

Corporate Reports: Is TWA a “Going Concern?”

(Appendix 8)

In the analysis below, TWA's going concern opinion, issued by their auditor, is analyzed from the 1996 corporate financial records. This analysis will list in detail the issues that convey several troubled operation areas as well as financial management control issues.

ACCT 4610 Project – TransWorld Airlines, Inc.

Prepared for Dr. Burkette

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Submitted by: Colleen Kispert & Bryon Ownby

TransWorld Airlines, Inc., or TWA, is a company that was organized in 1978. TWA is the successor to the corporation Transcontinental and Western Air, Inc., which were originally formed in 1934. TWA is the seventh largest U.S. air carrier as of 1996. TWA's primary business is transporting passengers, cargo, and mail. In addition, TWA operates Getaway Vacations, a tour packager.

TWA operates two main systems: North America and International. The North America system serves 37 states, the District of Columbia, Puerto Rico, Mexico, Canada, and the Caribbean. In 1996, 80% of TWA's total revenues were from the North America system revenues. Their international system consists of service from John F. Kennedy Airport in New York City and St. Louis to destinations in Europe and the Middle East. In 1996, 20% of TWA's total revenue comes from international systems. However, as part of their plan to improve profitability of its international operations, certain European routes were discontinued.

TWA's main source of revenue is the passenger airline business. To cut costs, TWA has indicated that it will be reducing contract services to third parties in the future. In the past 4 years prior to 1995, TWA has filed for two separate Chapter 11 reorganizations. In 1996, TWA announced its fresh start of accounting policy and procedures in accordance with the AICPA "SOP 90-7". This statement allows corporations a fresh start on accounting; however, any prior financial statements cannot be compared to after the date. TWA's date was September 1, 1995. As noted on the financial statement by the numbers, TWA has refocused the company's strategy and is trying to correct TWA's performance difficulties. The opinion of the auditors for TWA to be a going concern corporation is adequate from a student's perspective. Upon TWA corrections, it has also decided to not issue Common Stock Dividends. These earnings will be retained to finance the business and reduce its leverage.

After the 1995 Reorganization, the corporation is still losing money but in comparison to 1994, and in taking in the regards to the "SOP 90-7", the reorganization appears to be working. But with the debt and expense problems faced by TWA and in the industry itself, it may be a few more years before a net profit appears. Many of TWA's competitors like Eastern Airlines have declared bankruptcy or have merged with other airline corporations to form stronger entities. The financial status of TWA is of a going concern. Although operating income did increase by \$7.8 million on June 30, 1996, by the year-end on December 31, 1997, sales had decreased drastically. In TWA's history, the third quarter is the strongest time of the year for ticket sales. However, this quarter had resulted in some of the lowest earnings for TWA in quite a while. This decrease could also be related to the TWA Flight 800 crash in July of 1996 and with imposing quality inspections pending. Once again, TWA's management rethought its strategy. More security measures have resulted from February's 1997 President Commission on airline traffic standards and safety. A strong point for TWA is in the data files for passenger traffic both domestic and international flights from 1994-1996 which has increased over the years, but a decaying profit from each passenger is beginning to be seen in international flights.

For TWA, a comparison of the ratios between 1994 and 1996 indicate that the corporation has numerous strengths and weaknesses. One ratio that should be considered is the quick ratio. The quick ratio has decreased from .63 in 1995, to .43 in 1996. This could mean TWA might have difficulty in meeting its short-term needs. Another ratio is their current ratio. Their current ratio went down from .85 in 95, to .59 in 96. This decrease could mean TWA might have more trouble meeting maturing short-term obligations. Another ratio, which has notably changed, is the ratio of sales to cash. This increased from

3.61 in 95, to 19.57 in 96. From looking at the comparative balance sheets, this is caused by a decrease in cash with an increase in sales. Another ratio is the receivables turnover. This is one of the few positive ratios. This ratio decreased from 75.26 days in 95, to 24.60 days in 96. Lastly, is the ratio of net sales to working capital. This is negative 8.79. This is a negative number because TWA has no working capital. In regards to total liabilities, its ratio to Total Assets decreased while the ratio comparison to Invested Capital and Common Equity greatly increased. Debt, by TWA has become a substantial problem. The Current Debt to Equity ratio indicates debts have increased, and Long Term Debt to Equity ratio, in comparison to 1995, has increased. Total Debt to Equity and Total Assets to Equity have increase dramatically. The increase in these ratios can be related to the liquidity of cash and the liabilities of the corporation. TWA's Net Income ratios to Net Sales and Total Assets have increased while the ratio to Invested Capital and Common Equity has decreased. TWA is a corporation that is barely staying alive.

To compare the financial statements for TWA, the years of 1995-1996 are used. TWA's balance sheet indicates in an overall manner that Total Assets have decreased. Note worthy items of discretion to mention is the decrease in cash. This liquidity problem has gained the attention by management and many solutions have been exercised. Management's solution to the liquidity problem is by the availability of purchasing tickets in advance to have more cash and cash equivalents on hand. Other measures by management are the issue of notes and warrants along with ticket vouchers. A contract has been renewed between TWA and Karabu Ticket Program Services to buy tickets from TWA at discount prices and resale them for a profit for TWA. TWA's flight reliability is also being reviewed and restructured. For Current Assets, the Receivables have increase a little and the inventory level has decreased. In Property and Equipment, prepayments on flight equipment exist and an increase in Other Property and Equipment. In addition to property, property under capital leases has decreased. This can be a result of the decrease in services to third parties. The Investment in affiliated companies and receivables and other assets have increased; however, the Total Investments have decreased. For the Current Liability section, this reflects an increase in the accounts payable areas and a general decrease in Total Liabilities. However, Shareholder's Equity reflects a decrease from the prior 1995-year. Cash Flows are, in general, decreasing in operating activities in the areas like depreciation and amortization, equity in undistributed earnings of affiliates not consolidated, in receivables, in inventories, prepared expenses and other current assets. These items reflect the liquidity problem with cash and cash equivalents noted in the assets section of the balance sheet. In Cash Flows from Investing, its decrease indicates that the area of concern is with capital expenditures based on a Net Operating Loss that is carried forward in the amount of \$625 million indicating bad investment procedures. However, the Financing Activities by TWA have increased and have resulted in a positive cash flow. The Income Statement for TWA indicate many reasons why the auditors gave an unqualified opinion but with a modification paragraph indicating a going concern. Operating Revenue increased by 7.2%, traffic increased but a concern is related to the increase in Operating Expensed of 14%. Within this measure, Salaries increased 11.1% and a 0.8% increase in passenger sales commission. Aircraft maintenance increased by 41% because of the traffic, third parties, and the higher levels of scheduled maintenance programs. An increase in fuel prices contributed to the increase in operating expenses also. Passenger Food and Beverage increased by 7.1% and General Operating Expenses increased by 11.6%, all creating the rise in expenses over the revenues. Upon the decrease in stock prices, the shutdown of TWE and the flights to Athens and Frankfurt and the related inventories reflected a cost of \$63.7 million in the retirement of these fleets.

In conclusion, there are many possible reasons that TWA could be deemed a going concern. We agree with the auditors that a going concern clause is necessary. Their source of revenue, sales, were not impressive in the last quarter of the year. In addition, their cash and other liquid assets are too low to be much of a cushion against any unplanned uses. In short, TWA is merely hanging on by a thread. In order for TWA to stay alive, some definite changes or improvements are going to have to take place.

Source:

Current year financials - 1996