Chapter 2

The Balance Sheet

ANSWERS TO QUESTIONS

1. (a) An asset is a resource owned by a company that has measurable value and is expected to provide future benefits.

   (b) A current asset is an asset that will be used up or turned into cash within the next 12 months.

   (c) A liability is a debt or obligation arising from past transactions or events, which the company is likely to pay, settle, or fulfill by sacrificing resources in the future.

   (d) A current liability is a debt or obligation that will be paid, settled, or fulfilled within one year.

   (e) Common stock includes the amount of financing (cash and sometimes other assets) provided to the company by stockholders in exchange for shares of common stock.

   (f) Retained earnings are the cumulative earnings of a company that are not distributed to the owners and instead are reinvested in the business.

2. A transaction is an exchange or event that has a direct and measurable financial effect on the assets, liabilities, or stockholders' equity of a business. Transactions include two different types of events: (1) external exchanges and (2) internal events. The first situation (1) is exemplified by the sale of goods or services to customers. The second situation (2) is exemplified by employees using up the benefits of equipment owned by the company.

3. Accounts are used to accumulate and report the effects of different business activities. Accounts are necessary to keep track of all increases and decreases in the basic accounting equation.

4. The basic accounting equation is: Assets = Liabilities + Stockholders' Equity.

5. Debit is the left side of a T-account and credit is the right side of a T-account. A debit is an increase in assets or a decrease in liabilities or stockholders' equity. A credit is the opposite – a decrease in assets or an increase in liabilities or stockholders' equity.

6. Transaction analysis is the process of studying a transaction to determine its financial effect on the business in terms of the basic accounting equation:

   Assets = Liabilities + Stockholders' Equity

   The two principles underlying the process are:

   - * Duality of effects: every transaction affects at least two accounts.
   - * A=L+SE; the accounting equation must remain in balance after each transaction.

7. The accounting equalities in transaction analysis are:

   (a) Assets = Liabilities + Stockholders' Equity
   (b) Debits = Credits

8. A journal entry is a method for expressing the effects of a transaction on accounts in a debits equal credits format. The title of the account(s) to be debited is (are) listed first. The title of the account(s) to be credited is (are) listed underneath the debited accounts and both account title(s) and amount(s) are indented to the right. (An optional explanation can be included on the lines following the journal entry; this explanation is omitted in most textbook examples and homework problems because the description of the transaction in the textbook already provides the explanation.)

9. T-accounts are a simplified version of the ledger, which summarizes transaction effects for each account. T-accounts show increases on the left (debit) side for assets, which are on the left side of the accounting equation. T-accounts show increases on the right (credit) side for liabilities and stockholders' equity, which are on the right side of the accounting equation. The T-account is a tool for summarizing transaction effects for each account and determining balances.

10. The cost principle requires that assets and liabilities be recorded at their original cost to the company.

11. Because the customer list was not purchased by her salon (it was developed internally), her salon does not report it on the balance sheet. Knowing this, she should be sure to advise her banker that the salon has established a loyal group of customers that holds considerable value for generating future revenues (but is excluded from the balance sheet for accounting reasons).

Authors' Recommended Solution Time
(Time in minutes)

Mini-exercises		*Exercises*		*Problems*		*Skills Development Cases**		*Continuing Case*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	2	1	8	CP2-1	45	1	15	1	30
2	2	2	10	CP2-2	50	2	15		
3	4	3	5	CP2-3	50	3	45		
4	4	4	5	PA2-1	45	4	20		
5	4	5	3	PA2-2	50	5	20		
6	4	6	5	PA2-3	50	6	10		
7	3	7	3	PB2-1	45	7	35		
8	3	8	10	PB2-2	50				
9	5	9	5	PB2-3	50				
10	6	10	15						
11	6	11	20						
12	6	12	25						
13	10	13	10						
14	10	14	15						
15	10	15	30						
16	10								
17	10								
18	10								
19	10								
20	10								
21	15								
22	10								
23	3								
24	8								
25	8								

* Due to the nature of cases, it is very difficult to estimate the amount of time students will need to complete them. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear, and by offering suggestions (about how to research topics or what companies to select). The skills developed by these cases are indicated in the table on the following page.

Case	Financial Analysis	Research	Ethical Reasoning	Critical Thinking	Technology	Writing	Teamwork
1	x						
2	x						
3	x	x			x	x	x
4	x		X	x			
5	x		X	x		x	
6	x			x			
7	x				x		

ANSWERS TO MINI-EXERCISES

M2-1

	Debit	**Credit**
Assets	*Increases*	*Decreases*
Liabilities	*Decreases*	*Increases*
Stockholders' Equity	*Decreases*	*Increases*

M2-2

	Increase	**Decrease**
Assets	*Debit*	*Credit*
Liabilities	*Credit*	*Debit*
Stockholders' Equity	*Credit*	*Debit*

M2-3 (1) D (2) C (3) A (4) I (5) F (6) B

M2-4 (1) CL (2) CL (3) CA (4) NCA (5) CA (6) SE (7) NCA
(8) CL (9) NCA (10) CL (11) SE (12) CA

M2-5

	Req. 1 Category	Req. 2 Normal Balance
1)	CA	Debit
2)	CL	Credit
3)	SE	Credit
4)	NCL	Credit
5)	CL	Credit
6)	NCA	Debit
7)	SE	Credit
8)	CL	Credit
9)	CA	Debit

M2-6

	Req.1 Category	Req.2 Normal Balance
1)	CL	Credit
2)	CA	Debit
3)	CA	Debit
4)	SE	Credit
5)	NCL	Credit
6)	NCA	Debit
7)	SE	Credit
8)	CL	Credit

M2-7

1) Yes
2) No
3) Yes
4) No
5) No
6) Yes

M2-8

1) Yes
2) Yes
3) No – This event involves only a written promise to rent the store space. No exchange of cash, goods, or services has occurred.
4) Yes
5) No

M2-9

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Cash	+3,940		Note Payable (short-term)	+3,940			
b.	Cash	+4,630					Common Stock	+4,630
c.	Cash Equipment	–200 +1,000		Note Payable (short-term)	+800			
d.	Cash Supplies	–300 +300						
e.	Supplies	+700		Accounts Payable	+700			

M2-10

a.	Cash (+A)	3,940	
	Note Payable (short-term) (+L)		3,940
b.	Cash (+A)	4,630	
	Common Stock (+SE)		4,630
c.	Equipment (+A)	1,000	
	Cash (-A)		200
	Note Payable (short-term) (+L)		800
d.	Supplies (+A)	300	
	Cash (-A)		300
e.	Supplies (+A)	700	
	Accounts Payable (+L)		700

M2-11

Cash (A)

Beg.	0	
(a)	3,940	200 (c)
(b)	4,630	300 (d)
End.	8,070	

Supplies (A)

Beg.	0	
(d)	300	
(e)	700	
End.	1,000	

Equipment (A)

Beg.	0	
(c)	1,000	
End.	1,000	

Accounts Payable (L)

	0 Beg.
	700 (e)
	700 End.

Note Payable (short-term) (L)

	0 Beg.
	3,940 (a)
	800 (c)
	4,740 End.

Common Stock (SE)

	0 Beg.
	4,630 (b)
	4,630 End.

M2-12

SPOTLIGHTER INC.
Balance Sheet
At January 31

Assets		*Liabilities*	
Current Assets:		*Current Liabilities:*	
Cash	$ 8,070	Accounts Payable	$ 700
Supplies	1,000	Notes Payable	4,740
Total Current Assets	9,070	*Total Current Liabilities*	5,440
Property, Plant and Equipment	1,000	*Stockholders' Equity*	
		Common Stock	4,630
Total Assets	$ 10,070	*Total Liabilities & Stockholders' Equity*	$10,070

M2-13

a.	Cash (+A)	70,000	
	Common Stock (+SE)		70,000
b.	Land (+A)	60,000	
	Cash (-A)		60,000
c.	Supplies (+A)	9,000	
	Accounts Payable (+L)		9,000
d.	Cash (+A)	25,000	
	Note Payable (long-term) (+L)		25,000
e.	No transaction		

M2-14

	Assets		=	Liabilities		+	Stockholders' Equity	
(a	Cash	+ 70,000					Common Stock	+ 70,000
(b)	Cash	- 60,000						
	Land	+ 60,000						
(c)	Supplies	+ 9,000		Accounts Payable	+ 9,000			
(d)	Cash	+ 25,000		Note Payable (long-term)	+ 25,000			
(e)	No transaction							
		104,000			34,000			70,000

M2-15

a.	Equipment (+A)	4,000	
	Cash (-A)		4,000
b.	Inventory (+A)	7,000	
	Accounts Payable (+L)		7,000
c.	Cash (+A)	4,000	
	Note Payable (short-term) (+L)		4,000
d.	Accounts Payable (-L)	1,500	
	Cash (-A)		1,500
e.	Note Payable (short-term) (-L)	4,000	
	Cash (-A)		4,000

M2-16

	Assets		=	Liabilities		+	Stockholders' Equity
(a)	Cash	- 4,000					
	Equipment	+ 4,000					
(b)	Inventory	+ 7,000		Accounts Payable	+ 7,000		
(c)	Cash	+ 4,000		Note Payable (short-term)	+ 4,000		
(d)	Cash	- 1,500		Accounts Payable	- 1,500		
(e)	Cash	- 4,000		Note Payable (short-term)	- 4,000		
		5,500			5,500		

M2-17

a.	Equipment (+A)	12,000	
	Accounts Payable (+L)		12,000
b.	Accounts Payable (-L)	6,000	
	Cash (-A)..		6,000
c.	Cash (+A)	400	
	Accounts Receivable (-A)..		400
d.	Cash (+A)	15,000	
	Common Stock (+SE)		15,000
e.	Equipment(+A)……………………..	60,000	
	Cash (-A)..		10,000
	Note Payable (long-term) (+L).......................................		50,000

M2-18

	Assets		**=**	**Liabilities**		**+**	**Stockholders' Equity**	
(a)	Equipment	+ 12,000		Accounts Payable	+ 12,000			
(b)	Cash	- 6,000		Accounts Payable	- 6,000			
(c)	Cash	+ 400						
	Accounts Receivable	- 400						
(d)	Cash	+ 15,000					Common Stock	+ 15,000
(e)	Cash	- 10,000		Note Payable (long-term)	+ 50,000			
	Equipment	+ 60,000						
		+ 71,000			+ 56,000			+ 15,000

M2-19

a.	Cash (+A)	50	
	Accounts Receivable (-A)		50
b.	No transaction		
c.	Accounts Payable (-L)	2,000	
	Cash (-A)		2,000
d.	Note Payable (short-term) (-L)	5,000	
	Cash (-A)		5,000
e.	Equipment (+A)	2,200	
	Cash (-A)		1,000
	Note Payable (short-term) (+L)		1,200

M2-20

	Assets		=	Liabilities		+	Stockholders' Equity
(a)	Cash	+ 50					
	Accounts Receivable	- 50					
(b)	No transaction						
(c)	Cash	- 2,000		Accounts Payable	- 2,000		
(d)	Cash	- 5,000		Note Payable (short-term)	- 5,000		
(e)	Cash	- 1,000		Note Payable	+1,200		
	Equipment	+ 2,200		(short-term)			
		- 5,800			- 5,800		

M2-21

CHARLIE'S **CRISPY CHICKEN**
Balance Sheet
At September 30

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	$ 1,800	Accounts Payable	$ 2,000
Supplies	1,500	Salaries and Wages Payable	200
Total Current Assets	3,300	Total Current Liabilities	2,200
Equipment	38,000	Note Payable (long-term)	25,000
Land	18,900	**Total Liabilities**	27,200
Total Assets	$60,200		
		Stockholders' Equity	
		Common Stock	30,000
		Retained Earnings	3,000
		Total Stockholders' Equity	33,000
		Total Liabilities & Stockholders' Equity	$60,200

CCC's current ratio (3,300/2,200 = 1.5) suggests the company has enough current assets that could be converted into cash to cover its current liabilities. At September 30, CCC had $1.50 of current assets for each dollar of current liabilities.

M2-22

Req. 1

FACEBOOK, INC.
Balance Sheet
At September 30, 2013

(amounts in millions)

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$ 3,100	Accounts Payable	$ 700
Short Term Investments	6,300	Notes Payable (short-term)	300
Prepaid Rent	1,100	*Total Current Liabilities*	1,000
Total Current Assets	10,500	Note Payable (long-term)	900
		Total Liabilities	1,900
Software	1,700		
Equipment	2,700	*Stockholders' Equity*	
Total Non-Current Assets	4,400	Common Stock	10,400
Total Assets	$ 14,900	Retained Earnings	2,600
		Total Stockholders' Equity	13,000
		Total Liabilities & Stockholders' Equity	$ 14,900

Req. 2

As of September 30, 2013, stockholders' equity has provided the primary source of financing for Facebook, Inc. The company has financed $13,000 of its assets with stockholders' equity and only $1,900 with liabilities.

Req. 3

Facebook's current ratio ($10,500/$1,000 = 10.5) suggests the company has enough current assets that could be converted into cash to cover its current liabilities. Specifically, the current ratio of 10.5 implies that, at September 30, 2013, Facebook had $10.50 of current assets for each dollar of current liabilities.

M2-23

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Current Ratio} = \frac{\$30{,}000}{\$15{,}000} = 2.0$$

Yes, it is likely that Mister Ribs will be able to pay its current liabilities as they come due. The current ratio of 2.0 indicates that for every dollar in current liabilities, the company has two dollars in current assets. This ratio indicates a good ability to pay.

M2-24

a. Decrease $\frac{\$30{,}000 - \$2{,}000}{\$15{,}000 + \$0} = 1.87$

b. Increase $\frac{\$30{,}000 + \$2{,}000}{\$15{,}000 + \$0} = 2.13$

c. Increase $\frac{\$30{,}000 + \$5{,}000}{\$15{,}000 + \$0} = 2.33$

d. Decrease $\frac{\$30{,}000 + \$500}{\$15{,}000 + \$500} = 1.97$

M2-25

a. Decrease $\frac{\$1{,}000{,}000 + \$20{,}000}{\$500{,}000 + \$20{,}000} = 1.96$

b. Increase $\frac{\$1{,}000{,}000 - \$50{,}000}{\$500{,}000 - \$50{,}000} = 2.11$

c. Increase $\frac{\$1{,}000{,}000 + \$100{,}000}{\$500{,}000 + \$0} = 2.20$

d. Decrease $\frac{\$1{,}000{,}000 + \$250{,}000}{\$500{,}000 + \$250{,}000} = 1.67$

ANSWERS TO EXERCISES

E2-1	(1) E	(2) F	(3) B	(4) N	(5) I
	(6) A	(7) K	(8) M	(9) L	(10) D

E2-2

Req. 1

	Given	**Received**	
(a)	Note Payable (short-term)	Equipment	
(b)	Cash	Equipment	
(c)	—	—	*No exchange transaction*
(d)	Common Stock	Cash	
(e)	Cash	Land	
(f)	—	—	*No company transaction*
(g)	Note Payable (short-term)	Cash	
(h)	Cash	Note Payable (long-term)	

Req. 2
The truck in (b) would be recorded as an asset of $21,000. The land in (e) would be recorded as an asset of $50,000. These are applications of the cost principle.

Req. 3
The agreement in *(c)* involves no exchange or receipt of cash, goods, or services and thus is not a transaction. Because transaction *(f)* occurs between the owner and others, the separate entity assumption implies this transaction does not affect the business.

E2-3

Account	***Balance Sheet Classification***	***Debit or Credit Balance***
1. Land	NCA	Debit
2. Retained Earnings	SE	Credit
3. Note Payable (3 years)	NCL	Credit
4. Accounts Receivable	CA	Debit
5. Supplies	CA	Debit
6. Common Stock	SE	Credit
7. Equipment	NCA	Debit
8. Accounts Payable	CL	Credit
9. Cash	CA	Debit
10. Income Taxes Payable	CL	Credit

E2-4

	Assets		=	**Liabilities**		+	**Stockholders' Equity**	
a.	Cash	+10,000	=				Common Stock	+10,000
b.	Cash	+7,000	=	Note Payable (short-term)	+7,000			
c.	Equipment	+800	=	Accounts Payable	+800			
d.	Land Cash	+12,000 –1,000	=	Note Payable (long term)	+11,000			
e.	Equipment Cash	+3,000 –1,000	=	Accounts Payable	+2,000			

E2-5

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Equipment Cash	+216 –211	=	Note Payable (long-term)	+5			
b.	Cash	+21	=				Common Stock	+21
c.	*No effect*							
	TOTALS	26	=		5	+		21

Req. 2

The separate entity assumption states that transactions of the business are separate from transactions of the owners. Because transaction *(c)* occurs between the owners and others in the stock market, there is no effect on the business.

Req. 3

The greater increase in stockholders' equity (versus liabilities) indicates that these transactions led NIKE to rely proportionately more on stockholders (versus creditors).

E2-6

a.	Cash (+A)	10,000	
	Common Stock (+SE)		10,000
b.	Cash (+A)	7,000	
	Note Payable (short-term) (+L)		7,000
c.	Equipment (+A)	800	
	Accounts Payable (+L)		800
d.	Land (+A)	12,000	
	Cash (-A)		1,000
	Note Payable (long-term) (+L)		11,000
e.	Equipment (+A)	3,000	
	Cash (-A)		1,000
	Accounts Payable (+L)		2,000

E2-7

Req. 1

a.	Equipment (+A)	216	
	Cash (-A)		211
	Note Payable (long-term) (+L)		5
b.	Cash (+A)	21	
	Common Stock (+SE)		21

c. No journal entry required.

Req. 2

The separate entity assumption states that transactions of the business are separate from transactions of the owners. Because transaction *(c)* occurs between the owners and others in the stock market, there is no effect on the business.

E2-8

Req. 1

Cash (A)

Beg.	0		
(a)	60,000	3,000	(b)
End.	57,000		

Equipment (A)

Beg.	0		
(b)	12,000		
End.	12,000		

Note Payable (L)

		0	Beg.
		9,000	(b)
		9,000	End.

Common Stock (SE)

		0	Beg.
		60,000	(a)
		60,000	End.

Req. 2

Assets $ 69,000 = Liabilities $ 9,000 + Stockholders' Equity $ 60,000

Req. 3

The agreement in *(c)* involves no exchange or receipt of cash, goods, or services and thus is not yet a transaction. Because transaction *(d)* occurs between the owners and others, the separate entity assumption implies this transaction does not affect the business.

E2-9

Req. 1

Transaction	***Brief Explanation***
1	Issued common stock for $12,000 cash.
2	Borrowed $50,000 cash and signed a note for this amount.
3	Purchased equipment for $12,000; paid $4,000 cash and gave an $8,000 Note Payable for the balance.
4	Borrowed $4,000 cash and signed a note for this amount.

Req. 2

From table:

	Cash	+	Equipment	=	Note Payable	+	Common Stock
Ending	62,000	+	12,000	=	62,000	+	12,000

Req. 3

Most of Home Comfort's financing has come from liabilities. The company has financed $62,000 of its investment in assets with liabilities and only $12,000 with stockholders' equity.

E2-10

Req 1:

		Assets		=	Liabilities		+	Stockholders' Equity	
(a)	No transaction - no obligation exists until the supplies are received.								
(b)	Cash Equipment	- 10,000 + 30,000			Note Payable (short-term)	+ 20,000			
(c)	Cash	+ 5,000			Note Payable (short-term)	+ 5,000			
(d)	No transaction - no obligation exists until the manager has worked.								
(e)	Cash	+ 10,000						Common Stock	+10,000
(f)	Supplies	+ 2,000			Accounts Payable	+ 2,000			
		+ 37,000				+ 27,000			+10,000

Req 2:

(a) No transaction

(b)	Equipment (+A)………….. ………………………	30,000	
	Cash (-A)…………………………………………		10,000
	Note Payable (short-term) (+L)..………………		20,000
(c)	Cash (+A)…………………….……………………..	5,000	
	Note Payable (short-term) (+L)…………………		5,000
(d)	No transaction		
(e)	Cash (+A)……………………………………………	10,000	
	Common Stock (+SE)…...………………………		10,000
(f)	Supplies (+A) ……………………………..……..	2,000	
	Accounts Payable(+L) ……………………..…..		2,000

Req 3:

Beginning Assets	220,000
Net Change in Assets	+ 37,000
Ending Assets	257,000

E2-11

Req. 1

	Assets		Liabilities			Stockholders' Equity
	Cash	**Equipment**	**Accounts Payable**	**ST Notes Payable**	**LT Notes Payable**	**Common Stock**
Beg.	0	0	0	0	0	0
a.	+60,000					+60,000
b.	+20,000				+20,000	
c.	No transaction, therefore no financial effects to record.					
d.	-2,000	+9,000		+7,000		
e.	-8,000	+16,000	+8,000			
End.	70,000	25,000	8,000	7,000	20,000	60,000

Req 2:

a.	Cash (+A)	60,000	
	Common Stock (+SE)		60,000
b.	Cash (+A)	20,000	
	Note Payable (long-term) (+L)		20,000

c. No transaction has occurred because there has been no exchange of cash, goods, or services.

d.	Equipment (+A)	9,000	
	Cash (-A)		2,000
	Note Payable (short-term) (+L)		7,000
e.	Equipment (+A)	16,000	
	Cash (-A)		8,000
	Accounts Payable (+L)		8,000

E2-11 (continued)

Req. 3:

DOWN.COM
Balance Sheet
At May 31

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$70,000	Accounts Payable	$8,000
		Note Payable (short-term)	7,000
Total Current Assets	70,000	*Total Current Liabilities*	15,000
Noncurrent Assets		Note Payable (long-term)	20,000
Equipment	25,000	Total Liabilities	35,000
Total Assets	$95,000	*Stockholders' Equity*	
		Common Stock	60,000
		Retained Earnings	0
		Total Stockholders' Equity	60,000
		Total Liabilities & Stockholders' Equity	$95,000

E2-12

Req. 1

	Assets			=	Liabilities		+	Stockholders' Equity
	Cash	**Equipment**	**Land**		**Accounts Payable**	**Notes Payable**		**Common Stock**
(a)	+40,000			=				+40,000
(b)			+12,000	=		+12,000		
(c)	-2,000	+20,000		=		+18,000		
(d)	-2,000	+2,000		=				
(e)		No change*				No change		
	+36,000	+22,000	+12,000	=		+30,000		+40,000

*Event (e) is not considered a transaction of the company because the separate entity assumption (from Chapter 1) states that transactions of the owners are separate from transactions of the business.

Req. 2

a.	Cash (+A)	40,000	
	Common Stock (+SE)		40,000
b.	Land (+A)	12,000	
	Note Payable (long-term) (+L)		12,000
c.	Equipment (+A)	20,000	
	Cash (-A)		2,000
	Note Payable (long-term) (+L)		18,000
d.	Equipment (+A)	2,000	
	Cash (-A)		2,000

e. This is not a transaction of the business, so a journal entry is not needed.

E2-12 (continued)

Req. 3

Cash (A)

Beg.	0		
(a)	40,000	2,000	(c)
		2,000	(d)
End.	36,000		

Equipment (A)

Beg.	0		
(c)	20,000		
(d)	2,000		
End.	22,000		

Land (A)

Beg.	0		
(b)	12,000		
End.	12,000		

Note Payable (L)

		0	Beg.
		12,000	(b)
		18,000	(c)
		30,000	End.

Common Stock (SE)

		0	Beg.
		40,000	(a)
		40,000	End.

Req. 4

LASER DELIVERY SERVICES, INC.
Balance Sheet
At December 31

Assets		*Liabilities*	
Current Assets		Notes Payable (long-term)	$30,000
Cash	$36,000	*Total Liabilities*	30,000
Total Current Assets	36,000		
Equipment	22,000	*Stockholders' Equity*	
Land	12,000	Common Stock	40,000
Total Assets	$70,000	*Total Liabilities & Stockholders' Equity*	$70,000

Req. 5

LDS's assets were financed primarily by stockholders' equity. The stockholders' equity financed $40,000 of the company's assets and liabilities financed $30,000.

E2-13

Transaction	***Brief Explanation***
(a)	Issued common stock for $17,000 cash.
(b)	Purchased a building for $50,000; paid $10,000 cash and gave a $40,000 note payable for the balance.
(c)	Used cash to purchase supplies costing $1,500.

E2-14

Req. 1

September 30, 2013

$$\text{Current Ratio} = \frac{\$1{,}180{,}200}{\$\ 270{,}700} = 4.36$$

December 31, 2012

$$\text{Current Ratio} = \frac{\$1{,}122{,}600}{\$\ 252{,}100} = 4.45$$

Req. 2

The company's current ratio decreased, which implies a decreased ability to pay current liabilities.

Req. 3

$$\text{Current Ratio} = \frac{\$1{,}180{,}200 - \$10{,}000}{\$270{,}700 - \$10{,}000} = 4.49$$

Paying down Accounts Payable in this case (when the current ratio is larger than one) increases the current ratio.

Req. 4

As of September 30, 2013, stockholders' equity has provided the primary source of financing for Columbia Sportswear, Inc. The company has financed $1,219,800 of its assets with stockholders' equity and only $314,500 with liabilities.

E2-15

Req. 1

	Assets		=	**Liabilities**		+	**Stockholders' Equity**	
1.	Cash	+12,000	=				Common Stock	+12,000
2.	Cash	+30,000	=	Note Payable (long-term)	+30,000			
3.	Equipment Cash	+40,000 - 35,000	=	Note Payable (short-term)	+5,000			
4.	Supplies	+900	=	Accounts Payable	+900			

Req. 2

1.	Cash (+A)	12,000	
	Common Stock (+SE)		12,000
2.	Cash (+A)	30,000	
	Note Payable (long-term) (+L)		30,000
3.	Equipment (+A)	40,000	
	Cash (-A)		35,000
	Note Payable (short-term) (+L)		5,000
4.	Supplies (+A)	900	
	Accounts Payable (+L)		900

E2-15 (continued)

Req. 2 (continued)

Cash (A)

Beg.	0		
(1)	12,000	35,000	(3)
(2)	30,000		
End.	7,000		

Supplies (A)

Beg.	0		
(4)	900		
End.	900		

Equipment (A)

Beg.	0		
(3)	40,000		
End.	40,000		

Accounts Payable (L)

		0	Beg.
		900	(4)
		900	End.

Notes Payable (short-term) (L)

		0	Beg.
		5,000	(3)
		5,000	End.

Notes Payable (long-term) (L)

		0	Beg.
		30,000	(2)
		30,000	End.

Common Stock (SE)

		0	Beg.
		12,000	(1)
		12,000	End.

E2-15 (continued)

Req. 3

BUSINESS SIM CORP.
Balance Sheet
At September 30

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$ 7,000	Accounts Payable	$ 900
Supplies	900	Note Payable	5,000
Total Current Assets	7,900	*Total Current Liabilities*	5,900
		Note Payable	30,000
		Total Liabilities	35,900
		Stockholders' Equity	
Equipment	40,000	Common Stock	12,000
		Retained Earnings	0
		Total Stockholders' Equity	12,000
Total Assets	$ 47,900	*Total Liabilities & Stockholders' Equity*	$ 47,900

Req. 4

At September 30, BSC reported $7,900 of current assets and $5,900 of current liabilities, resulting in a current ratio of 1.33 (7,900/5,900). Because this ratio is greater than 1.3, BSC is complying with the loan covenant. (This means that the bank will not be able to demand repayment or renegotiation of the $30,000 note payable until it matures in two years.)

ANSWERS TO COACHED PROBLEMS

CP2-1

Req. 1

Ag BioTech was organized as a corporation. Only a corporation issues shares of stock to its owners in exchange for their investment, as ABT did in transaction (a).

Req. 2

	Assets					=	**Liabilities**	+	**Stockholders' Equity**	
	Cash	**Supplies**	**Land**	**Building**	**Equipment**		**Note Payable**		**Common Stock**	**Retained Earnings**
(a)	+40,000					=			+40,000	
(b)	–13,000		+18,000	+65,000	+16,000	=	+86,000			
(c)	No effect									
(d)	–3,000	+3,000				=			No change	
(e)	+6,000		–6,000			=			No change	
	+30,000	+3,000	+12,000	+65,000	+16,000	=	+86,000		+40,000	

Req. 3

The transaction between the two stockholders (event *c*) was not included in the spreadsheet. Because event *(c)* occurs between the owners and others, the separate entity assumption implies this transaction does not affect the business.

CP2-1 (Continued)

Req. 4

(a) Total assets = \$30,000 + \$3,000 + \$12,000 + \$65,000 + \$16,000
= \$126,000

(b) Total liabilities = \$86,000

(c) Total stockholders' equity = Total assets – Total liabilities
= \$126,000 – \$86,000 = \$40,000

(d) Cash balance = \$40,000 – \$13,000 – \$3,000 + \$6,000 = \$30,000

(e) Total current assets = \$30,000 + \$3,000 = \$33,000

Req. 5

As of January 31, the financing for ABT's assets came primarily from liabilities. For ABT, the liabilities financed \$86,000 of its assets and stockholders' equity financed \$40,000.

CP2-2

Req. 1

	Assets					=	Liabilities		+ Stockholders' Equity	
	Cash	Supplies	Building	Equip	Land		Accounts Payable	Notes Payable	Common Stock	Retained Earnings
	16,000	5,000	200,000	18,000	90,000	=	4,000	17,000	308,000	0
a.	+200,000					=			+200,000	
b.	+30,000					=		+30,000		
c.	-41,000		+141,000			=		+100,000		
d.	-100,000			+100,000		=				
e.		+10,000					+10,000			
	105,000	15,000	341,000	118,000	90,000	=	14,000	147,000	508,000	0

CP2-2 (continued)

Req. 2

a.	Cash (+A)	200,000	
	Common Stock (+SE)		200,000
b.	Cash (+A)	30,000	
	Note Payable (long-term) (+L)		30,000
c.	Building (+A)	141,000	
	Cash (-A)		41,000
	Note Payable (long-term) (+L)		100,000
d.	Equipment (+A)	100,000	
	Cash (-A)		100,000
e.	Supplies (+A)	10,000	
	Accounts Payable (+L)		10,000

Req. 3

Cash (A)

Beg.	16,000		
(a)	200,000	41,000	(c)
(b)	30,000	100,000	(d)
End.	105,000		

Supplies (A)

Beg.	5,000	
(e)	10,000	
End.	15,000	

Equipment (A)

Beg.	18,000	
(d)	100,000	
End.	118,000	

Building (A)

Beg.	200,000	
(c)	141,000	
End.	341,000	

Land (A)

Beg.	90,000	
End.	90,000	

Accounts Payable (L)

	4,000	Beg.
	10,000	(e)
	14,000	End.

Notes Payable (long-term) (L)

	17,000	Beg.
	30,000	(b)
	100,000	(c)
	147,000	End.

Common Stock (SE)

	308,000	Beg.
	200,000	(a)
	508,000	End.

Retained Earnings (SE)

	0	Beg.
	0	End.

CP2-2 (continued)

Req. 4

ATHLETIC PERFORMANCE COMPANY
Trial Balance
At July 31

	Debits	Credits
Cash	$105,000	
Supplies	15,000	
Equipment	118,000	
Building	341,000	
Land	90,000	
Accounts Payable		$ 14,000
Notes Payable		147,000
Common Stock		508,000
Retained Earnings		0
TOTALS	$669,000	$669,000

Req. 5

ATHLETIC PERFORMANCE COMPANY
Balance Sheet
At July 31

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$105,000	Accounts Payable	$ 14,000
Supplies	15,000	*Total Current Liabilities*	14,000
Total Current Assets	120,000		
		Notes Payable	147,000
		Total Liabilities	161,000
Equipment	118,000	*Stockholders' Equity*	
Building	341,000	Common Stock	508,000
Land	90,000	Retained Earnings	0
		Total Stockholders' Equity	508,000
Total Assets	$669,000	*Total Liabilities & Stockholders' Equity*	$669,000

Req. 6

As of July 31, most of APC's financing has come from stockholders' equity. Stockholders' equity has financed $508,000 of APC's assets and liabilities financed $161,000.

CP2-3

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Equipment Cash	+21,000 -5,000		Note Payable (long-term)	+16,000			
b.	Cash	+20,000					Common Stock	+20,000
c.	Cash	+50,000		Note Payable (long-term)	+50,000			
d.	Supplies Cash	+4,000 -4,000						
e.	Buildings Cash	+41,000 -12,000		Note Payable (long)	+29,000			
f.	No effect (because the president has not yet started working for the company).							

Req. 2

a.	Equipment (+A)	21,000	
	Cash (-A)		5,000
	Note Payable (long-term) (+L)		16,000
b.	Cash (+A)	20,000	
	Common Stock (+SE)		20,000
c.	Cash (+A)	50,000	
	Note Payable (long-term) (+L)		50,000
d.	Supplies (+A)	4,000	
	Cash (-A)		4,000
e.	Buildings (+A)	41,000	
	Cash (-A)		12,000
	Note Payable (long-term) (+L)		29,000

f. No effect (because the president has not yet started working for the company).

CP2-3 (continued)

Req. 3

Cash (A)

Beg.	35,000		
(b)	20,000	5,000	(a)
(c)	50,000	4,000	(d)
		12,000	(e)
End.	84,000		

Accounts Receivable (A)

Beg.	5,000		
End.	5,000		

Inventory (A)

Beg.	40,000		
End.	40,000		

Supplies (A)

Beg.	5,000		
(d)	4,000		
End.	9,000		

Equipment (A)

Beg.	80,000		
(a)	21,000		
End.	101,000		

Buildings (A)

Beg.	120,000		
(e)	41,000		
End.	161,000		

Notes Receivable (A)

Beg.	2,000		
End.	2,000		

Land (A)

Beg.	30,000		
End.	30,000		

Accounts Payable (L)

		37,000	Beg.
		37,000	End.

Notes Payable (L)

		80,000	Beg.
		16,000	(a)
		50,000	(c)
		29,000	(e)
		175,000	End.

Common Stock (SE)

		150,000	Beg.
		20,000	(b)
		170,000	End.

Retained Earnings (SE)

		50,000	Beg.
		50,000	End

Req. 4

No effect was recorded for event *(f)*. The agreement in *(f)* has not yet involved an exchange or receipt of cash, goods, or services and thus is not a transaction.

CP2-3 (continued)

Req. 5

PERFORMANCE PLASTICS COMPANY
Balance Sheet
At December 31

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$ 84,000	Accounts Payable	$ 37,000
Accounts Receivable	5,000	*Total Current Liabilities*	37,000
Inventory	40,000		
Supplies	9,000	Notes Payable	175,000
Total Current Assets	138,000	*Total Liabilities*	212,000
Notes Receivable	2,000	*Stockholders' Equity*	
Equipment	101,000	Common Stock	170,000
Buildings	161,000	Retained Earnings	50,000
Land	30,000	*Total Stockholders' Equity*	220,000
Total Assets	$432,000	*Total Liabilities & Stockholders' Equity*	$432,000

Req. 6

As of December 31, more of PPC's financing has come from stockholders' equity. Stockholders' equity has financed $220,000 of PPC's assets and liabilities financed $212,000.

ANSWERS TO GROUP A PROBLEMS

PA2-1

Req. 1

	Assets			=	Liabilities	+	Stockholders' Equity	
	Cash	Equipment	Buildings		Notes Payable		Common Stock	Retained Earnings
(a)	+100,000			=			+100,000	
(b)	+120,000			=	+120,000			
(c)	–200,000		+200,000	=				
(d)	–3,000	+30,000		=	+27,000			
(e)		–3,000		=	–3,000			
(f)	–7,000	+10,000		=	+3,000			
(g)	No effect			=				
	+10,000	+37,000	+200,000	=	+147,000		+100,000	
Changes		+ $247,000			+ $147,000		+$100,000	

Req. 2

The transaction between the stockholder and his neighbor (event *g*) was not included in the spreadsheet. Because event *(g)* occurs between an owner and another person, the separate entity assumption implies this transaction does not affect the business.

Req. 3

(a) Beginning total assets $500,000 + Changes $247,000 = $747,000 Ending total assets

(b) Beginning total liabilities $200,000 + Changes $147,000 = $347,000 Ending total liabilities

(c) Ending total assets $747,000 – Ending total liabilities $347,000 = Ending stockholders' equity $400,000

Or, Beginning stockholders' equity $300,000 + Changes in stockholders' equity $100,000 = Ending stockholders' equity $400,000.

PA2-1 (continued)

Req. 4

As of the end of the year, MI's assets were financed by slightly more stockholders' equity than liabilities. MI's stockholders' equity financed $400,000 of the company's total assets and liabilities financed $347,000.

PA2-2

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Cash	+400,000					Common Stock	+400,000
b.	Cash	+100,000		Note Payable (long)	+100,000			
c.	Buildings Cash	+182,000 -82,000		Note Payable (long)	+100,000			
d.	Equipment Cash	+200,000 -200,000						
e.	Supplies	+30,000		Accounts Payable	+30,000			

Req. 2

a.	Cash (+A)	400,000	
	Common Stock (+SE)		400,000
b.	Cash (+A)	100,000	
	Note Payable (long-term) (+L)		100,000
c.	Buildings (+A)	182,000	
	Cash (-A)		82,000
	Note Payable (long-term) (+L)		100,000
d.	Equipment (+A)	200,000	
	Cash (-A)		200,000
e.	Supplies (+A)	30,000	
	Accounts Payable (+L)		30,000

PA2-2 (continued)

Req. 3

Cash (A)

Beg.	36,000		
(a)	400,000	82,000	(c)
(b)	100,000	200,000	(d)
End.	254,000		

Supplies (A)

Beg.	7,000		
(e)	30,000		
End.	37,000		

Equipment (A)

Beg.	118,000		
(d)	200,000		
End.	318,000		

Buildings (A)

Beg.	100,000		
(c)	182,000		
End.	282,000		

Land (A)

Beg.	200,000		
End.	200,000		

Accounts Payable (L)

		20,000	Beg.
		30,000	(e)
		50,000	End.

Note Payable (L)

		2,000	Beg.
		100,000	(b)
		100,000	(c)
		202,000	End.

Common Stock (SE)

		180,000	Beg.
		400,000	(a)
		580,000	End.

Retained Earnings (SE)

		259,000	Beg.
		259,000	End.

Req. 4

DELIBERATE SPEED CORPORATION
Trial Balance
At July 31

	Debits	Credits
Cash	$254,000	
Supplies	37,000	
Equipment	318,000	
Buildings	282,000	
Land	200,000	
Accounts Payable		$ 50,000
Notes Payable		202,000
Common Stock		580,000
Retained Earnings		259,000
TOTALS	$1,091,000	$1,091,000

PA2-2 (continued)

Req. 5

DELIBERATE SPEED CORPORATION
Balance Sheet
At July 31

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$ 254,000	Accounts Payable	$ 50,000
Supplies	37,000	*Total Current Liabilities*	50,000
Total Current Assets	291,000		
		Notes Payable	202,000
		Total Liabilities	252,000
Equipment	318,000	*Stockholders' Equity*	
Buildings	282,000	Common Stock	580,000
Land	200,000	Retained Earnings	259,000
		Total Stockholders' Equity	839,000
Total Assets	$ 1,091,000	*Total Liabilities & Stockholders' Equity*	$ 1,091,000

Req. 6

As of July 31, most of DSC's financing has come from stockholders' equity. Stockholders' equity has financed $839,000 of DSC's assets and liabilities financed $252,000.

PA2-3

Req. 1

	Assets		=	Liabilities		+	Stockholders’ Equity	
a.	Inventory Cash	+30 -30						
b.	Cash	+20					Common Stock	+20
c.	Equipment Cash	+170 -80		Note Payable (long-term)	+90			
d.	Cash	+10		Note Payable (short-term)	+10			
e.	*No effect.*							

Req. 2

a.	Inventory (+A)	30	
	Cash (-A)		30
b.	Cash (+A)	20	
	Common Stock (+SE)		20
c.	Equipment (+A)	170	
	Cash (-A)		80
	Note Payable (+L)		90
d.	Cash (+A)	10	
	Note Payable (short-term) (+L)		10
e.	No effect.		

PA2-3 (continued)

Req. 3

Cash (A)

Beg.	106		
(b)	20	30	(a)
(d)	10	80	(c)
End.	26		

Accounts Receivable (A)

Beg.	13		
End.	13		

Inventory (A)

Beg.	142		
(a)	30		
End.	172		

Short-term Investments (A)

Beg.	13		
End.	13		

Equipment (A)

Beg.	290		
(c)	170		
End.	460		

Software (A)

Beg.	50		
End.	50		

Prepaid Rent (A)

Beg.	23		
End.	23		

Accounts Payable (L)

		121	Beg.
		121	End.

Salaries and Wages Payable (L)

		23	Beg.
		23	End.

Notes Payable (short-term) (L)

		1	Beg.
		10	(d)
		11	End.

Notes Payable (long-term) (L)

		150	Beg.
		90	(c)
		240	End.

Common Stock (SE)

		21	Beg.
		20	(b)
		41	End.

Retained Earnings (SE)

		321	Beg.
		321	End.

Req. 4

The negotiations to purchase a sawmill were not included with the transactions. Since event (e) is just at the negotiation stage, it involves no exchange of cash, goods, or services and thus is not a transaction.

PA2-3 (continued)

Req. 5

ETHAN ALLEN INTERIORS, INC.
Balance Sheet
At December 31, 2013
(in millions of dollars)

Assets	
Current Assets	
Cash	$ 26
Short-term Investments	13
Accounts Receivable	13
Inventory	172
Prepaid Rent	23
Total Current Assets	247
Equipment	460
Software	50
Total Assets	$757
Liabilities	
Current Liabilities	
Accounts Payable	$ 121
Salaries and Wages Payable	23
Notes Payable (short-term)	11
Total Current Liabilities	155
Notes Payable (long-term)	240
Total Liabilities	395
Stockholders’ Equity	
Common Stock	41
Retained Earnings	321
Total Stockholders’ Equity	362
Total Liabilities and Stockholders’ Equity	$757

Req. 6

As of December 31, 2013, the financing for Ethan Allen’s investment in assets has come primarily from liabilities. Liabilities financed $395,000,000 of the company’s total assets and shareholders’ equity financed $362,000,000.

Req. 7

As of September 30, 2013, Ethan Allen had $297 of current assets ($106 + 13 + 13 + 142 + 23) and $145 of current liabilities ($121 + 1 + 23), yielding a current ratio of 2.05. Although considered a strong level of liquidity, Ethan Allen’s ratio is less than the 4.73 for LinkedIn, so LinkedIn was in a better position to pay liabilities as they come due in the next year.

ANSWERS TO GROUP B PROBLEMS

PB2-1

Req. 1

	Assets			=	Liabilities	+	Stockholders' Equity	
	Cash	**Equipment**	**Buildings**		**Notes Payable**		**Common Stock**	**Retained Earnings**
(a)	+109,000			=			+109,000	
(b)	+186,000			=	+186,000			
(c)	No effect			=				
(d)	–200,000		+200,000	=				
(e)	–12,000	+44,000		=	+32,000			
(f)	+4,000	–4,000		=				
	+87,000	+40,000	+200,000	=	+218,000		+109,000	
Changes		+ $327,000			+ $218,000		+$109,000	

Req. 2

The transaction between the stockholder and another investor (event *c*) was not included in the spreadsheet. Because event *(c)* occurs between an owner and another investor, the separate entity assumption implies this transaction does not affect the business.

Req. 3

(a) Beginning total assets $2,255,000 + Changes $327,000 = $2,582,000 Ending total assets

(b) Beginning total liabilities $1,780,000 + Changes $218,000 = $1,998,000 Ending total liabilities

(c) Ending total assets $2,582,000 – Ending total liabilities $1,998,000 = Ending stockholders' equity $584,000

Or, Beginning stockholders' equity $475,000 + Changes in stockholders' equity $109,000 = Ending stockholders' equity $584,000.

PB2-1 (continued)

Req. 4

As of December 31, Swish Watch Corporation's assets were financed primarily by liabilities. Swish Watch Corporation's liabilities financed $1,998,000 of the company's total assets and stockholders' equity financed $584,000.

PB2-2

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Cash	+600,000					Common Stock	+600,000
b.	Cash	+60,000		Note Payable (long-term)	+60,000			
c.	Buildings Cash	+166,000 -66,000		Note Payable (long-term)	+100,000			
d.	Equipment Cash	+90,000 -90,000						
e.	Supplies	+90,000		Accounts Payable	+90,000			

Req. 2

a.	Cash (+A)	600,000	
	Common Stock (+SE)		600,000
b.	Cash (+A)	60,000	
	Note Payable (long-term) (+L)		60,000
c.	Buildings (+A)	166,000	
	Cash (-A)		66,000
	Note Payable (long-term) (+L)		100,000
d.	Equipment (+A)	90,000	
	Cash (-A)		90,000
e.	Supplies (+A)	90,000	
	Accounts Payable (+L)		90,000

PB2-2 (continued)

Req. 3

Cash (A)

Beg.	90,000		
(a)	600,000	66,000	(c)
(b)	60,000	90,000	(d)
End.	594,000		

Supplies (A)

Beg.	9,000		
(e)	90,000		
End.	99,000		

Equipment (A)

Beg.	148,000		
(d)	90,000		
End.	238,000		

Buildings (A)

Beg.	500,000		
(c)	166,000		
End.	666,000		

Land (A)

Beg.	444,000		
End.	444,000		

Accounts Payable (L)

		50,000	Beg.
		90,000	(e)
		140,000	End.

Notes Payable (L)

		5,000	Beg.
		60,000	(b)
		100,000	(c)
		165,000	End.

Common Stock (SE)

		170,000	Beg.
		600,000	(a)
		770,000	End.

Retained Earnings (SE)

		966,000	Beg.
		966,000	End.

Req. 4

BEARINGS & BRAKES CORPORATION
Trial Balance
At July 31

	Debits	Credits
Cash	$594,000	
Supplies	99,000	
Equipment	238,000	
Buildings	666,000	
Land	444,000	
Accounts Payable		$ 140,000
Notes Payable		165,000
Common Stock		770,000
Retained Earnings		966,000
TOTALS	$2,041,000	$2,041,000

PB2-2 (continued)

Req. 5

BEARINGS & BRAKES CORPORATION
Balance Sheet
At July 31

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$ 594,000	Accounts Payable	$ 140,000
Supplies	99,000	*Total Current Liabilities*	140,000
Total Current Assets	693,000		
		Notes Payable	165,000
		Total Liabilities	305,000
Equipment	238,000	*Stockholders' Equity*	
Buildings	666,000	Common Stock	770,000
Land	444,000	Retained Earnings	966,000
		Total Stockholders' Equity	1,736,000
Total Assets	$ 2,041,000	*Total Liabilities & Stockholders' Equity*	$ 2,041,000

Req. 6

As of July 31, most of B&B's financing has come from stockholders' equity. Stockholders' equity has financed $1,736,000 of B&B's assets and liabilities financed $305,000.

PB2-3

Req. 1

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Intangible Assets Cash	+1,000 -1,000						
b.	Cash	+10,000					Common Stock	+10,000
c.	Equipment Cash	+13,500 -4,000		Note Payable	+9,500			
d.	Cash	-800		Salaries and Wages Payable	-800			
e.	*No effect.*							

Req. 2

a.	Intangible Assets (+A)	1,000	
	Cash (-A)..		1,000
b.	Cash (+A)	10,000	
	Common Stock (+SE)		10,000
c.	Equipment (+A)	13,500	
	Cash (-A)..		4,000
	Note Payable (+L)		9,500
d.	Salaries and Wages Payable (-L).......................................	800	
	Cash (-A)..		800
e.	No effect.		

PB2-3 (continued)

Req. 3

Cash (A)

Beg.	2,560		
(b)	10,000	1,000	(a)
		4,000	(c)
		800	(d)
End.	6,760		

Accounts Receivable (A)

Beg.	560		
End.	560		

Inventory (A)

Beg.	1,110		
End.	1,110		

Prepaid Rent (A)

Beg.	570		
End.	570		

Short-term Investments (A)

Beg.	660		
End.	660		

Equipment (A)

Beg.	3,220		
(c)	13,500		
End.	16,720		

Intangible Assets (A)

Beg.	2,850		
(a)	1,000		
End.	3,850		

Accounts Payable (L)

		4,110	Beg.
		4,110	End.

Salaries and Wages Payable (L)

		1,270	Beg.
(d)	800		
		470	End.

Notes Payable (long-term) (L)

		1,660	Beg.
		9,500	(c)
		11,160	End.

Common Stock (SE)

		350	Beg.
		10,000	(b)
		10,350	End.

Retained Earnings (SE)

		4,140	Beg.
		4140	End.

PB2-3 (continued)

Req. 4

The negotiations to purchase a coffee farm were not included in the transactions. Because event (e) involves only negotiations, it does not constitute an exchange of cash, goods, or services and thus is not a transaction.

Req. 5

STARBUCKS
Balance Sheet
At December 31, 2013
(in millions of dollars)

Assets	
Current Assets	
Cash	$ 6,760
Short-term Investments	660
Accounts Receivable	560
Inventory	1,110
Prepaid Rent	570
Total Current Assets	9,660
Property, Plant, and Equipment	16,720
Intangible Assets	3,850
Total Assets	$30,230
Liabilities	
Current Liabilities	
Accounts Payable	$ 4,110
Salaries and Wages Payable	470
Total Current Liabilities	4,580
Notes Payable (long-term)	11,160
Total Liabilities	15,740
Stockholders' Equity	
Common Stock	10,350
Retained Earnings	4,140
Total Stockholders' Equity	14,490
Total Liabilities and Stockholders' Equity	$ 30,230

Req. 6

As of December 31, 2013, financing for Starbucks' assets has come primarily from liabilities. Stockholders' equity financed $14,490,000,000 of the company's total assets and liabilities financed $15,740,000,000.

PB2-3 (continued)

Req. 7

Starbucks	Apple
Current Ratio = $\frac{\$5{,}460^{*}}{\$5{,}380^{**}}$ = 1.01	Current Ratio = $\frac{\$73{,}300}{\$43{,}700}$ = 1.68

* ($2,560 Cash + $560 AR + $1,110 Inventory + $570 Prepaid + $660 Invest = $5,460)
** ($4,110 AP + $1,270 Salaries & Wages Payable = $5,380)

Apple was in a better position to pay current liabilities because for every dollar of liabilities, Apple had $1.68 of current assets, whereas Starbucks had $1.01 of current assets for every dollar of current liabilities.

ANSWERS TO SKILLS DEVELOPMENT CASES

S2-1

1. D
2. B
3. B
4. A

S2-2

Req. 1

Lowe's:
Assets = Liabilities + Shareholders' Equity
$32,732,000,000 = $20,879,000,000 + $11,853,000,000

The Home Depot:
Assets = Liabilities + Shareholders' Equity
$40,518,000,000 = $27,996,000,000 + $12,522,000,000

The Home Depot is larger in terms of total assets of $40,518,000,000 compared to Lowe's total assets of $32,732,000,000.

Req. 2

Lowe's current liabilities of $8,876,000,000 are less than the $10,749,000,000 reported by The Home Depot.

The Home Depot:

$$\text{Current Ratio} = \frac{\$15,279}{\$10,749} = 1.42$$

Lowes:

$$\text{Current Ratio} = \frac{\$10,296}{\$8,876} = 1.16$$

The Home Depot has a larger current ratio, implying better ability to pay current liabilities as they come due.

Req. 3

The amount reported for inventory on the balance sheet represents the original cost of the products to Lowe's, not the expected selling price. The cost principle requires that transactions be recorded at their original cost to the company.

S2-2 (continued)

Req. 4

Financing for the Lowe's investment in assets has come more from liabilities than stockholders' equity. Lowe's liabilities have financed $20,879,000,000 of the total assets of the company and stockholders' equity has financed $11,853,000,000.

The more the company has in assets and the less it has in liabilities, the more likely the company will be able to pay all that it owes to creditors, making the company a less risky investment. To predict whether a company is likely to pay all that it owes to creditors and still have something left over to pay out to owners, creditors and investors consider the relative amounts of assets, liabilities, and shareholders' equity. To calculate the percentage of assets financed by creditors, simply divide total liabilities by total assets and multiply by 100.

Lowe's $$\frac{\text{Total liabilities}}{\text{Total assets}} \text{ x } 100 = \frac{20{,}879{,}000{,}000}{32{,}732{,}000{,}000} \text{ x } 100 = \quad 63.8\%$$

Home Depot $$\frac{\text{Total liabilities}}{\text{Total assets}} \text{ x } 100 = \frac{27{,}996{,}000{,}000}{40{,}518{,}000{,}000} \text{ x } 100 = \quad 69.1\%$$

This places Lowe's in a less risky financial position for investors because it has a smaller percentage of its assets financed by creditors (or liabilities).

S2-3

The solution to this team project will depend on the companies and/or accounting period selected for analysis.

S2-4

Req. 1

Assets = Liabilities + Stockholders' Equity
$15,000 = $15,000 + 0

Ponzi received $15,000 cash ($5,000 from each of the three lenders) in exchange for a promise to repay that money in 90 days. The 50% interest that Ponzi is paying is not a factor in the accounting equation yet because interest is not owed until time has passed. As of December 27, 1919, the interest is just a promise and so no transaction has occurred.

Req. 2

If two of the lenders are repaid their original loan plus the 50% interest there will be no cash left in the business to repay the third lender. It was possible for Ponzi to remain in "business" for 8 months because he continued to collect more money from new lenders, which was used to repay the other lenders.

Req. 3

With the exception of Ponzi and his first lenders (family and friends), almost everyone who provided funds to him was harmed financially. Beyond that, the credibility of all new businesses and their founders was called into question. Ultimately, schemes like Ponzi's led to the creation of accounting rules and stock regulation, but not until thousands of innocent people lost millions of dollars.

S2-5

Req. 1

The president is concerned with the amount of assets that are reported on the balance sheet because investors and creditors judge the riskiness of the company by comparing the amount of recorded assets to liabilities. The greater the amount of the company's assets for a given amount of liabilities, the less risky the company appears to investors and creditors.

Req. 2

The accounting concept that relates to reporting "Intellectual Abilities" as an asset is measurement and, specifically, the cost principle. In the case of "Intellectual Abilities," the company has not acquired this asset through an identifiable transaction (and there exists no known cost for this asset), so it cannot be reported on the balance sheet as an asset.

Req. 3

The accounting concept that relates to reporting the land is the cost principle, which requires that nonfinancial investments such as land be reported at cost even if an appraisal suggests it is worth more. In this case, if the op in land value is judged to be permanent, conservatism would require that the amount recorded for land be reduced to the lower amount.

Req. 4

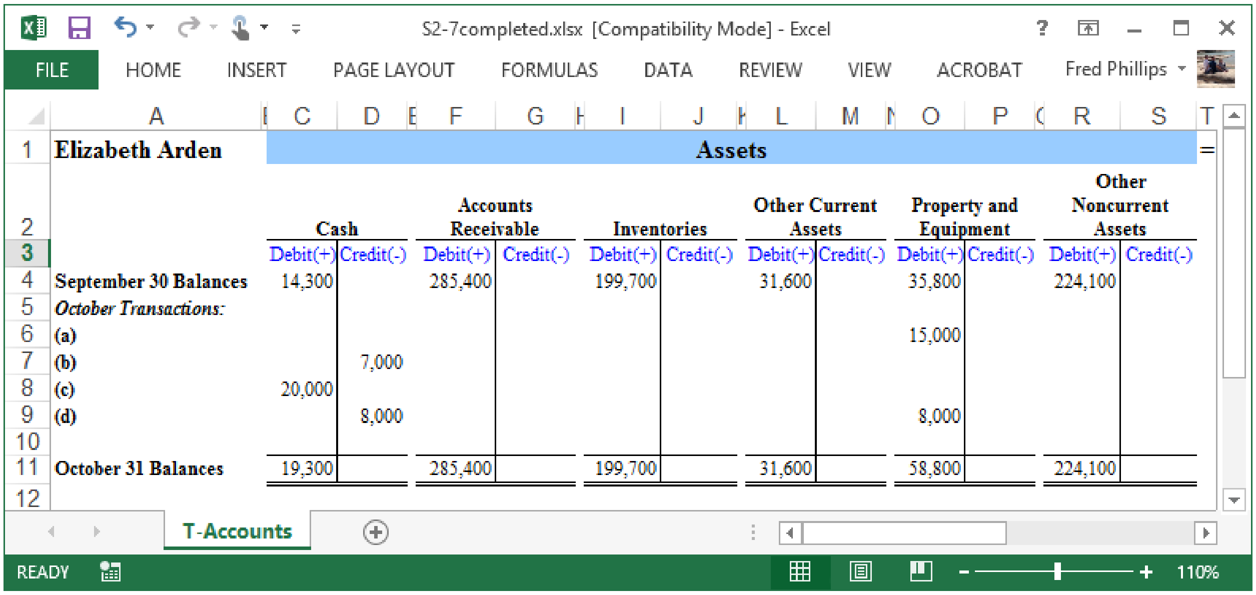
Parties that might be hurt by the president's suggestions include investors, lenders, and other creditors. The bank in particular could be hurt because its managers will consider the company's recorded assets as a benchmark for assessing the company's credit risk. Also, if you were to go along with the president's requests, you also could be personally hurt because you might be charged as an accomplice to fraudulent financial reporting.

You should not report the "Intellectual Abilities" on the balance sheet. Also, you should insist that the amount reported for land be reported at cost, following the cost principle.

S2-6

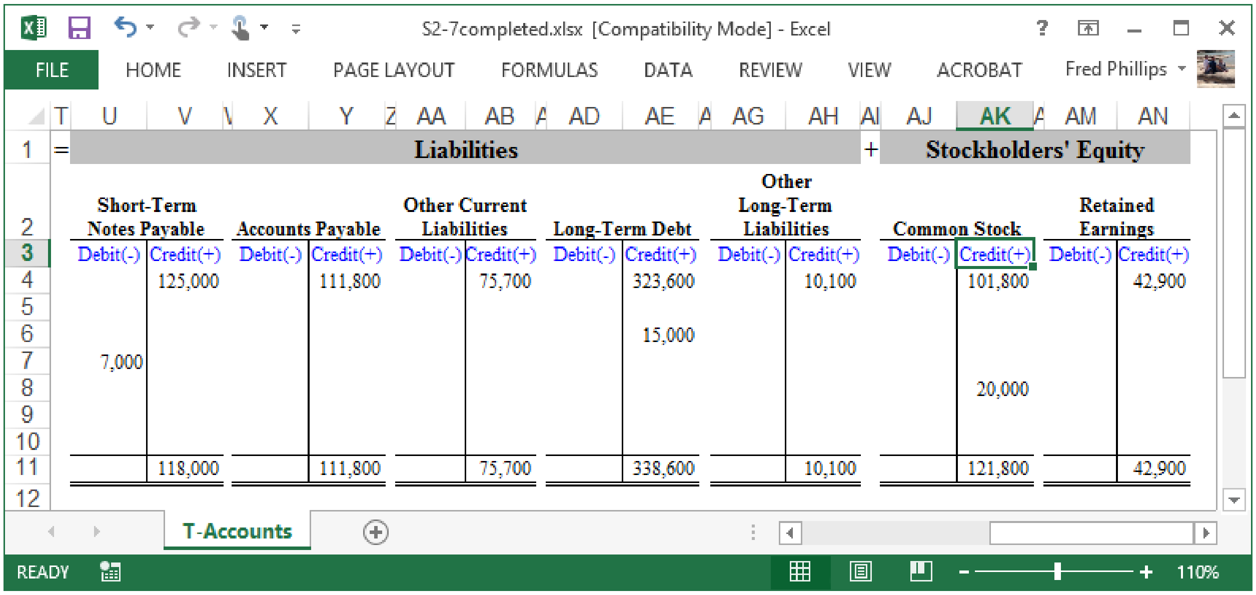
The major deficiency in this balance sheet is the inclusion of the owner's personal residence as a business asset. Under the separate entity assumption, each business must be accounted for as a separate organization, apart from its owners. The improper inclusion of this asset as part of Betsey Jordan's business overstates total assets by $300,000; total assets should be $105,000 rather than $405,000, and stockholder's equity should be only $5,000, rather than $305,000. Betsey Jordan's business is far riskier than suggested by this balance sheet.

S2-7



Elizabeth Arden — **Assets** =

	Cash		Accounts Receivable		Inventories		Other Current Assets		Property and Equipment		Other Noncurrent Assets	
	Debit(+)	Credit(-)	Debit(+)	Credit(-)	Debit(+)	Credit(-)	Debit(+)	Credit(-)	Debit(+)	Credit(-)	Debit(+)	Credit(-)
September 30 Balances	14,300		285,400		199,700		31,600		35,800		224,100	
October Transactions:												
(a)									15,000			
(b)		7,000										
(c)	20,000											
(d)		8,000							8,000			
October 31 Balances	19,300		285,400		199,700		31,600		58,800		224,100	



= **Liabilities** + **Stockholders' Equity**

	Short-Term Notes Payable		Accounts Payable		Other Current Liabilities		Long-Term Debt		Other Long-Term Liabilities		Common Stock		Retained Earnings	
3	Debit(-)	Credit(+)	Debit(-)	Credit(+)	Debit(-)	Credit(+)	Debit(-)	Credit(+)	Debit(-)	Credit(+)	Debit(-)	Credit(+)	Debit(-)	Credit(+)
4		125,000		111,800		75,700		323,600		10,100		101,800		42,900
5														
6								15,000						
7	7,000													
8												20,000		
9														
10														
11		118,000		111,800		75,700		338,600		10,100		121,800		42,900

ANSWERS TO CONTINUING CASE

CC2-1

Req. 1

a.	Cash (+A)	80,000	
	Common Stock (+SE)		80,000
b.	Land (+A)	9,000	
	Cash (-A)		2,000
	Note Payable (long-term) (+L)		7,000
c.	This is an exchange of only promises, so it is not a transaction.		
d.	Equipment (+A)	18,000	
	Cash (-A)		18,000
e.	Supplies (+A)	1,000	
	Accounts Payable (+L)		1,000
f.	Accounts Payable (-L)	350	
	Cash (-A)		350
g.	No transaction. Separate entity assumption.		

Cash (A)

Beg.	0	
(a)	80,000	2,000 (b)
		18,000 (d)
		350 (f)
End.	59,650	

Supplies (A)

Beg.	0	
(e)	1,000	
End.	1,000	

Equipment (A)

Beg.	0	
(d)	18,000	
End.	18,000	

Land (A)

Beg.	0	
(b)	9,000	
End.	9,000	

Accounts Payable (L)

		0 Beg.
(f)	350	1,000 (e)
		650 End.

Notes Payable (long-term) (L)

	0 Beg.
	7,000 (b)
	7,000 End.

Common Stock (SE)

	0 Beg.
	80,000 (a)
	80,000 End.

CC2-1 (Continued)

Req. 3

NICOLE'S GETAWAY SPA
Balance Sheet
At April 30

Assets	
Current Assets	
Cash	$ 59,650
Supplies	1,000
Total Current Assets	60,650
Equipment	18,000
Land	9,000
Total Assets	$ 87,650
Liabilities	
Current Liabilities	
Accounts Payable	$ 650
Total Current Liabilities	650
Notes Payable	7,000
Total Liabilities	7,650
Stockholders' Equity:	
Common Stock	80,000
Retained Earnings	0
Total Stockholders' Equity	80,000
Total Liabilities and Stockholders' Equity	$ 87,650

Req. 4

The current ratio indicates the proportion of current assets relative to current liabilities. As of April 30, NGS has 93.3 times more current assets than current liabilities ($60,650 ÷ $650 = 93.3). Clearly, NGS is presently able to pay its current liabilities with no difficulty. Nevertheless, this is likely to change in the future when some of the initial start-up cash is used to operate the company.