

GAAP Comprehensive Case

Target Corporation prepares its financial statements according to U.S. GAAP. Target's financial statements and disclosure notes for the year ended February 3, 2018, are available in Connect. This material is also available under the Investor Relations link at the company's website (www.target.com). This case addresses a variety of characteristics of financial statements prepared using U.S. GAAP. Questions are grouped in parts according to various sections of the textbook.

Part A: Financial Statements, Income Measurement, and Current Assets

- A1. What amounts did Target report for the following items for the year ended February 3, 2018?
 - a. Total revenues
 - b. Income from current operations
 - c. Net income or net loss
 - d. Total assets
 - e. Total equity
- A2. What was Target's basic earnings per share for the year ended February 3, 2018?
- A3. What is Target's fiscal year-end? Why do you think Target chose that year-end?
- A4. Regarding Target's audit report:
 - a. Who is Target's auditor?
 - b. Did Target receive a "clean" (unmodified) audit opinion?
- A5. Refer to Target's balance sheet for the years ended February 3, 2018, and January 28, 2017. Based on the amounts reported for accumulated depreciation, and assuming no depreciable assets were sold during the year, prepare an adjusting entry to record Target's depreciation for the year.
- A6. Refer to Target's statement of cash flows for the year ended February 3, 2018. Assuming your answer to requirement 1 includes all depreciation expense recognized during the year, how much amortization expense was recognized during the year?
- A7. Note 13 provides information on Target's current assets. Assume all prepaid expenses are for prepaid insurance and that insurance expense comprises \$50 million of the \$14,248 million of selling, general, and administrative expenses reported in the income statement for the year ended February 3, 2018. How much cash did Target pay for insurance coverage during the year? Prepare the adjusting entry Target would make to record all insurance expense for the year. What would be the effect on the income statement and balance sheet if Target didn't record an adjusting entry for prepaid expenses?
- A8. By what name does Target label its balance sheet?
- A9. What amounts did Target report for the following items on February 3, 2018?
 - a. Current assets
 - b. Long-term assets
 - c. Total assets

- d. Current liabilities
 - e. Long-term liabilities
 - f. Total liabilities
 - g. Total shareholders' equity
- A10. What was Target's largest current asset? What was its largest current liability?
- A11. Compute Target's current ratio and debt to equity ratio in 2018?
- A12. Assuming Target's industry had an average current ratio of 1.0 and an average debt to equity ratio of 2.5, comment on Target's liquidity and long-term solvency.
- A13. Why do you think Target has chosen to have its fiscal year end on January 30, as opposed to December 31?
- A14. Regarding Target's audit report:
- a. Who is Target's auditor?
 - b. Did Target receive a "clean" (unqualified) audit opinion?
- A15. By what name does Target label its income statement?
- A16. What amounts did Target report for the following items for the year ended February 3, 2018?
- a. Sales
 - b. Gross margin
 - c. Earnings from continuing operations before income taxes
 - d. Net earnings from continuing operations
 - e. Net earnings
- A17. What was Target's basic earnings per share for the year ended February 3, 2018?
- A18. Does Target report any items as part of its comprehensive income? If so, what are they.
- A19. Does Target prepare the statement of cash flows using the direct method or the indirect method?
- A20. Which is higher, net earnings or operating cash flows? Which line item is the biggest reason for this difference? Explain why.
- A21. What are the largest investing cash flow and the largest financing cash flow reported by the company for the year ended February 3, 2018?
- A22. On what line of Target's income statement is revenue reported? What was the amount of revenue Target reported for the fiscal year ended February 3, 2018?
- A23. Disclosure Note 2 indicates that Target generally records revenue in retail stores at the point of sale. Does that suggest that Target generally records revenue at a point in time or over a period of time? Explain.
- A24. Disclosure Note 2 indicates that customers ("guests") can return some merchandise within 90 days of purchase and can return other merchandise within a year of purchase. How are Target's revenue and net income affected by returns, given that it does not know at the time a sale is made which items will be returned?
- A25. Disclosure Note 2 indicates that "Commissions earned on sales generated by leased departments are included within sales and were \$44 million . . . in 2017 . . ." Do you think it likely that Target is accounting for those sales as a principal or an agent? Explain.
- A26. Disclosure Note 2 discusses Target's accounting for gift card sales. Does Target recognize revenue when it sells a gift card to a customer? If not, when does it recognize revenue? Explain.
- A27. Disclosure Note 4 discussed how Target accounts for consideration received from vendors, which they call "vendor income." Does that consideration produce revenue for Target? Does that consideration produce revenue for Target's vendors? Explain.
- A28. What is Target's policy for designating investments as cash equivalents?
- A29. What is Target's balance of cash equivalents for the fiscal year ended February 3, 2018?

- A30. What is Target's policy with respect to accounting for merchandise returns?
- A31. Does Target have accounts receivable? Speculate as to why it has the balance that it has. (Hint, see Disclosure Notes 9, 11 and 13.)
- A32. Does Target use average cost, FIFO, or LIFO as its inventory cost flow assumption?
- A33. In addition to the purchase price, what additional expenditures does the company include in the initial cost of merchandise?
- A34. Calculate the gross profit ratio and the inventory turnover ratio for the fiscal year ended February 3, 2018. Compare Target's ratios with the industry averages of 24.5% and 7.1 times. Determine whether Target's ratios indicate the company is more/less profitable and sells its inventory more/less frequently compared to the industry average.
- A35. What retail indices (internally measured or externally measured) does Target use to measure the LIFO provision?
- A36. Does Target adjust the retail value of inventory for permanent markups or permanent markdowns to effectively report inventory at the lower of cost or market?
- A37. Target has agreements with certain vendors whereby Target does not purchase or pay for merchandise until the merchandise is ultimately sold to a customer. Are sales and cost of sales of this inventory included in Target's income statement? Is unsold inventory at the end of the year included as part of ending inventory in the balance sheet?

Part B: Property, Plant, and Equipment and Intangible Assets

- B1. What amount (\$ in millions) does Target report for net property and equipment for the year ended February 3, 2018? What is the largest category of property and equipment reported on the face of the balance sheet?
- B2. What amount (\$ in millions) of cash was used in the fiscal year ended February 3, 2018, to purchase property and equipment? Is this an increase or decrease compared to the previous year?
- B3. Do you think a company like Target would have more research and development costs or more advertising costs? Explain.
- B4. What is Target's fixed-asset turnover ratio for the fiscal year ended February 3, 2018? What is the ratio intended to measure?
- B5. Does Target include any intangible assets in total assets (yes/no)? Hint: see Notes 15 and 16.
- B6. Compare the property and equipment listed in the balance sheet with the list in Note 14. What are the estimated useful lives for recording depreciation? Is land listed in Note 14 (yes/no)?
- B7. In Note 14, which depreciation method does Target use for property and equipment for financial reporting? Which depreciation method is used for tax purposes? Why might these methods be chosen?
- B8. In Note 14, how does Target record repairs and maintenance expense?
- B9. In Note 14, does Target report any impairment of property and equipment for the year ended February 3, 2018? If so, what was the amount and what were the reasons for the impairments?
- B10. From Notes 15 and 16, were any impairments related to intangible assets recorded for the year ended February 3, 2018? If so, what was the amount and what were the reasons for the impairments?

Part D: Liabilities

- D1. Target's Consolidated Statement of Financial Position (its balance sheet) discloses its current assets and current liabilities.
- What are the four components of Target's current liabilities?
 - Are current assets sufficient to cover current liabilities? What is the current ratio for the year ended February 3, 2018? How does the ratio compare with the prior year?
 - Why might a company want to avoid having its current ratio be too low? Too high?
- D2. Disclosure Note 2 discusses Target's accounting for gift card sales. Disclosure Note 18 indicates the amount of gift card liability that is recognized in Target's balance sheet.
- By how much did Target's gift card liability change between February 3, 2018 and January 28, 2017?
 - How would the following affect Target's gift card liability (indicate "increase," "decrease," or "no change" for each):
 - Sale of a gift card
 - Redemption of a gift card (the holder using it to acquire goods or services)
 - Increase in breakage estimated for gift cards already sold
- D3. Disclosure Note 19 discusses Target's accounting for contingencies.
- What is Target's approach for accruing losses for litigation claims associated with the data breach? Is their approach appropriate?
 - Target experienced a data breach in 2013, when "an intruder stole certain payment card and other guest information from our network." Target recorded a contingent liability for litigation associated with the data breach at that time, and continues to update that liability over time based on new information. Related new expenses for fiscal 2017 totaled \$5 million. Prepare a journal entry to record Target's recognition of new expenses associated with the data breach litigation.
- D4. Calculate the debt to equity ratio for Target at February 3, 2018. The average ratio for companies in the Discount Retailers industry sector in a comparable time period was 2.0.
- D5. Calculate Target's times interest earned ratio for the year ended February 3, 2018. The coverage for companies in the Discount Retailers industry sector in a comparable time period was 6.9.

Part E: Leases, Income Taxes, and Pensions

- E1. Refer to disclosure note 22 following Target's financial statements. What is the amount reported for "capital" leases (shown as the present value of minimum lease payments)? What is the total of those lease payments? What accounts for the difference between the two amounts?
- E2. What is the total of the operating lease payments?

- E3. New lease accounting guidance (discussed in Chapter 15) will require companies to report a liability for operating leases at present value as well as for capital leases (now called finance leases). If Target had used the new lease accounting guidance in its fiscal 2017 financial statements, what would be the amount reported as a liability for operating leases? Hint: Assume the payments “after 2020” are to be paid evenly over a 16 years period and all payments are at the end of years indicated. Target indicates elsewhere in its financial statements that 6% is an appropriate discount rate for its leases.
- E4. Refer to *Note 22: Leases*. New lease accounting guidance requires companies to record a right-of-use asset and a lease liability for all leases, with the exception of short-term leases, at present value. If Target had used the new lease accounting guidance in its fiscal 2017 (February 3, 2018) financial statements, what would be the amount reported as a liability for its leases, operating and capital (finance) combined [rounded to nearest \$ million]?
Hint: Assume the payments “after 2020” are to be paid evenly over a 16-year period and all payments are at the end of years indicated. Target indicates elsewhere in its financial statements that 6% is an appropriate discount rate for its leases.
- E5. From the income statement, determine the income tax expense for the year ended February 3, 2018. Tie that number to the second table in Disclosure Note 23, “Provision for Income Taxes,” and prepare a summary journal entry that records Target’s tax expense from continuing operations for the year ended February 3, 2018.
- E6. Focusing on the third table in Disclosure Note 23, “Net Deferred Tax Asset/ (Liability),” calculate the change in net deferred tax assets or liability. By how much did that amount change? To what extent did you account for that change in the journal entry you wrote for the first requirement of this case? List possible causes of any difference.
- E7. Target’s Note 23 indicates that “In December 2017, the U.S. government enacted the Tax Cuts and Jobs Act tax reform legislation (the Tax Act), which among other matters reduced the U.S. corporate income tax rate from 35 percent to 21 percent effective January 1, 2018. . . . We have recorded a provisional \$352 million net tax benefit primarily related to the remeasurement of certain deferred tax assets and liabilities, including \$381 million of benefit from the new lower rate, partially offset by \$29 million of deferred income tax expense from our foreign operations.” What’s the effect on net income?
- E8. What is Target’s liability for unrecognized tax benefits as of February 3, 2018? If Target were to prevail in court and realize \$50 million more in tax savings than it thought more likely than not to occur, what would be the effect on the liability for unrecognized tax benefits and on net income?
- E9. What were the changes in Target’s Projected Benefits Obligation in the fiscal years ended February 3, 2018 (fiscal 2017), and January 28, 2017 (fiscal 2016), for its qualified pension plans?
- E10. What were the changes in Target’s Pension Plan Assets in the fiscal years ended February 3, 2018, and January 28, 2017, for its qualified pension plans?
- E11. Were these pension plans overfunded or underfunded for the fiscal years ended February 3, 2018, and January 28, 2017?
- E12. What were the components of Target’s Pension Expense in the fiscal years 2017, 2016, and 2015?

- F10. What was the effect of the change on depreciation and amortization in fiscal 2016?
- F11. Was the effect of the change on earnings per share in fiscal 2017 an increase, a decrease, or no effect?
- F12. Is Target's cash provided by operating activities (a) increasing or (b) decreasing?
- F13. Is Target's cash provided by operating activities more or less than net income in fiscal 2017?
- F14. Is Target increasing or decreasing its investment in property and equipment?
- F15. Is Target increasing or decreasing its long-term debt?
- F16. Some transactions that don't increase or decrease cash must be reported in conjunction with a statement of cash flows. What activity of this type did Target report during each of the three years presented?