</th>
<th>Sales</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>$180,663</td>
<td>$16,389</td>
<td>$421,849</td>
<td>53,175</td>
</tr>
<tr>
<td>2010</td>
<td>170,407</td>
<td>14,320</td>
<td>408,085</td>
<td>50,468</td>
</tr>
<tr>
<td>2009</td>
<td>163,429</td>
<td>13,381</td>
<td>404,254</td>
<td>53,285</td>
</tr>
</tbody>
</table>

Required

a. Compute the return on equity (ROE) for 2010 and 2011.
   \[ \text{ROE}_{2010} = \frac{16,320}{170,407} = 9.6\% \]
   \[ \text{ROE}_{2011} = \frac{16,358}{170,468} = 9.6\% \]
   What trend, if any, is evident? How does Wal-Mart’s ROE compare with the approximately 20% median ROE for companies in the Dow Jones Industrial average for 2011?

b. Compute the return on assets (ROA) for 2010 and 2011.
   \[ \text{ROA}_{2010} = \frac{14,320}{170,407 + 163,429} = 8.6\% \]
   \[ \text{ROA}_{2011} = \frac{16,358}{170,468 + 165,667} = 9.3\% \]
   What trends, if any, are evident? How does Wal-Mart’s ROA compare with the approximate 6.7% median ROA for companies in the Dow Jones Industrial average for 2011?

In terms of ROA on assets

- **Increasing returns on assets**

   - Low cost purchases from all over the world.
   - Low prices and high volume.
   - Low selling and administrative expenses.
P1-36. Formulating Financial Statements from Raw Data Following is selected financial information from General Mills, Inc., for its fiscal year ended May 29, 2011 ($ millions).
Revenue ........................................... $14,880.2
Cash from operating activities .................................. 1,526.8
Cash, beginning year .................................................. 673.2
Stockholders’ equity .................................................. 6,612.2
Noncash assets .......................................................... 18,054.9
Cash from financing activities* ...................................... (865.3)
Cost of goods sold .................................................... 8,926.7
Total expenses (other than cost of goods sold) .................... 4,155.2
Cash, ending year ...................................................... 619.6
Total liabilities .......................................................... 12,062.3
Cash from investing activities ........................................ (715.1)
* Cash from financing activities includes the effects of foreign exchange rate fluctuations.

Required
a. Prepare
   Income statement

   Revenue  $14,880.2
   Cost of Goods Sold  8,926.7
   Gross Profit  5,953.5
   Expenses  4,155.2
   Net Income  1,798.3

   Balance sheet

   Cash  619.6
   Total Assets  18,674.5
   Total Liabilities  12,062.3
   Owners Equity  6,612.2

   Statement of cash flows

   Cash from operating activities  1,526.8
   Cash from investing activities  (715.1)
   Cash from financing activities  (865.3)
   Net cash flow  673.2
   Beginning Cash  619.6
   Ending Cash  1,293.2

b. Do the negative amounts for cash from investing activities and cash from financing activities concern us? Explain.
   No, normal uses of operating cash (i.e., purchase equipment and (ii) pay dividends) & purchase some

   c. Using the statements prepared for part a, compute the following ratios (for this part only, use the year-end balance instead of the average for assets and stockholders’ equity):
      i. Profit margin
         \[
         \text{Profit margin} = \frac{1,798.3}{14,880.2} = 12.1\% 
         \]
      ii. Asset turnover
         \[
         \text{Asset turnover} = \frac{14,880.2}{18,674.5} = 0.797 
         \]
      iii. Return on assets
         \[
         \text{Return on assets} = \frac{1,798.3}{18,674.5} = 9.6\% 
         \]
      iv. Return on equity
         \[
         \text{Return on equity} = \frac{1,798.3}{6,612.2} = 27.2\% 
         \]
1. A list of assets, liabilities and equity can be found on which of the following?  
   a. Balance Sheet    d. Income Statement  
   c. Statement of Stockholders' Equity  

2. American Airlines' 2007 balance sheet reported the following (in millions)  
   Total Assets $25,385  
   Total Liabilities 23,941  
   Contributed Capital $4,422  
What was American Airlines' Total liabilities and Stockholders' Equity at December 31, 2007?  
   a. $25,385 million  b. $23,941 million  c. $28,363 million d. $4,422 million  
   e. There is not enough information to determine the answer.  

3. In its 2007 annual report, Kohl's Corporation reported the following (in millions):  
   Total assets $10,560  
   Total shareholders' equity $6,102  
   Total liabilities $4,458  
What proportion of Kohl's Corporation is financed by non-owners?  
   a. 42%  b. 58%  c. 37%  d. 73%  e. None of these  

4. Which of the following is included as a component of stockholders' equity?  
   e. Dividends  

5. A statement of cash flows usually does not include which of the following?  
   a. Net income  b. Increase in accounts receivable  c. Contributed capital  
   d. Depreciation expense  e. None of these  

6. A clean audit opinion includes which of the following assertions:  
   A) Financial statements present fairly the company's financial condition  
   B) The auditor certifies the financials to be error free  
   C) The financial statements are the auditor's responsibility  
   D) Management has handled transactions efficiently in all material respects  
   E) All of the above  

7. On October 2, 2011 Starbucks Corporation reported, on its Form 10-K, the following (in millions):  
   Total assets $7,360.4  
   Total stockholders' equity 4,387.3  
   Total current liabilities 2,075.8  
What did Starbucks's report as Total Liabilities on October 2, 2011?  
   A) $2,311.5 million  B) $2,075.8 million  
   C) $2,973.1 million  D) $7,360.4 million  
   E) None of the above  

8. In its 2010 annual report, Caterpillar Inc. reported the following (in millions):  
   Sales $39,667  $29,540  
   Cost of goods sold 30,367 23,886  
As a percentage of Sales, did Caterpillar's gross profit increase or decrease during 2010?  
   A) Gross profit increased from 19% to 24%  B) Gross profit decreased from 24% to 19%  
   C) Gross profit increased from 76% to 81%  D) Gross profit decreased from 81% to 76%  
   E) There is not enough information to answer the question.
9. Sales for the year = $108,229, Net Income for the year = $13,144, Income from equity investments = $3,309, and average Equity during the year = $47,556. Return on Equity (ROE) for the year is:
   A) 12.1%
   B) 27.6%
   C) 43.9%
   D) 227.6%
   E) There is not enough information to answer the question.

10. Assets are recorded in the balance sheet in order of:
   A) Market Value
   B) Historic Value
   C) Liquidity
   D) Maturity
   E) None of the above

EXERCISES
Exercise In its December 31, 2011 annual report, Mattel, Inc. reports the following items.

<table>
<thead>
<tr>
<th>($ thousands)</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash flows from operating activities</td>
<td>$ 664,693</td>
</tr>
<tr>
<td>Revenues</td>
<td>6,266,037</td>
</tr>
<tr>
<td>Stockholders' equity</td>
<td>2,610,603</td>
</tr>
<tr>
<td>Net cash flows from financing activities</td>
<td>(402,199)</td>
</tr>
<tr>
<td>Total assets</td>
<td>5,671,638</td>
</tr>
<tr>
<td>Cash, end of year</td>
<td>1,369,113</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>5,497,529</td>
</tr>
<tr>
<td>Noncash assets</td>
<td>4,302,525</td>
</tr>
<tr>
<td>Net cash flows from investing activities</td>
<td>(174,504)</td>
</tr>
<tr>
<td>Net income</td>
<td>768,508</td>
</tr>
<tr>
<td>Cash, beginning of year</td>
<td>$1,281,123</td>
</tr>
</tbody>
</table>

REQUIRED: Prepare a summarized balance sheet, income statement, and cash flow statement for Mattel, Inc. for 2011.


\[
\begin{array}{cccc}
\text{Cash} & 1,369,113 \\
\text{Non Cash Assets} & 4,302,525 \\
\text{Total Assets} & 5,671,638 \\
\text{TOTAL LIABILITIES} & 3,061,035 \\
\text{Stockholders Equity} & 2,610,603 \\
\end{array}
\]

b. Income Statement

\[
\begin{array}{c}
\text{Revenues} & 6,266,037 \\
\text{Total Expenses} & 5,497,529 \\
\text{Net Income} & 768,508 \\
\end{array}
\]

c. Cash Flow Statement

\[
\begin{array}{c}
\text{Cash Flows from Operating Activities} & 664,693 \\
\text{Net Income} & 768,508 \\
\text{Cash, Beginning of Year} & 1,281,123 \\
\text{Cash, Ending} & 1,369,113 \\
\end{array}
\]
Exercise  Identify the financial statements in which you would find each of the items listed below. Some items may appear on more than one statement. Indicate all financial statements that apply to each item. The possible choices are:

B : Balance sheet  
I : Income Statement  
CF : Statement of Cash Flows

<table>
<thead>
<tr>
<th>Financial Statement Item</th>
<th>Financial Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Office building</td>
<td>B</td>
</tr>
<tr>
<td>b. Revenues</td>
<td>I</td>
</tr>
<tr>
<td>c. Dividends</td>
<td>CF</td>
</tr>
<tr>
<td>d. Proceeds of sale of investments</td>
<td>CF</td>
</tr>
<tr>
<td>e. Administrative Expense</td>
<td>I</td>
</tr>
<tr>
<td>f. Treasury stock</td>
<td>B</td>
</tr>
</tbody>
</table>

Module 1 Questions

1. Why should a company be liquid?
2. Why should a company be solvent?
3. Why are sufficient earnings necessary?
4. Who or what can overrule the SEC (Securities and Exchange Commission)?
5. Why are footnotes to the financial reports necessary?
6. What does the statement “The stock market is efficient” mean?
7. What is “inside information”? How should it be disclosed?
8. Why will most financial reports filed with the SEC have a clean audit opinion?
9. When we calculate return on assets, what is in the denominator (bottom) of the division?
10. Return on sales times asset turnover will equal what measure?
11. What types of events can change the balance of retained earnings?
12. If we know the Total Assets and the Total Liabilities, how do we find the Total Owners Equity?