Solutions Manual for Fundamentals of Financial Accounting 6th Phillips

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

		Debit	Credit
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

			=			+	Stockholders' Equity
	Assets			**Liabilities**			
(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, 2016

(amounts in millions)

Assets		*Liabilities*	
Current Assets		*Current Liabilities*	
Cash	$ 6,000	Accounts Payable	$ 2,600
Short Term Investments	20,100	*Total Current Liabilities*	2,600
Accounts Receivable	3,100	Note Payable (long-term)	3,000
Prepaid Rent	1,100	*Total Liabilities*	5,600
Total Current Assets	30,300		
		Stockholders' Equity	
Software	21,500	Common Stock	15,700
Equipment	7,900	Retained Earnings	38,400
Total Non-Current Assets	29,400	Total Stockholders' Equity	54,100
Total Assets	$ 59,700	**Total Liabilities & Stockholders' Equity**	$ 59,700

Req. 2

As of September 30, 2016, stockholders' equity has provided the primary source of financing for Facebook, Inc. The company has financed $54,100 of its assets with stockholders' equity and only $5,600 with liabilities.

Req. 3

Facebook's current ratio ($30,300/$2,600 = 11.65) suggests the company has enough current assets that could be converted into cash to cover its current liabilities. Specifically, the current ratio of 11.65 implies that, at September 30, 2016, Facebook had $11.65 of current assets for each dollar of current liabilities.

M2-23

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

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

(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

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

E2-6

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).

E2-7

Req. 1

		Debit	Credit
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)

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

Equipment (A)

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

Note Payable (L)

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

Common Stock (SE)

Debit	Credit	
	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		- 10,000		Note Payable	+ 20,000			
	Equipment		+ 30,000		(short-term)				
(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:

		Debit	Credit
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.

		Debit	Credit
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, INC
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 (long-term)**		**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

		Debit	Credit
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, 2016

$$\text{Current Ratio} = \frac{\$1{,}328}{\$\ 333} = 3.99$$

December 31, 2015

$$\text{Current Ratio} = \frac{\$1{,}249}{\$\ 366} = 3.41$$

Req. 2

The company's current ratio increased, which implies an increased ability to pay current liabilities.

Req. 3

$$\text{Current Ratio} = \frac{\$1{,}328 - \$10}{\$333 - \$10} = 4.08$$

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, 2016, stockholders' equity has provided the primary source of financing for Columbia Sportswear, Inc. The company has financed $1,521 of its assets with stockholders' equity and only $401 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

		Debit	Credit
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 1.34 (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 (long-term)		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	0

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 (long-term)	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

		Debit	Credit
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-term)	+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 (long-term)		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-term)	+100,000			
c.	Buildings Cash	+182,000 -82,000		Note Payable (long-term)	+100,000			
d.	Equipment Cash	+200,000 -200,000						
e.	Supplies	+30,000		Accounts Payable	+30,000			

Req. 2

		Debit	Credit
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

As of September 30, 2016, Ethan Allen had $273 of current assets ($79 + 10 + 160 + 24) and $135 of current liabilities ($109 + 23 + 3), yielding a current ratio of 2.02. Although considered a strong level of liquidity, Ethan Allen's ratio is less than the 2.15 for TripAdvisor, so TripAdvisor was in a better position to pay liabilities as they come due in the next year.

Req. 2

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Inventory Cash	+30 -30						
b.	Cash	+20					Common Stock	+20
c.	Equipment Cash	+170 -60		Note Payable (long-term)	+110			
d.	Cash	+10		Note Payable (short-term)	+10			
e.	*No effect.*							

Req. 3

		Debit	Credit
a.	Inventory (+A)	30	
	Cash (-A)		30
b.	Cash (+A)	20	
	Common Stock (+SE)		20
c.	Equipment (+A)	170	
	Cash (-A)		60
	Note Payable (long-term) (+L)		110
d.	Cash (+A)	10	
	Note Payable (short-term) (+L)		10
e.	No effect.		

PA2-3 (continued)

Req. 4

Cash (A)

Beg.	79		
(b)	20	30	(a)
(d)	10	60	(c)
End.	19		

Accounts Receivable (A)

Beg.	10		
End.	10		

Inventory (A)

Beg.	160		
(a)	30		
End.	190		

Prepaid Rent (A)

Beg.	24		
End.	24		

Equipment (A)

Beg.	273		
(c)	170		
End.	443		

Software (A)

Beg.	45		
End.	45		

Accounts Payable (L)

		109	Beg.
		109	End.

Salaries and Wages Payable (L)

		23	Beg.
		23	End.

Notes Payable (short-term) (L)

		3	Beg.
		10	(d)
		13	End.

Notes Payable (long-term) (L)

		60	Beg.
		110	(c)
		170	End.

Common Stock (SE)

		376	Beg.
		20	(b)
		396	End.

Retained Earnings (SE)

		20	Beg.
		20	End.

Req. 5

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. 6

ETHAN ALLEN INTERIORS, INC.
Balance Sheet
At December 31, 2016
(in millions of dollars)

Assets	
Current Assets	
Cash	$ 19
Accounts Receivable	10
Inventory	190
Prepaid Rent	24
Total Current Assets	243
Equipment	443
Software	45
Total Assets	$731
Liabilities	
Current Liabilities	
Accounts Payable	$ 109
Salaries and Wages Payable	23
Notes Payable (short-term)	13
Total Current Liabilities	145
Notes Payable (long-term)	170
Total Liabilities	315
Stockholders' Equity	
Common Stock	396
Retained Earnings	20
Total Stockholders' Equity	416
Total Liabilities and Stockholders' Equity	$731

Req. 7

As reported in Requirement 6, Ethan Allen had $243 of current assets and $145 of current liabilities, yielding a current ratio of 1.68. Because a current ratio of 1.68 is less than the current ratio of 2.02 at September 30, it suggests the transactions decreased the company's ability to pay its current liabilities as they come due.

Req. 8

As of December 31, 2016, the financing for Ethan Allen's investment in assets has come primarily from stockholders' equity. Liabilities financed $315,000,000 of the company's total assets and shareholders' equity financed $416,000,000.

ANSWERS TO GROUP B PROBLEMS

PB2-1

Req. 1

	Assets			=	Liabilities	+	Stockholders' Equity	
	Cash	Equipment	Buildings		Notes Payable (long-term)		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

Starbucks	Apple
Current Ratio = $4,760* / $4,550** = 1.05	Current Ratio = $106,869 / $ 79,006 = 1.35

* ($2,130 Cash + $770 AR + $1,380 Inv. + $350 Ppd Rent + $130 S/T Invst = $4,760)
** ($4,150 AP + $400 Short term Note Payable = $4,550)

Apple was in a better position to pay current liabilities because for every dollar of liabilities, Apple had $1.35 of current assets, whereas Starbucks had $1.05 of current assets for every dollar of current liabilities

Req. 2

	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 (long-term)	+9,500			
d.	Cash	-800		Accounts Payable	-800			
e.	*No effect.*							

Req. 3

		Debit	Credit
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 (long-term) (+L)		9,500
d.	Accounts Payable (-L)	800	
	Cash (-A)		800
e.	No effect.		

PB2-3 (continued)

Req. 4

Cash (A)

Beg.	2,130	
(b)	10,000	1,000 (a)
		4,000 (c)
		800 (d)
End.	6,330	

Accounts Receivable (A)

Beg.	770	
End.	770	

Inventory (A)

Beg.	1,380	
End.	1,380	

Short-term Investments (A)

Beg.	130	
End.	130	

Prepaid Rent (A)

Beg.	350	
End.	350	

Equipment (A)

Beg.	4,530	
(c)	13,500	
End.	18,030	

Intangible Assets (A)

Beg.	5,040	
(a)	1,000	
End.	6,040	

Accounts Payable (L)

	4,150	Beg.
(d) 800		
	3,350	End.

Notes Payable (short-term) (L)

	400	Beg.
	400	End.

Notes Payable (long-term) (L)

	3,200	Beg.
	9,500	(c)
	12,700	End.

Common Stock (SE)

	630	Beg.
	10,000	(b)
	10,630	End.

Retained Earnings (SE)

	5,950	Beg.
	5,950	End.

PB2-3 (continued)

Req. 5

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. 6

STARBUCKS
Balance Sheet
At December 31, 2016
(in millions of dollars)

Assets	
Current Assets	
Cash	$ 6,330
Short-term Investments	130
Accounts Receivable	770
Inventory	1,380
Prepaid Rent	350
Total Current Assets	8,960
Property, Plant, and Equipment	18,030
Intangible Assets	6,040
Total Assets	$33,030
Liabilities	
Current Liabilities	
Accounts Payable	$ 3,350
Notes Payable (short-term)	400
Total Current Liabilities	3,750
Notes Payable (long-term)	12,700
Total Liabilities	16,450
Stockholders' Equity	
Common Stock	10,630
Retained Earnings	5,950
Total Stockholders' Equity	16,580
Total Liabilities and Stockholders' Equity	$ 33,030

Req. 7

With current assets of $8,960 and current liabilities of $3,750, Starbucks' current ratio after the transactions listed in *(a) – (e)* is 2.39. Prior to these transactions, Starbucks' current ratio was calculated at 1.05, so these transactions increased Starbucks' ability to pay current liabilities in the next year.

PB2-3 (continued)

Req. 8

As of December 31, 2016, financing for Starbucks' assets has come primarily from stockholders' equity. Stockholders' equity financed $16,580,000,000 of the company's total assets and liabilities financed $16,450,000,000.

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
$34,408,000,000 = $27,974,000,000 + $6,434,000,000

The Home Depot:
Assets = Liabilities + Shareholders' Equity
$42,966,000,000 = $38,633,000,000 + $4,333,000,000

The Home Depot is larger in terms of total assets of $42,966,000,000 compared to Lowe's total assets of $34,408,000,000.

Req. 2

Lowe's current liabilities of $11,974,000,000 are less than the $14,133,000,000 reported by The Home Depot.

The Home Depot:
Current Ratio = $\frac{\$17{,}724}{\$14{,}133} = 1.25$

Lowes:
Current Ratio = $\frac{\$12{,}000}{\$11{,}974} = 1.00$

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 $27,974,000,000 of the total assets of the company and stockholders' equity has financed $6,434,000,000.

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 $\frac{\text{Total liabilities}}{\text{Total assets}} \times 100 = \frac{27{,}974{,}000{,}000}{34{,}408{,}000{,}000} \times 100 =$ 81.3%

Home Depot $\frac{\text{Total liabilities}}{\text{Total assets}} \times 100 = \frac{38{,}633{,}000{,}000}{42{,}966{,}000{,}000} \times 100 =$ 89.9%

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.

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

S2-7completed.xlsx [Compatibility Mode] - Excel

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	

T-Accounts

S2-7completed.xlsx [Compatibility Mode] - Excel

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

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

T-Accounts

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.		

Req. 2

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.

CHAPTER 2
THE BALANCE SHEET

Student Learning Objectives and Related Assignment Materials

Student Learning Objectives	*Mini-Exercises*	*Exercises*	*Coached Problems*	*Problems (Groups A & B)*	*Skills Development Cases*	*Continuing Case*
LO 2-1 Identify financial effects of common business activities that affect the balance sheet.	4, 5, 6	1, 2, 3, 4*, 6, 9, 11, 13, 14			1, 2, 3, 4, 5, 6	1†
LO 2-2 Apply transaction analysis to accounting transactions.	3, 7, 8, 9	1, 2, 4*, 6, 8, 9, 10, 11, 12, 13, 15^	1, 2, 3	A1, A2, A3, B1, B2, B3	7	1†
LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet.	1, 2, 3, 5, 6, 10, 11, 14, 15*, 16, 17*, 18, 19*^, 20	1, 3, 5*, 7, 8, 10, 12, 13, 15^	2, 3	A2, A3, B2, B3		1†
LO 2-4 Prepare a trial balance and a classified balance sheet.	4, 5, 6, 12, 13*, 21, 22	3, 9, 10, 12, 15^	2, 3	A2, A3, B2, B3	1, 2, 3, 4, 6	1†
LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts.	3, 22, 23, 24^, 25^	1, 2, 6, 7, 8, 11, 14, 15^	1, 2, 3	A1, A2, A3, B1, B2, B3	1, 2, 3, 4, 5, 6	1†
LO 2-S1 Describe examples of common career paths in accounting.						

* Animated solution included in the PowerPoint Slides.

^ Particularly challenging; requires students to combine multiple concepts in order to advance to the next level of accounting knowledge.

† Continuing Case 2-1 builds on the story of Nicole's Getaway Spa, introduced in Chapter 1. This case focuses on analyzing transactions, preparing and recording journal entries, posting to T-accounts, preparing a classified balance sheet, and interpreting the current ratio. This case will be extended in future chapters.

Overview

The entrepreneur from Chapter 1 organizes his business as a corporation and completes business transactions to establish the business.

Students learn how to analyze and record business transactions that affect the balance sheet and then prepare and interpret a classified balance sheet.

Synopsis of Chapter Revisions

Focus Company: **Noodlecake Studios**

- New contemporary focus company: continuation of business case from Chapter 1
- New Spotlight on Business Decisions to highlight the value of accounting automation
- Updated analysis of current ratios in Exhibit 2.14 and Spotlight on Financial Reporting to focus on technology companies, including Apple, Expedia, Electronic Arts, Facebook, and TripAdvisor
- Reviewed and updated all end-of-chapter material, including financial data for Columbia Sportswear, Ethan Allen Interiors, Starbucks, and others

PowerPoint Slides

Student Learning Objective	***PowerPoint® Slides***
LO 2-1 Identify financial effects of common business activities that affect the balance sheet.	2-2 through 2-6
LO 2-2 Apply transaction analysis to accounting transactions.	2-7 through 2-19
LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet.	2-20 through 2-34
LO 2-4 Prepare a trial balance and a classified balance sheet.	2-35 through 2-37
LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts.	2-38 through 2-40
LO 2-S1 Describe examples of common career paths in accounting.	2-42 through 2-43

Animated Builds and Animated Solutions	***PowerPoint® Slides***
Mini-Exercise 2-13	2-45 through 2-46
Mini-Exercise 2-15	2-47 through 2-48
Mini-Exercise 2-17	2-49 through 2-50
Mini-Exercise 2-19	2-51 through 2-52
Exercise 2-4	2-53
Exercise 2-5	2-54 through 2-55

Chapter Summary

LO 2-1 Identify financial effects of common business activities that affect the balance sheet.

- Financing activities involve debt transactions with lenders (e.g., Notes Payable) or equity transactions with investors (e.g., Common Stock).
- Investing activities involve buying and selling long-term assets (e.g., Buildings, Equipment).
- Operating activities involve day-to-day transactions with suppliers, employees, and customers, and typically affect current assets and current liabilities.

<u>Chapter Summary</u>, continued

LO 2-2 Apply transaction analysis to accounting transactions.

- Transactions include external exchanges and internal events.
- Transaction analysis is based on the duality of effects and the basic accounting equation. *Duality of effects* means that every transaction affects at least two accounts.
- Transaction analysis follows a systematic approach of picturing the documented business activity; naming the exchanged asset, liability, and stockholders' equity accounts; and analyzing the financial effects on the basic accounting equation.

LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet.

- Debit means left and credit means right.
- Debits increase assets and decrease liabilities and stockholders' equity.
- Credits decrease assets and increase liabilities and stockholders' equity.
- Journal entries express, in debits-equal-credits form, the effects of a transaction on various asset, liability, and stockholders' equity accounts. Journal entries are used to record financial information in the accounting system, which is later summarized by accounts in the ledger (T-accounts).
- 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.

LO 2-4 Prepare a trial balance and a classified balance sheet.

- A trial balance checks on the equality of debit and credit balances.
- A *classified balance sheet* separately classifies assets as current if they will be used up or turned into cash within one year. Liabilities are classified as current if they will be paid, settled, or fulfilled within one year.

LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts.

- The current ratio divides current assets by current liabilities to determine the extent to which current assets are likely to be sufficient for paying current liabilities.
- Because accounting is transaction-based, the balance sheet does not necessarily represent the current value of a business. Some assets are not recorded because they do not arise from transactions.
- The amounts recorded for assets and liabilities may not represent current values because under the cost principle they generally are recorded at cost, using the exchange amounts established at the time of the initial transaction.

Accounting Decision Tools

Current Ratio = Current Assets ÷ Current Liabilities

- It tells you whether current assets are sufficient to pay current liabilities.
- A higher ratio means better ability to pay.

Chapter Outline	Teaching Notes
LO 2-1 Identify financial effects of common business activities that affect the balance sheet.	
I. Understand the Business	
A. Building a Balance Sheet from Business Activities	
1. **Asset**—Probable future economic benefits owned by the business as a result of past transactions.	
2. **Liabilities**—Probable debts or obligations of the entity that result from past transactions, which will be fulfilled by providing assets or services.	
3. **Stockholders' equity**—The financing provided by the owners and the operations of the business.	
4. Key activity for any start-up company is to obtain financing.	Illustrated in Exhibit 2.1
a. Equity financing—Financing a business through owners' contributions and reinvestments of profit.	
b. Debt financing—Financing a business through loans and other amounts that must be repaid.	
c. A business is obligated to repay debt financing, but it is not obligated to repay its equity financing.	
5. After obtaining initial financing, company will start investing in assets that will be used when business opens.	Illustrated in Exhibit 2.2
6. Features important for understanding how accounting works; a company always:	
a. Documents its activities.	
b. Receives something and gives something (basic feature of all business activities).	
c. Determines a dollar amount for each exchange based on value of items given and exchanged.	
i. Exchange is either to earn a profit immediately or obtain resources that will allow it to earn a profit later.	*Fundamental idea of business is to create value through exchange.*
ii. Any exchange that affects company's assets, liabilities, or stockholders' equity must be captured in and reported by the accounting system.	
iii. A dollar amount is determined for each exchange based on the value (cost) of items given and received.	
iv. Because the accounting system captures both what is received and what is given, it is often referred to as a "double-entry" system.	
v. **Cost principle**—Requires assets to be initially recorded at the historical cash-equivalent cost, which is the amount paid or payable on the date of the transaction.	

Chapter Outline	Teaching Notes
7. Accounting for business activities:	Illustrated in Exhibit 2.3
a. Picture the documented activity.	
b. Name what's exchanged—Building on the last step, assign names to what your business has received and given.	*Ultimate goal—capture financial effects so that they can be reported in financial statements for use by decision makers.*
c. Analyze the financial affects—Building on the last step, show how the costs cause elements of the accounting equation to increase and/or decrease.	
B. Transactions and Other Activities	
1. **Transaction**—An event or activity that has a direct economic effect on the assets, liabilities, or stockholders' equity of a business.	
2. Transactions include two types of events:	
a. External exchanges—Exchanges involving assets, liabilities, and/or stockholders' equity between the company and someone else.	
b. Internal events—Events that do not involve exchanges with others outside the business, but rather occur within the company itself.	
3. Exchange of only promises is not an accounting transaction.	
a. Documents are created to indicate these activities occurred.	
b. Later, when promises result in actually receiving or giving an asset or service, they become transactions captured by the accounting system.	

LO 2-2 Apply transaction analysis to accounting transactions.

Chapter Outline	Teaching Notes
II. The Accounting Cycle	
A. Step 1—Analyze Transactions	
1. A systematic accounting process is used to capture and report the financial effects of a company's activities.	
a. Process is called the accounting cycle; repeats itself over and over.	Illustrated by circular graphic in text
b. Steps include: analyze, record, summarize, prepare trial balance, and report financial statements.	
2. Transaction analysis involves determining whether a transaction exists and, if it does, analyzing its impact on the accounting equation.	*Analyze transactions from the standpoint of the business, not its owners.*
a. Duality of effects—Every transaction has at least two effects on the basic accounting equation.	
b. A = L + SE—The dollar amount for assets must always equal the total of liabilities plus stockholders' equity for every accounting transaction.	
c. As part of transaction analysis, a name (or account title) is given to each item exchanged.	

Chapter Outline	Teaching Notes
d. **Chart of accounts**—A summary of all account names (and corresponding account numbers) used to record financial results in the accounting system. i. Ensures account titles are used consistently. ii. Tailored to each company's business. iii. Many account titles are common across all companies; others may be used only by a particular company.	Illustrated in Exhibit 2.4 *Chart of accounts shown in Chapter 2 includes only balance sheet accounts.*
3. Illustrative Business Activities (a) Issue Stock to Owners—Jordan incorporates Noodlecake Studios, Inc., and the company issues common stock to Jordan and Ty as evidence of their total contribution of $10,000 cash, which is deposited in the company's bank account. • Name: Noodlecake has received $10,000 cash. Noodlecake issues $10,000 of common stock. • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) +10,000 = Common Stock (SE) +10,000	*Stress <u>that students should not skip this section</u> with the plan of coming back to it later; the next part of the chapter builds on this part.*
(b) Invest in Logo/Trademarks—Noodlecake pays $300 cash to create the company's logo. • Name: Noodlecake has received a logo costing $300. Noodlecake gave $300 cash. • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) −300 + Logo/Trademarks (A) +300 = 0	*This transaction did not affect liabilities or stockholders' equity; the decrease in one asset was offset by an increase in another asset.*
(c) Obtain Loan from Bank—Noodlecake borrows $20,000 from a bank, depositing those funds in its bank account and signing a formal agreement to repay the loan in two years. • Name: Noodlecake has received $20,000 cash. Noodlecake gave a note, payable to the bank for $20,000. • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) +20,000 = Note Payable (L) +20,000	*Notes payable are like accounts payable except they:* *(a) charge interest,* *(b) can be outstanding for periods either shorter or longer than one year, and* *(c) are documented using formal documents called notes.*
(d) Invest in Equipment—Noodlecake purchases and receives $9,600 in computers, printers, and desks, signing a purchase order to indicate its promise to pay $9,600 at the end of the month. • Name: Noodlecake has received $9,600 of equipment. Noodlecake gave a promise to pay $9,600 on account.	

Chapter Outline	Teaching Notes
• Analyze: Assets = Liabilities + Stockholders' Equity Equipment (A) +9,600 = Accounts Payable +9,600	
(e) Pay Supplier—Noodlecake pays $5,000 of its promise to the equipment supplier in (d). • Name: Noodlecake has received back its $5,000 promise to pay on account. Noodlecake gave $5,000 cash. • Analyze: Assets = Liabilities + Stockholders' Equity Cash –5,000 = Accounts Payable –5,000	*Stress that the company would typically wait until the end of the month to pay the amount owed to the supplier.*
(f) Order Software for App—Noodlecake signs a contract with a programmer for program code for the Tiny Warriors game app for $9,000. No code has been received yet. • Name: An exchange of only promises is not a transaction. This does not affect the accounting equation. • Analyze: Assets = Liabilities + Stockholders' Equity No change = No change	*Not all business activities are considered accounting transactions.*
(g) Receive Software—Noodlecake receives the $9,000 of app game code ordered in (f); pays $4,000 cash, and promises to pay the remaining $5,000 next month. • Name: Noodlecake has received software costing $9,000. Noodlecake gave $4,000 cash and a promise to pay $5,000 on account. • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) –4,000 + Software (A) +9,000 = Accounts Payable (L) +5,000	✓ Supplemental Enrichment Activity (Activity) #1 ✓ Activity #2
(h) Receive Supplies—Noodlecake receives supplies costing $600 on account. • Name: Noodlecake has received supplies costing $600. Noodlecake gave a promise to pay $600 on account. • Analyze: Assets = Liabilities + Stockholders' Equity Supplies (A) +600 = Accounts Payable (L) +600	

Chapter Outline	Teaching Notes
B. Steps 2 and 3: Record and Summarize	
1. One method for recording and summarizing the financial effects of accounting transactions is to prepare a spreadsheet.	Illustrated in Exhibit 2.5
a. By summing each spreadsheet column, the new balances can be computed at the end of the month and reported on a balance sheet.	
b. This method is impractical for most large organizations.	
2. Most companies use computerized accounting systems, which can handle a large number of transactions.	
a. These systems follow the accounting cycle, which is repeated month-after-month and year-after-year.	
b. Three-step analyze-record-summarize process is applied to daily transactions, as well as adjustments at the end of each month, before preparing a trial balance and financial statements; same three steps are part of the closing processes that occurs at the end of each year.	*Focus here is on applying the three-step process during the period to activities that affect only balance sheet accounts.*
3. Transactions are analyzed, and their financial effects are entered into journals each day they occur; later, these journal entries are summarized in ledger accounts that keep track of the financial effects on each account.	Illustrated in Exhibit 2.6
a. **Journal**—A record of each day's transactions.	
b. **Ledger**—A collection of records that summarizes, for each account, the effects of transactions entered in the journal.	

LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet.

C. The Debit/Credit Framework	✓ Activity #3
1. Think of the accounting equation (A = L + SE) as an old-fashioned scale that tips at the equals sign; assets are put on the left side of the scale and liabilities and stockholders' equity accounts are put on the right.	✓ Activity #4
2. Each individual account has two sides, with one side used for increases and the other for decreases.	
3. Accounts increase on the same side as they appear in A = L + SE (decreases are the opposite side):	
a. Assets increase on the left side of the account.	
b. Liabilities increase on the right side of the account.	
c. Stockholders' equity accounts increase on the right side of the account.	
4. Left is debit (*dr*); right is credit (*cr*).	
a. **Debit** (dr)—When used as a noun, debit is the left side of an account; when used as a verb, debit is the act of recording the debit portion of a journal entry to a particular account.	

Chapter Outline	Teaching Notes
b. **Credit** (cr)— When used as a noun, credit is the right side of an account; when used as a verb, credit is the act of recording the credit portion of a journal entry to a particular account.	
5. When combined with how increases and decreases are entered into accounts, the following rules emerge:	
a. Use debits for increases in assets (and for decreases in liabilities and stockholders' equity accounts).	Illustrated in Exhibit 2.7
b. Use credits for increases in liabilities and stockholders' equity accounts (and for decreases in assets).	
6. Normal balance for an account is the side on which it increases.	
a. Assets accounts normally have debit balances.	
b. Liabilities and stockholders' equity accounts normally have credit balances.	
7. In addition to requiring that A = L + SE, the double-entry system also requires that debits = credits.	
a. Step 1: Analyzing Transactions—The debit/credit framework does not change this step.	
b. Step 2: Recording Journal Entries—The financial effects of transactions are entered into a journal using a debits-equal-credits format.	
8. **Journal entries**—An accounting method for expressing the effects of a transaction in a debits-equal-credits format.	Illustrated in Exhibit 2.8
a. A date is included for each transaction.	
b. Debits appear first; credits are written below the debits and are indented to the right (words and amounts).	
c. Total debits must equal total credits.	
d. Dollar signs are not used.	
e. The reference column (Ref.) will be used later (in step 3) to indicate when the journal entry has been summarized in the ledger accounts.	
f. A brief explanation of the transaction is written below the debits and credits.	
g. The line after the description is left blank before showing the next journal entry.	
D. Step 3: Summarizing in Ledger Accounts:	
1. After journal entries have been recorded (in step 2), their dollar amounts are copied ("posted") to each ledger account affected by the transaction so that account balances can be computed.	Illustrated in Exhibit 2.9
2. The posting of journal entries to general ledger accounts is kept track of by writing the account number in the Ref. column of the journal and the journal page number in the Ref. column of the ledger.	✓ Activity #5

Chapter Outline

3. **T-account**—A simplified version of a ledger account used for summarizing transaction effects and determining balances for each account.
   a. Every account starts with a beginning balance, normally on the side where increases are summarized.
   b. Dollar signs are not needed in journal entries and T-accounts.
   c. Each amount is accompanied by a reference to the related journal entry, which makes it easy to trace back to the original transaction should errors occur.
   d. To find ending account balance, express the T-account as equations:
      Beginning balance plus the "+" side minus the "–" side equals the ending balance
   e. Ending balance is double underlined to distinguish it; it is shown on the side that has the greater total dollar amount.

E. Noodlecake's Accounting Records

(a) Issue Stock to Owners—Jordan incorporates Noodlecake Studios, Inc., and the company issues common stock to Jordan and Ty as evidence of their total contribution of $10,000 cash, which is deposited in the company's bank account.

1. Analyze: Assets = Liabilities + Stockholders' Equity
   Cash (A) +10,000 = Common Stock (SE) +10,000
2. Record:

	Debit	Credit
Cash (+A)	10,000	
Common Stock (+SE)		10,000

(b) Invest in Equipment—Noodlecake pays $300 cash to create the company's logo.

1. Analyze: Assets = Liabilities + Stockholders' Equity
   Cash (A) –300; Logo and Trademarks (A) +300 = 0
2. Record:

	Debit	Credit
Logo and Trademarks (+A)	300	
Cash (–A)		300

(c) Obtain Loan from Bank—Noodlecake borrows $20,000 from a bank and signs a formal agreement to repay the loan in two years.

1. Analyze: Assets = Liabilities + Stockholders' Equity
   Cash (A) +20,000 = Note Payable (long-term) (L) +20,000
2. Record:

	Debit	Credit
Cash (+A)	20,000	
Note Payable (long-term) (+L)		20,000

Teaching Notes

Illustrated in Exhibit 2.10

"Spotlight on Business Decisions" feature addresses the automation of mundane accounting tasks

Illustrated in Exhibit 2.11

Refer to illustrations of transactions (a) through (g) in textbook for Step 3—Summarize (which includes posting to T-accounts).

Chapter Outline	**Teaching Notes**

(d) Invest in Equipment—Noodlecake purchases and receives $9,600 in computers, printers, and desks, signing a purchase order to indicate its promise to pay $9,600 at the end of the month.

1. Analyze: Assets = Liabilities + Stockholders' Equity
   Equipment (A) +9,600 = Accounts Payable +9,600
2. Record:

	Debit	Credit
Equipment (+A)	9,600	
Accounts Payable (+L)		9,600

(e) Pay Supplier—Noodlecake pays $5,000 to the equipment supplier in (d).

1. Analyze: Assets = Liabilities + Stockholders' Equity
   Cash –5,000 = Accounts Payable –5,000
2. Record:

	Debit	Credit
Accounts Payable (–L)	5,000	
Cash (–A)		5,000

(f) Order Software—Noodlecake signs a contract for program code for a game app for $9,000. No code has been received yet.

1. Analyze: Assets = Liabilities + Stockholders' Equity
   No change = No change
2. Record—No journal entry is needed.

(g) Receive Software—Noodlecake receives the $9,000 of app game code ordered in (f); pays $4,000 cash, and promises to pay the remaining $5,000 next month.

1. Analyze: Assets = Liabilities + Stockholders' Equity
   Cash (A) –4,000 + Software (A) +9,000 = Accounts Payable (L) +5,000
2. Record:

	Debit	Credit
Software (+A)	9,000	
Cash (–A)		4,000
Accounts Payable (+L)		5,000

(h) Receive Supplies—Noodlecake receives supplies costing $600 on account.

1. Analyze:
   Assets = Liabilities + Stockholders' Equity
   Supplies (A) +600 = Accounts Payable (L) +600
2. Record:

	Debit	Credit
Supplies (+A)	600	
Accounts Payable (+L)		600

Chapter Outline	Teaching Notes
LO 2-4 Prepare a trial balance and a classified balance sheet.	
F. Preparing a Trial Balance and a Balance Sheet	✓ Activity #6
1. **Trial balance**—A list of all accounts with their balances to provide a check on the equality of the debits and credits; if the column totals are equal, a balance sheet can be prepared.	Illustrated in Exhibit 2.12
2. **Classified balance sheet**—A balance sheet that classifies assets and liabilities into current and other (long-term) categories.	Illustrated in Exhibit 2.13
a. Categories:	
i. **Current assets**—Assets that will be used up or turned into cash within 12 months or the next operating cycle, whichever is longer.	
ii. **Current liabilities**—Short-term obligations that will be paid in cash (or fulfilled with other current assets) within 12 months or the next operating cycle, whichever is longer.	
iii. **Noncurrent**—Long-term; assets and liabilities that do not meet the definition of current.	
b. Companies list assets in order of liquidity (how soon they will be used up or turned into cash) and liabilities in order of maturity (how soon they will be paid in cash or fulfilled by providing a service).	
LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts.	
III. Evaluate the Results	
A. Assessing the Ability to Pay	
1. The classified balance sheet format makes it easy to see whether current assets are sufficient to pay current liabilities.	The "Spotlight on Financial Reporting" feature explains how analysts reacted to Facebook's high current ratio and Expedia's low current ratio.
2. The only problem with this approach is that looking at total dollar amounts can be awkward, especially if we want to compare across several companies.	
3. Current Ratio	✓ Activity #7
a. Current assets divided by current liabilities.	
b. Used to evaluate the ability to pay liabilities as they come due in the short run.	
c. Generally speaking, a high ratio suggests good liquidity.	Illustrated in Exhibit 2.14
B. Balance Sheet Concepts and Values	
1. Some mistakenly believe the purpose of a balance sheet is to report what a business is actually worth.	
2. In fact, *net worth* is a term that many accountants and analysts use when referring to stockholders' equity.	

Chapter Outline	Teaching Notes
3. The answer comes from knowing that accounting is based on recording and reporting transactions:	
a. What is (and is not) recorded?	
i. Only measurable exchanges are recorded.	
ii. Items not acquired in an exchange are not listed on the balance sheet but they can still affect the value of a company.	
b. What amounts are assigned to recorded items?	
i. Following the cost principle, assets and liabilities are first recorded at cost, which is their cash equivalent value on the date of the transaction.	
• Later, if an asset's value increases, the increase is generally not recorded under GAAP unless it is a particular type of financial investment (as discussed in Appendix D).	
• If an asset's value falls, it is generally reported at that lower value.	
ii. Thus, the amount reported on the balance sheet may not be the asset's current value.	
C. Summary of the Accounting Cycle	Summarized in Exhibit 2.15
1. During the accounting period, transactions take place.	
a. Picture the documented activity.	
b. Name what's exchanged.	
c. Analyze the financial effects.	
d. Record a journal entry.	
e. Summarize in T-accounts.	
2. At the end of accounting period:	
a. Prepare a trial balance.	
b. Adjust the accounts.	*Covered in Chapter 4*
c. Prepare financial statements from the trial balance and distribute to users.	
d. Close the books	*Covered in Chapter 4*

LO 2-S1 Describe examples of common career paths in accounting.

IV. Accounting Careers	
A. Every business, government, and not-for-profit organization needs financial advice from an accountant.	
1. Accountants provide advice as an employee in a single organization (private accounting) or in a CPA firm (public accounting).	Overviewed in Exhibit 2A.1
2. Accountants may pursue a variety of certifications, including:	
i. CPA (Certified Public Accountant)	
ii. CFE (Certified Fraud Examiner)	
iii. CMA (Certified Management Accountant)	
iv. CIA (Certified Internal Auditor)	
v. CFM (Certified Financial Manager)	
vi. Cr. FA (Certified Forensic Accountant)	
vii. CFA (Chartered Financial Analyst)	

Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout 2–1

   Use this handout for an in-class activity designed to review the analysis of various business transactions that affect the balance sheet. The solution follows the handout master.

2. Handout 2–2

   This activity is a continuation of Activity #1. Use this handout for an in-class activity designed to continue the review of the analysis of various business transactions that affect the balance sheet. The solution follows the handout master.

3. Handout 2–3

   Use Handout 2-3 for an in-class activity designed to review the debit/credit framework. Note that these transactions are the same as those analyzed on Handout 2-1. However, it can be assigned even if Activity #1 was not assigned. The solution follows the handout master.

4. Handout 2–4

   This activity is a continuation of Activity #3. Use this handout for an in-class activity designed to review the debit/credit framework. Note that these transactions are the same as those analyzed on Handout 2–2. However, it can be assigned even if Activity #2 was not assigned. The solution follows the handout master.

5. Handout 2–5

   Use this handout for an in-class activity designed to review the posting of various balance sheet transactions to T-accounts. This activity is a continuation of Activity #3 and Activity #4; it should be assigned only if both of those activities were assigned. The solution follows the handout master.

6. Handout 2–6

   Use this handout for an in-class activity designed to review the preparation of a trial balance and a classified balance sheet. This activity is a continuation of Activity #5; it should be assigned only if that activity was assigned. The solution follows the handout master.

7. Use Handout 2–7

   Use this handout for an in-class activity designed to review the calculation and interpretation of the current ratio. This activity is a continuation of Activity #6; it should be assigned only if that activity was assigned. The solution follows the handout master.

HANDOUT 2–1

ANALYZING TRANSACTIONS

Analyze each of the following transactions by answering each of the questions. Use the spreadsheet on the following page to keep track of the amount in each account:

(a) Stockholder invests $10,000 into the business in exchange for common stock.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

HANDOUT 2–1, continued

(d) Purchases $300 of supplies on account.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(e) Signs contract for first website design for $10,000.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

Spreadsheet

	Assets					=	Liabilities			+	SE
Ref.	Cash	+	Supplies	+	Property, Plant & Equipment	=	Accounts Payable	+	Notes Payable (short-term)	+	Common Stock
(a)											
(b)											
(c)											
(d)											
(e)											

<u>HANDOUT 2–1 SOLUTION</u>, continued

ANALYZING TRANSACTIONS

Analyze each of the following transactions by answering each of the questions. Use the spreadsheet on the following page to keep track of the amount in each account:

(a) Stockholder invests $10,000 into the business in exchange for common stock.

1.	Does a transaction exist?	Yes—received cash and gave stock.
2.	Examine it for accounts affected.	Cash and Common Stock
3.	Classify each account affected.	Cash is an Asset (A) and Common Stock is Stockholders' Equity (SE)
4.	Identify direction and amount.	Cash (A) + $10,000 = Stockholders' Equity (SE) + $10,000.
5.	Ensure the equation still balances.	Yes—see below.

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

1.	Does a transaction exist?	Yes—received cash and gave a note payable.
2.	Examine it for accounts affected.	Cash and Notes Payable (short-term)
3.	Classify each account affected.	Cash is an Asset (A) and Notes Payable (short-term) is a Liability (L)
4.	Identify direction and amount.	Cash (A) + $15,000 = Notes Payable (short-term) + $15,000.
5.	Ensure the equation still balances.	Yes—see below.

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

1.	Does a transaction exist?	Yes—paid cash and received truck and equipment.
2.	Examine it for accounts affected.	Cash and Equipment
3.	Classify each account affected.	Cash is an Asset (A) and Equipment is an Asset (A)
4.	Identify direction and amount.	Cash (A) − $20,000 and Equipment (A) + 20,000
5.	Ensure the equation still balances.	Yes—see below.

HANDOUT 2–1 SOLUTION, continued

(d) Purchases $300 of supplies on account.

1.	Does a transaction exist?	Yes—received supplies and obligated to pay for them.
2.	Examine it for accounts affected.	Supplies and Accounts Payable
3.	Classify each account affected.	Supplies is an Asset (A) and Accounts Payable is a Liability (L)
4.	Identify direction and amount.	Supplies (A) + $300 and Accounts Payable (L) + $300.
5.	Ensure the equation still balances.	Yes—see below.

(e) Signs contract for first website design for $10,000.

1.	Does a transaction exist?	No—no exchange took place.
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

Spreadsheet

	Assets					=	Liabilities			+	Stockholders' Equity
Ref.	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Notes Payable (short-term)	+	Common Stock
(a)	+10,000					=					+10,000
(b)	+15,000					=			+15,000		
(c)	–20,000				+20,000	=					
(d)			+300			=	+300				
Total	5,000		300		20,000		300		15,000		10,000
	$25,300						$15,300				$10,000

HANDOUT 2–2

ANALYZING TRANSACTIONS

Analyze the following transactions as set forth below. Use the spreadsheet on the next page to keep track of the amount in each account:

(f) Pays $300 to the supplier in (d).

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(g) Purchases and pays for $600 of supplies.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(h) Purchases and pays for equipment costing $1,000.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(i) Orders a $900 lawn mower, to be delivered next month.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

<u>HANDOUT 2–2</u>, continued

Spreadsheet

	Assets					=	Liabilities			+	Stockholders' Equity
Ref.	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Notes Payable (short-term)	+	Common Stock
(a)	+10,000					=					+10,000
(b)	+15,000					=			+15,000		
(c)	–20,000				+20,000	=					
(d)			+300			=	+300				
(f)											
(g)											
(h)											
(i)											

HANDOUT 2–2 SOLUTION

ANALYZING TRANSACTIONS

Analyze the following transactions as set forth below. Use the spreadsheet on the next page to keep track of the amount in each account:

(f) Pays $300 to the supplier in (d).

1.	Does a transaction exist?	Yes—paid cash to reduce accounts payable.
2.	Examine it for accounts affected.	Cash and Accounts Payable
3.	Classify each account affected.	Cash is an Asset (A) and Accounts Payable is a Liability (L)
4.	Identify direction and amount.	Cash (A) – $300 = Liabilities (L) – $300
5.	Ensure the equation still balances.	Yes—see below.

(g) Purchases and pays for $600 of supplies.

1.	Does a transaction exist?	Yes—paid cash to purchase supplies.
2.	Examine it for accounts affected.	Cash and Supplies
3.	Classify each account affected.	Cash is an Asset (A) and Supplies is an Asset
4.	Identify direction and amount.	Cash (A) – $600 and Supplies (A) – $600.
5.	Ensure the equation still balances.	Yes—see below.

(h) Purchases and pays for equipment costing $1,000.

1.	Does a transaction exist?	Yes—paid cash to purchase equipment
2.	Examine it for accounts affected.	Cash and Equipment
3.	Classify each account affected.	Cash is an Asset (A) and Equipment is an Asset (A)
4.	Identify direction and amount.	Cash (A) – $1,000 and Equipment (A) – $1,000
5.	Ensure the equation still balances.	Yes—see below.

(i) Orders a $900 computer, to be delivered next month.

1.	Does a transaction exist?	No.
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

HANDOUT 2–2 SOLUTION, continued

Spreadsheet

	Assets					=	Liabilities			+	Stockholders' Equity
Ref.	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Notes Payable (short-term)	+	Common Stock
(a)	+10,000					=					+10,000
(b)	+15,000					=			+15,000		
(c)	–20,000				+20,000	=					
(d)			+300			=	+300				
(f)	–300						–300				
(g)	–600		+600								
(h)	–1,000				+1,000						
(i)											

HANDOUT 2–3

THE DEBIT/CREDIT FRAMEWORK

The following activities occurred during January Year 1. Prepare a journal entry to ensure that the basic accounting equation balances for each transaction.

(a) Stockholder invests $10,000 into the business in exchange for common stock.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity	

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

<u>HANDOUT 2–3</u>, continued

(d) Purchases $300 of supplies on account.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

(e) Signs contract for first website design for $10,000.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

HANDOUT 2–3 SOLUTION

THE DEBIT/CREDIT FRAMEWORK

The following activities occurred during January Year 1. Prepare a journal entry to ensure that the basic accounting equation balances for each transaction.

(a) Stockholder invests $10,000 into the business.

Debit and credit the accounts affected

(a)	Cash (+A)	10,000	
	Common Stock (+SE)		10,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Cash	+10,000					Common Stock	+10,000

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

Debit and credit the accounts affected

(b)	Cash (+A)	15,000	
	Note Payable (+L)		15,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Cash	+15,000		Note Payable	+15,000			

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

Debit and credit the accounts affected

(c)	Equipment (+A)	20,000	
	Cash (–A)		20,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Cash	–20,000						
Equipment	+20,000						

<u>HANDOUT 2–3 SOLUTION</u>, continued

(d) Purchases $300 of supplies on account.

Debit and credit the accounts affected

(d)	Supplies (+A)	300	
	Accounts Payable (+A)		300

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity
Supplies	+300		Accounts Payable	+300		

(e) Signs contract for first website design for $10,000.

No entry—this is not a transaction.

HANDOUT 2–4

THE DEBIT/CREDIT FRAMEWORK

(f) Pays $300 to the supplier in (d).

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

(g) Purchases and pays for $600 of supplies.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

(h) Purchases and pays for equipment costing $1,000.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

HANDOUT 2–4, continued

(i) Orders a $900 computer, to be delivered in 90 days.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets	=	Liabilities	+	Stockholders' Equity

HANDOUT 2–4 SOLUTION

THE DEBIT/CREDIT FRAMEWORK

(f) Pays $300 to the supplier in (d).

Debit and credit the accounts affected

(f)	Accounts Payable (–L)	300	
	Cash (–A)		300

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity
Cash	–300		Accounts Payable	–300		

(g) Purchases and pays for $600 of supplies.

Debit and credit the accounts affected

(g)	Supplies (+A)	600	
	Cash (–A)		600

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity
Supplies	+600				
Cash	–600				

(h) Purchases and pays for equipment costing $1,000.

Debit and credit the accounts affected

(h)	Equipment (+A)	1,000	
	Cash (–A)		1,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity
Equipment	+1,000				
Cash	–1,000				

(i) Orders a $900 computer, to be delivered in 90 days.
No entry—this is not a transaction.

HANDOUT 2–5

POSTING TO T-ACCOUNTS

Post the transactions from Handouts 2-3 and 2-4 to and then determine the ending balances of each of the following T-accounts.

Assets	Liabilities	Stockholders’ Equity
+ Cash –	− Accounts Payable +	− Common Stock +
+ Supplies –	− Notes Payable (short-term) +	− Retained Earnings +
+ Equipment –		

HANDOUT 2–5 SOLUTION

POSTING TO T-ACCOUNTS

Post the transactions from Handouts 2-3 and 2-4 to and then determine the ending balances of each of the following T-accounts.

Assets

+ Cash –

BegBal	0		
(a)	10,000		
(b)	15,000	20,000	(c)
		300	(f)
		600	(g)
		1,000	(h)
EndBal	3,100		

+ Supplies –

BegBal	0		
(d)	300		
(g)	600		
EndBal	900		

+ Equipment –

BegBal	0		
(c)	20,000		
(h)	1,000		
EndBal	21,000		

Liabilities

− Accounts Payable +

		0	BegBal
(f)	300	300	(d)
		0	EndBal

− Notes Payable (short-term) +

		0	BegBal
		15,000	(b)
		15,000	EndBal

Stockholders' Equity

− Common Stock +

		0	BegBal
		10,000	(a)
		10,000	EndBal

− Retained Earnings +

		0	BegBal
		0	EndBal

HANDOUT 2–6

PREPARING A TRIAL BALANCE AND A BALANCE SHEET

Use the ending balances from the T-accounts on Handout 2-5 to prepare a trial balance as of December 31, Year 1.

World Wide Webster
Trial Balance
At December 31, Year 1

	Debit	Credit
Cash		
Supplies		
Equipment		
Notes Payable (short-term)		
Common Stock		
Retained Earnings		
Totals		

Use the trial balance to prepare a classified balance sheet.

<u>**HANDOUT 2–6 SOLUTION**</u>

PREPARING A TRIAL BALANCE AND A BALANCE SHEET

Use the ending balances from the T-accounts on Handout 2-5 to prepare a trial balance as of December 31, Year 1.

World Wide Webster
Trial Balance
At December 31, Year 1

	Debit	Credit
Cash	$ 3,100	
Supplies	900	
Equipment	21,000	
Notes Payable (short-term)		$15,000
Common Stock		10,000
Retained Earnings		0
Totals	$25,000	$25,000

Use the trial balance to prepare a classified balance sheet.

World Wide Webster
Balance Sheet
At December 31, Year 1

Assets

Current Assets:	
Cash	$ 3,100
Supplies	900
Total Current Assets	4,000
Equipment	21,000
Total Assets	$25,000

Liabilities

Current Liabilities:	
Notes Payable (short-term)	$15,000
Total Current Liabilities	15,000

Stockholders' Equity

Common Stock	10,000
Retained Earnings	0
Total Stockholders' Equity	10,000
Total Liabilities and Stockholders' Equity	$25,000

HANDOUT 2–7

CURRENT RATIO

Refer to the classified balance sheet from Handout 2-6 and calculate the current ratio of World Wide Webster as of December 31, Year 1. Then, interpret the current ratio.

Calculation:

Interpretation:

HANDOUT 2–7 SOLUTION

CURRENT RATIO

Refer to the classified balance sheet from Handout 2-6 and calculate the current ratio of World Wide Webster as of December 31, Year 1. Then, interpret the current ratio.

Calculation:

Current ratio = Current assets ÷ Current liabilities

Current ratio = $4,000 ÷ $15,000 = 0.27

Interpretation:

A current ratio of 0.27 indicates that the company has $0.27 of current assets for $1.00 of current liabilities as of December 31, Year 1. It does not appear that the company's current assets are sufficient to pay its current liabilities.

Chapter 2

The Balance Sheet

PowerPoint Author:

Brandy Mackintosh, CPA, CA

Learning Objective 2-1

Identify financial effects of common business activities that affect the balance sheet.

Building a Balance Sheet

Assets

Economic resources presently controlled by the company that have measurable value and are expected to benefit the company by producing cash inflows or reducing cash outflows in the future.

=

Liabilities

Measurable amounts that the company owes to creditors.

+

Stockholders' Equity

Owners' claim to the business resources.

Financing and Investing Activities

Assets

=

Liabilities

+

Stockholders' Equity

Invest in Assets

↑

Debt Financing

&

Equity Financing

Financing and Investing Activities Continued

Key Features

1. A company always documents its activities.

2. A company always receives something and gives something.

3. A dollar amount is determined for each exchange.

Your Goals

Picture the documented activity.

Name what's exchanged.

Analyze the financial effects.

Transactions and Other Activities

External Exchanges

Exchanges involving assets, liabilities, and stockholders' equity that you can see between the company and someone else.

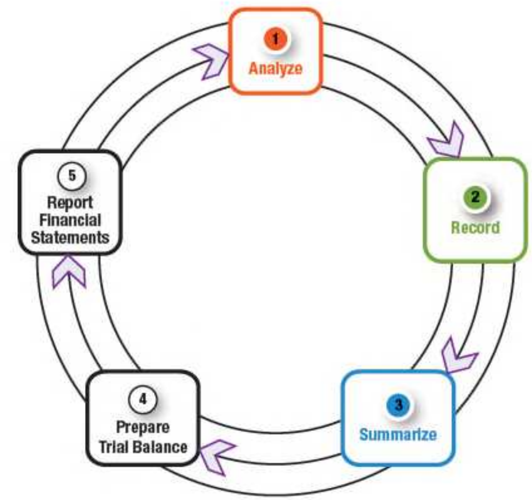
Internal Events

Events occurring within the company, for example, using some assets to create an inventory product.

Learning Objective 2-2

Apply transaction analysis to accounting transactions.

Study the Accounting Methods



A systematic accounting process is used to capture and report the financial effects of a company's transactions.

1 Analyze → 2 Record → 3 Summarize

A transaction is a business activity that affects the basic accounting equation.

Duality of Effects

Every transaction has at least two effects on the basic accounting equation.

A = L+ SE

Assets must equal liabilities plus stockholders' equity for every accounting transaction.

Step 1: Analyze Transactions

As part of transaction analysis, a name is given to each item exchanged. Accountants refer to these names as account titles.

The chart of accounts is tailored to each company's business, so although some account titles are common across all companies (Cash, Accounts Payable) others may be unique to a particular company.

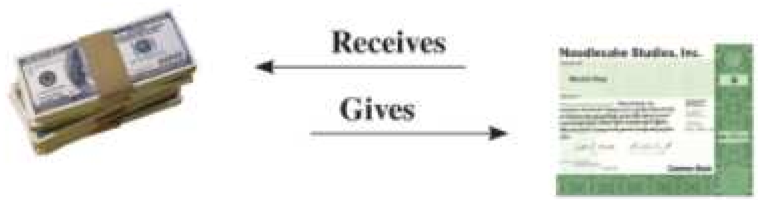
EXHIBIT 2.4 Noodlecake's (Partial) Chart of Accounts

Account Number	Account Name	Description
100	Cash	– Dollar amount of coins, paper money, funds in bank
140	Supplies	– Cost of paper, pens, business forms, etc.
173	Equipment	– Cost of computers, printers, desks, etc.
181	Logo and Trademarks	– Cost of purchased logo and trademarks
186	Software	– Cost of purchased software and technology
201	Accounts Payable	– Owed to suppliers for goods or services bought on credit
220	Notes Payable (long-term)	– Owed to lenders, as per terms of promissory note
301	Common Stock	– Stock issued for contributions made to the company
305	Retained Earnings	– Accumulated earnings (not yet distributed as dividends)

Step 1: Analyze Transactions (a)

(a) Issue Stock to Owners.

Jordan incorporates Noodlecake Studios Inc. on August 1. The company issues common stock to Jordan and Ty as evidence of their contribution of $10,000 cash, which is deposited in the company's bank account.



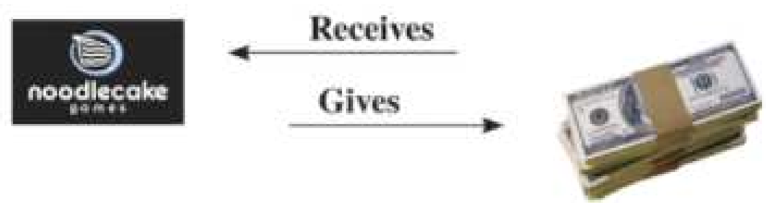
1. **Noodlecake receives $10,000 Cash.**
2. **Noodlecake gives $10,000 of Common Stock.**

Assets	=	Liabilities	+	Stockholders' Equity
(a) Cash +$10,000				Common Stock +$10,000

Step 1: Analyze Transactions (b)

(b) Invest in Logo/Trademark.

Noodlecake pays $300 cash to create the company's logo.



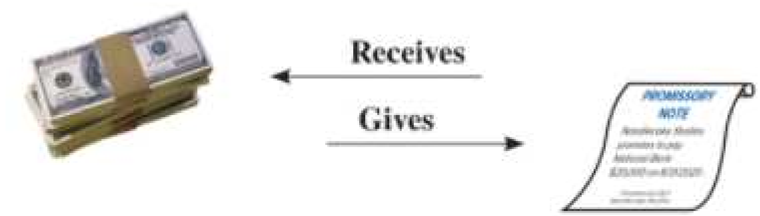
1. **Noodlecake receives a logo costing $300.**
2. **Noodlecake gives $300 Cash.**

Assets	=	Liabilities	+	Stockholders' Equity
(b) Logo/ Trademark +$300 Cash -$300				

Step 1: Analyze Transactions (c)

(c) Obtain Loan from Bank.

Noodlecake borrows $20,000 from a bank, depositing those funds in its bank account and signing a formal agreement to repay the loan in two years (on August 3, 2020).



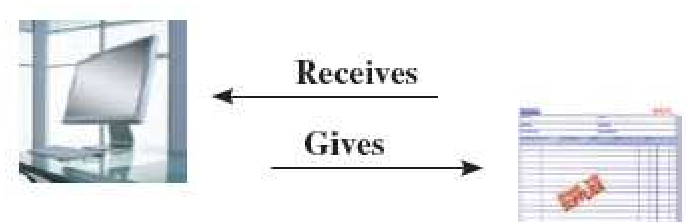
1. **Noodlecake receives $20,000 Cash.**
2. **Noodlecake gives a note, payable to the bank for $20,000.**

Assets	=	Liabilities	+	Stockholders' Equity
(c) Cash +$20,000		Note Payable +$20,000 (long-term)		

Step 1: Analyze Transactions (d)

(d) Invest in Equipment.

Noodlecake purchases and receives $9,600 in computers, printers, and desks, in exchange for its promise to pay $9,600 at the end of the month.



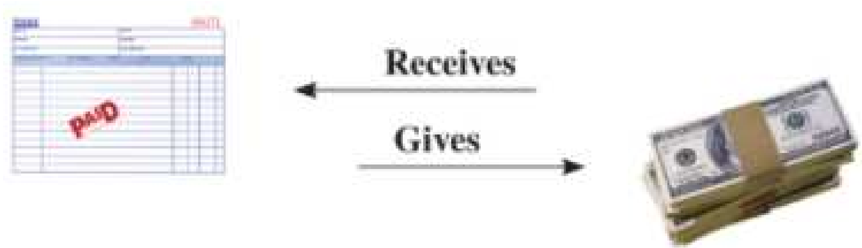
1. **Noodlecake receives $9,600 in equipment.**
2. **Noodlecake gives a promise to pay $9,600 on account.**

Assets	=	Liabilities	+	Stockholders' Equity
(d) Equipment +$9,600		Accounts Payable +$9,600		

Step 1: Analyze Transactions (e)

(e) Pay Supplier.

Noodlecake pays $5,000 to the equipment supplier in (d).



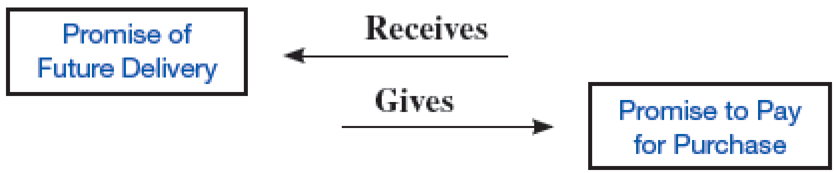
1. Noodlecake receives a release from $5,000 of its promise to pay on account.
2. Noodlecake gives $5,000 cash.

Assets	=	Liabilities	+	Stockholders' Equity
(e) Cash -$5,000		Accounts Payable -$5,000		

Step 1: Analyze Transactions (f)

(f) Order Software for App.

Noodlecake signs a contract with a programmer for program code for the Tiny Warriors game app for $9,000. No code has been received yet.



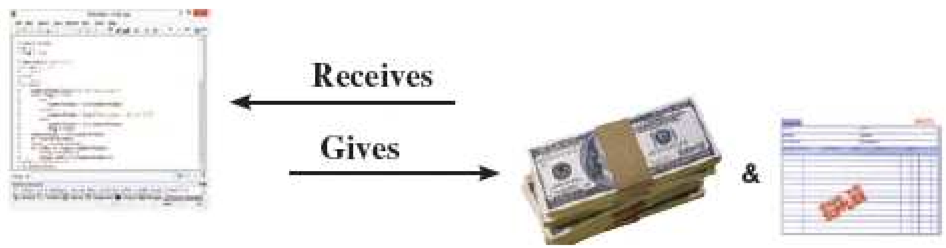
1. **An exchange of only promises is not a transaction.**
2. **There is no impact on the accounting equation.**

Assets	=	Liabilities	+	Stockholders' Equity
(f) No Change		No Change		No Change

Step 1: Analyze Transactions (g)

(g) Receive Software.

Noodlecake receives the $9,000 of app game code ordered in (f), pays $4,000 cash, and promises to pay the remaining $5,000 next month.



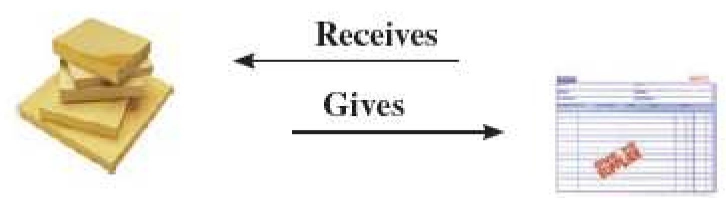
1. **Noodlecake receives software with a cost of $9,000.**
2. **Noodlecake gives Cash of $4,000 and gives a promise to pay $5,000 on account.**

Assets	=	Liabilities	+	Stockholders' Equity
(g) Cash -$4,000 Software +$9,000		Accounts Payable +$5,000		

Step 1: Analyze Transactions (h)

(h) Receive Supplies.

Noodlecake receives supplies costing $600 on account.



1. Noodlecake receives supplies with a cost of $600.
2. Noodlecake gives a promise to pay $600 on account.

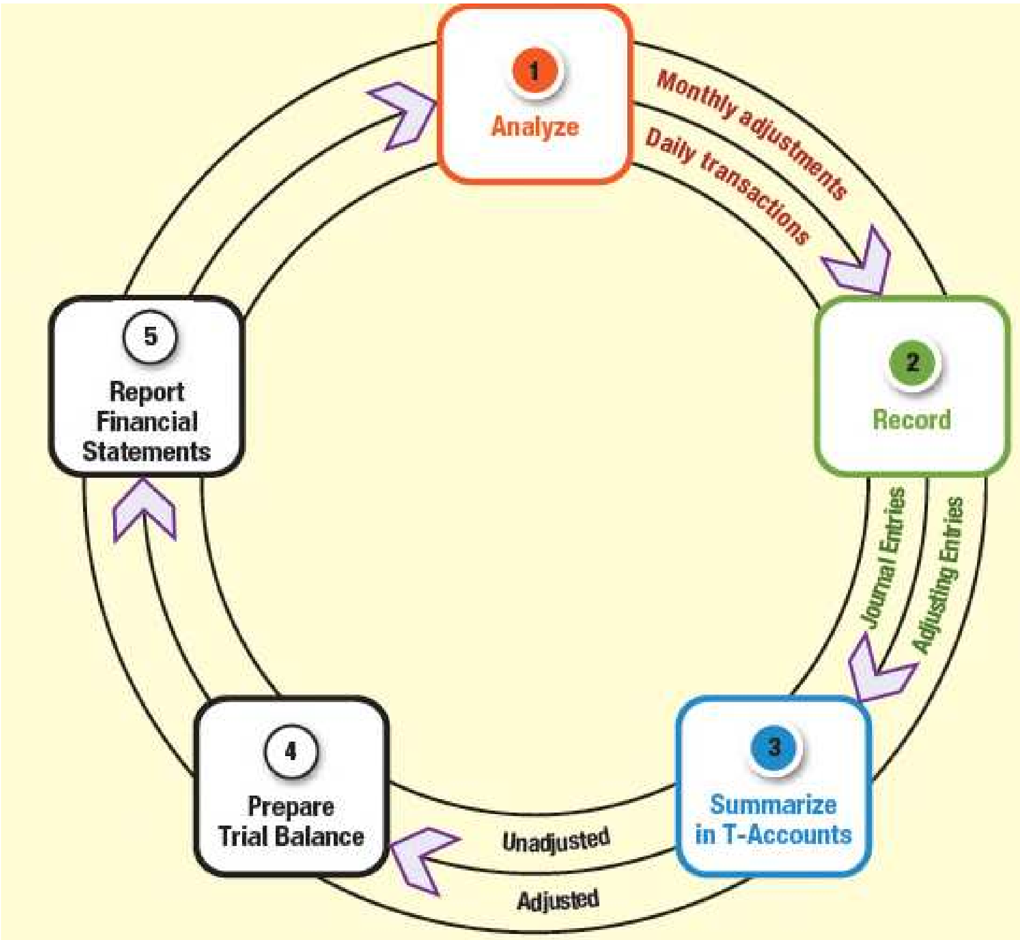
Assets	=	Liabilities	+	Stockholders' Equity
(g) Supplies +$600		Accounts Payable +$600		

Step 2 and 3: Record and Summarize

	Assets					=	Liabilities			Stockholders' Equity	
	Cash	Supplies	Equipment	Software	Logo/ Trademarks		Accounts Payable	Notes Payable	+	Common Stock	Retained Earnings
Beginning	0	0	0	0	0	=	0	0		0	0
(a)	+10,000					=				+10,000	
(b)	−300				+300	=					
(c)	+20,000					=		+20,000			
(d)			+9,600			=	+9,600				
(e)	−5,000					=	−5,000				
(f)			No change.			=		No change.			
(g)	−4,000			+9,000		=	+5,000				
(h)		+600				=	+600				
Ending	20,700	600	9,600	9,000	300	=	10,200	20,000	+	10,000	0

One way to record and summarize the financial effects of transactions would be to enter your understanding of their effects into a spreadsheet.

Step 2 and 3: Record and Summarize, continued

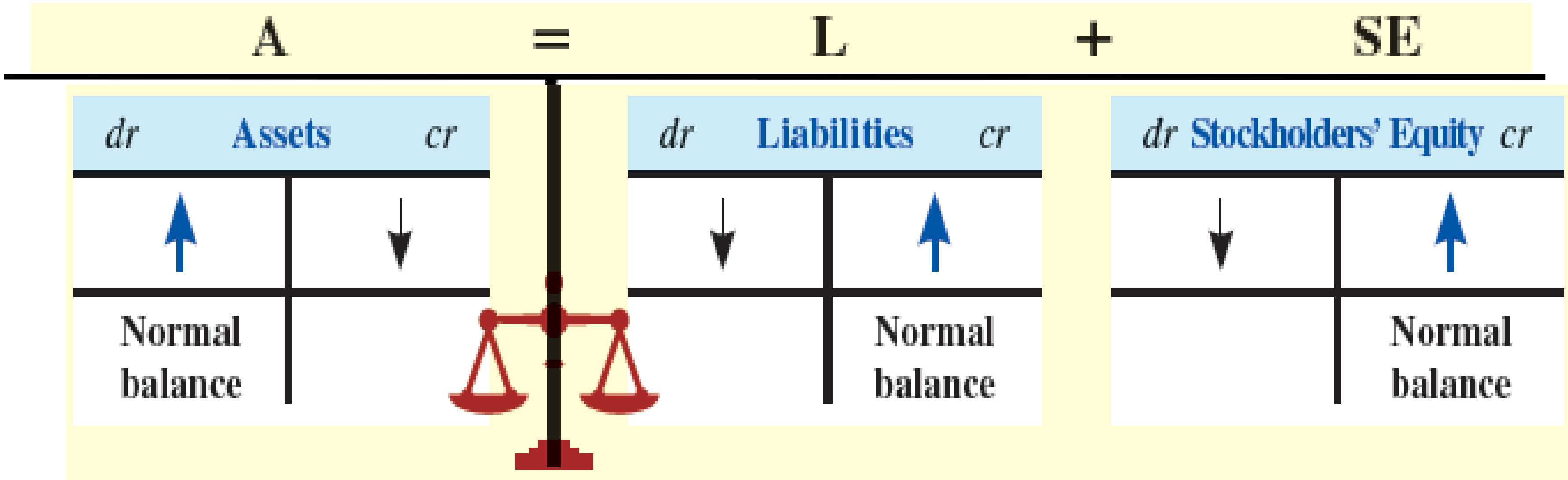


Most companies use computerized accounting systems, which can handle a large number of transactions. These systems follow a cycle, called the accounting cycle, which is repeated day-after-day, month-after-month, and year-after-year.

Learning Objective 2-3

Use journal entries and T-accounts to show how transactions affect the balance sheet.

The Debit/Credit Framework



Take special note of three important rules:

1. Accounts increase on the same side as they appear in A = L + SE.
2. Left is debit (dr), right is credit (cr).
3. The normal balance for an account is the side on which it increases.

Step 2: Recording Journal Entries

General Journal Page G1

	Date	Account Titles and Explanation	Ref.	Debit	Credit
(a)	Aug. 1	Cash		10,000	
		Common Stock			10,000
		(Financing from stockholders.)			
(b)	Aug. 2	Logo and Trademarks		300	
		Cash			300
		(Bought logo using cash.)			
(g)	Aug. 29	**Software**		**9,000**	
		Cash			**4,000**
		Accounts Payable			**5,000**
		(Bought app using cash and credit.)			

Step 2: Recording Journal Entries, continued

General Journal Page G1

Date	Account Titles and Explanation	Ref.	Debit	Credit
Aug. 1	Cash		10,000	
	Common Stock			10,000
	(Financing from stockholders.)			
Aug. 2	Logo and Trademarks		300	
	Cash			300
	(Bought logo using cash.)			
Aug. 29	**Software**		**9,000**	
	Cash			**4,000**
	Accounts Payable			**5,000**
	(Bought app using cash and credit.)			

		Debit	Credit
(g)	**Software** (+A)	9,000	
	Cash (−A)		4,000
	Accounts Payable (+L)		5,000

Step 3: Summarizing in Ledger Accounts

General Journal — Page G1

Date	Account Titles and Explanation	Ref.	Debit	Credit
Aug. 29	Software	186	9,000	
	Cash	100		4,000
	Accounts Payable	201		5,000
	(Bought app using cash and credit.)			

General Ledger — Software — Acct. 186

Date	Explanation	Ref.	Debit	Credit	Balance
Aug. 29		G1	9,000		9,000

General Ledger — Cash — Acct. 100

Date	Explanation	Ref.	Debit	Credit	Balance
Aug. 1		G1	10,000		10,000
Aug. 2		G1		300	9,700
Aug. 3		G1	20,000		29,700
Aug. 5		G1		5,000	24,700
Aug. 29		G1		4,000	20,700

General Ledger — Accounts Payable — Acct. 201

Date	Explanation	Ref.	Debit	Credit	Balance
Aug. 4		G1		9,600	9,600
Aug. 5		G1	5,000		4,600
Aug. 29		G1		5,000	9,600

Step 3: Summarizing in Ledger Accounts, continued

		Dewit	Credit
(g)	Software (+A)..	9,000	
	Cash (−A)..		4,000
	Accounts Payable (+L)......................		5,000

dr +	Software (A)		*cr* −
Beg. bal.	0		
(g)	9,000		
End. bal.	9,000		

dr +	Cash (A)		*cr* −
Beg. bal.	0	300	(b)
(a)	10,000	5,000	(e)
(c)	20,000	4,000	(g)
End. bal.	20,700		

dr −	Accounts Payable (L)		*cr* +
		0	Beg. bal.
(e)	5,000	9,600	(d)
		5,000	(g)
		9,600	End. bal.

Noodlecake's Accounting Records (a)

(a) Issue Stock to Owners.

Jordan incorporates Noodlecake Studios Inc. on August 1. The company issues common stock to Jordan and Ty as evidence of their contribution of $10,000 cash, which is deposited in the company's bank account.

1 Analyze

Assets	=	Liabilities	+	Stockholders' Equity
(a) Cash +$10,000				Common Stock +$10,000

2 Record

(a)	Cash (+A)	10,000	
	Common Stock (+SE)		10,000

3 Summarize

dr +	Cash (A)	cr -
Beg. Bal.	0	
(a)	10,000	

dr -	Common Stock (SE)	cr +
	0	Beg. Bal.
	10,000	(a)

Noodlecake’s Accounting Records (b)

(b) Invest in Logo and Trademarks.

Noodlecake pays $300 cash to create the company’s logo.

1 Analyze

	Assets	=	Liabilities	+	Stockholders’ Equity
(b)	Logo/trademarks +$300 Cash -$300				

2 Record

		Debit	Credit
(b)	Logo and Trademarks (+A)	300	
	Cash (-A)		300

3 Summarize

dr +	Cash (A)	cr -	
Beg. Bal.	0		
(a)	10,000	300	(b)

dr +	Logo and Trademarks (A)	cr -
Beg. Bal.	0	
(b)	300	

Noodlecake's Accounting Records (c)

(c) Obtain Loan from Bank.

Noodlecake borrows $20,000 from a bank, depositing those funds in its bank account and signing a formal agreement to repay the loan in two years (on August 3, 2020).

1 Analyze

Assets	=	Liabilities	+	Stockholders' Equity
(c) Cash +$20,000		Note Payable (long-term) +$20,000		

2 Record

(c)	Cash (+A)	20,000	
	Note Payable (long-term) (+L)		20,000

3 Summarize

dr +	Cash (A)		cr -
Beg. Bal.	0		
(a)	10,000	300	(b)
(c)	20,000		

dr -	Note Payable (long-term) (L)		cr +
		0	Beg. Bal.
		20,000	(c)

Noodlecake's Accounting Records (d)

(d) Invest in Equipment.

Noodlecake purchases and receives $9,600 in computers, printers, and desks, in exchange for its promise to pay $9,600 at the end of the month.

1 Analyze

Assets	=	Liabilities	+	Stockholders' Equity
(d) Equipment +$9,600		Accounts Payable +$9,600		

2 Record

(d) Equipment (+A)	9,600	
Accounts Payable (+L)		9,600

3 Summarize

dr +	Equipment (A)	cr -
Beg. Bal.	0	
(d)	9,600	

dr -	Accounts Payable (L)	cr +
	0	Beg. Bal.
	9,600	(d)

Noodlecake's Accounting Records (e)

(e) Pay Supplier.

Noodlecake pays $5,000 to the equipment supplier in (d).

1 Analyze

Assets	=	Liabilities	+	Stockholders' Equity
(e) Cash -$5,000		Accounts Payable -$5,000		

2 Record

		Debit	Credit
(e)	Accounts Payable (-L)	5,000	
	Cash (-A)		5,000

3 Summarize

dr +	Cash (A)		cr -
Beg. Bal.	0		
(a)	10,000	300	(b)
(c)	20,000	5,000	(e)

dr -	Accounts Payable (L)		cr +
		0	Beg. Bal.
(e)	5,000	9,600	(d)

Noodlecake's Accounting Records (f)

(f) Order Software.

Noodlecake signs a contract for program code for a game app for $9,000. No code has been received yet.

1 **Analyze**

Assets	=	Liabilities	+	Stockholders' Equity
(f) No Change		No Change		No Change

2 **Record**

Because this event involves the exchange of only promises, it is not considered a transaction. No journal entry is needed.

Noodlecake's Accounting Records (g)

(g) Receive Software.

Noodlecake receives the $9,000 of app game code ordered in (f), pays $4,000 cash, and promises to pay the remaining $5,000 next month.

1 Analyze

Assets	=	Liabilities	+	Stockholders' Equity
(g) Cash -$4,000 Software +$9,000		Accounts Payable +$5,000		

2 Record

(g)	Software (+A)	9,000	
	Cash (-A)		4,000
	Accounts Payable (+L)		5,000

3 Summarize

dr +	Cash (A)		cr -
Beg. Bal.	0		
(a)	10,000	300	(b)
(c)	20,000	5,000	(e)
		4,000	(g)

dr +	Software (A)		cr -
Beg. Bal.	0		
(g)	9,000		

dr -	Accounts Payable (L)		cr +
		0	Beg. Bal.
(e)	5,000	9,600	(d)
		5,000	(g)

Noodlecake's Accounting Records (h)

(h) Receive Supplies.

Noodlecake receives supplies costing $600 on account.

1 Analyze

Assets	=	Liabilities	+	Stockholders' Equity
(h) Supplies +$600		Accounts Payable +$600		

2 Record

(h)	Supplies (+A)	600	
	Accounts Payable (+L)		600

3 Summarize

dr +	Supplies (A)	cr -
Beg. Bal.	0	
(h)	600	

dr -		Accounts Payable (L)	cr +
		0	Beg. Bal.
(e)	5,000	9,600	(d)
		5,000	(g)
		600	(h)

T-Accounts for Noodlecake

Journal Entries	Debit	Credit
(a) Cash (+A)	10,000	
Common Stock (+SE)		10,000
(b) Logo (+A)	300	
Cash (−A)		300
(c) Cash (+A)	20,000	
Note Payable (+L)		20,000
(d) Equipment (+A)	9,600	
Accounts Payable (+L)		9,600
(e) Accounts Payable (−L)	5,000	
Cash (−A)		5,000
(f) Not a transaction so no journal entry.		
(g) Software (+A)	9,000	
Cash (−A)		4,000
Accounts Payable (+L)		5,000
(h) Supplies (+A)	600	
Accounts Payable (+L)		600

ASSETS = LIABILITIES + STOCKHOLDERS' EQUITY

ASSETS

Cash (A)			
Beg. bal.	0		
(a)	10,000	300	(b)
(c)	20,000	5,000	(e)
		4,000	(g)
End. bal.	20,700		

Software (A)			
Beg. bal.	0		
(g)	9,000		
End. bal.	9,000		

Supplies (A)			
Beg. bal.	0		
(h)	600		
End. bal.	600		

Logo/trademarks (A)			
Beg. bal.	0		
(b)	300		
End. bal.	300		

Equipment (A)			
Beg. bal.	0		
(d)	9,600		
End. bal.	9,600		

LIABILITIES

Accounts Payable (L)			
		0	Beg. bal.
(e)	5,000	9,600	(d)
		5,000	(g)
		600	(h)
		10,200	End. bal.

Note Payable (L)			
		0	Beg. bal.
		20,000	(c)
		20,000	End. bal.

STOCKHOLDERS' EQUITY

Common Stock (SE)			
		0	Beg. bal.
		10,000	(a)
		10,000	End. bal.

Learning Objective 2-4

Prepare a trial balance and a classified balance sheet.

Preparing a Trial Balance

NOODLECAKE STUDIOS, INC.
Trial Balance
At August 31, 2018

	Debit	Credit
Cash	20,700	
Supplies	600	
Equipment	9,600	
Software	9,000	
Logo and Trademarks	300	
Accounts Payable		10,200
Notes Payable		20,000
Common Stock		10,000
Totals	40,200	40,200

It's a good idea to check that the accounting records are in balance by determining whether debits = credits. We do this by preparing a trial balance.

Preparing a Classified Balance Sheet

NOODLECAKE STUDIOS, INC.
Balance Sheet
At August 31, 2018

Assets	
Current Assets	
Cash	$20,700
Supplies	600
Total Current Assets	21,300
Equipment	9,600
Software	9,000
Logo and Trademarks	300
Total Assets	$40,200
Liabilities and Stockholders' Equity	
Current Liabilities	
Accounts Payable	$10,200
Total Current Liabilities	10,200
Notes Payable	20,000
Total Liabilities	30,200
Stockholders' Equity	
Common Stock	10,000
Retained Earnings	0
Total Stockholders' Equity	10,000
Total Liabilities and Stockholders' Equity	$40,200

Current assets will be used up or turned into cash within the next 12 months of the balance sheet date.

Current liabilities are debts and other obligations that will be paid or fulfilled within 12 months of the balance sheet date.

Learning Objective 2-5

Interpret the balance sheet using the current ratio and an understanding of related concepts.

Assessing the Ability to Pay

NOODLECAKE STUDIOS, INC.
Balance Sheet
At August 31, 2018

Assets		
Current Assets		
Cash		$20,700
Supplies		600
Total Current Assets		21,300
Equipment		9,600
Software		9,000
Logo and Trademarks		300
Total Assets		$40,200
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable		$10,200
Total Current Liabilities		10,200
Notes Payable		20,000
Total Liabilities		30,200
Stockholders' Equity		
Common Stock		10,000
Retained Earnings		0
Total Stockholders' Equity		10,000
Total Liabilities and Stockholders' Equity		$40,200

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

$$= \frac{\$\ 21{,}300}{\$\ 10{,}200}$$

$$= 2.09$$

A higher current ratio generally means a better ability to pay.

Balance Sheet Concepts and Values

NOODLECAKE STUDIOS, INC.
Balance Sheet
At August 31, 2018

Assets	
Current Assets	
Cash	$20,700
Supplies	600
Total Current Assets	21,300
Equipment	9,600
Software	9,000
Logo and Trademarks	300
Total Assets	$40,200
Liabilities and Stockholders' Equity	
Current Liabilities	
Accounts Payable	$10,200
Total Current Liabilities	10,200
Notes Payable	20,000
Total Liabilities	30,200
Stockholders' Equity	
Common Stock	10,000
Retained Earnings	0
Total Stockholders' Equity	10,000
Total Liabilities and Stockholders' Equity	$40,200

What is (and is not) recorded?

- **Includes measurable items acquired through exchange.**
- **Excludes other items (such as creativity and vision).**

What amounts are assigned?

- **Initially recorded at cost.**
- **Decreases in asset value are recorded, but generally increases are not.**

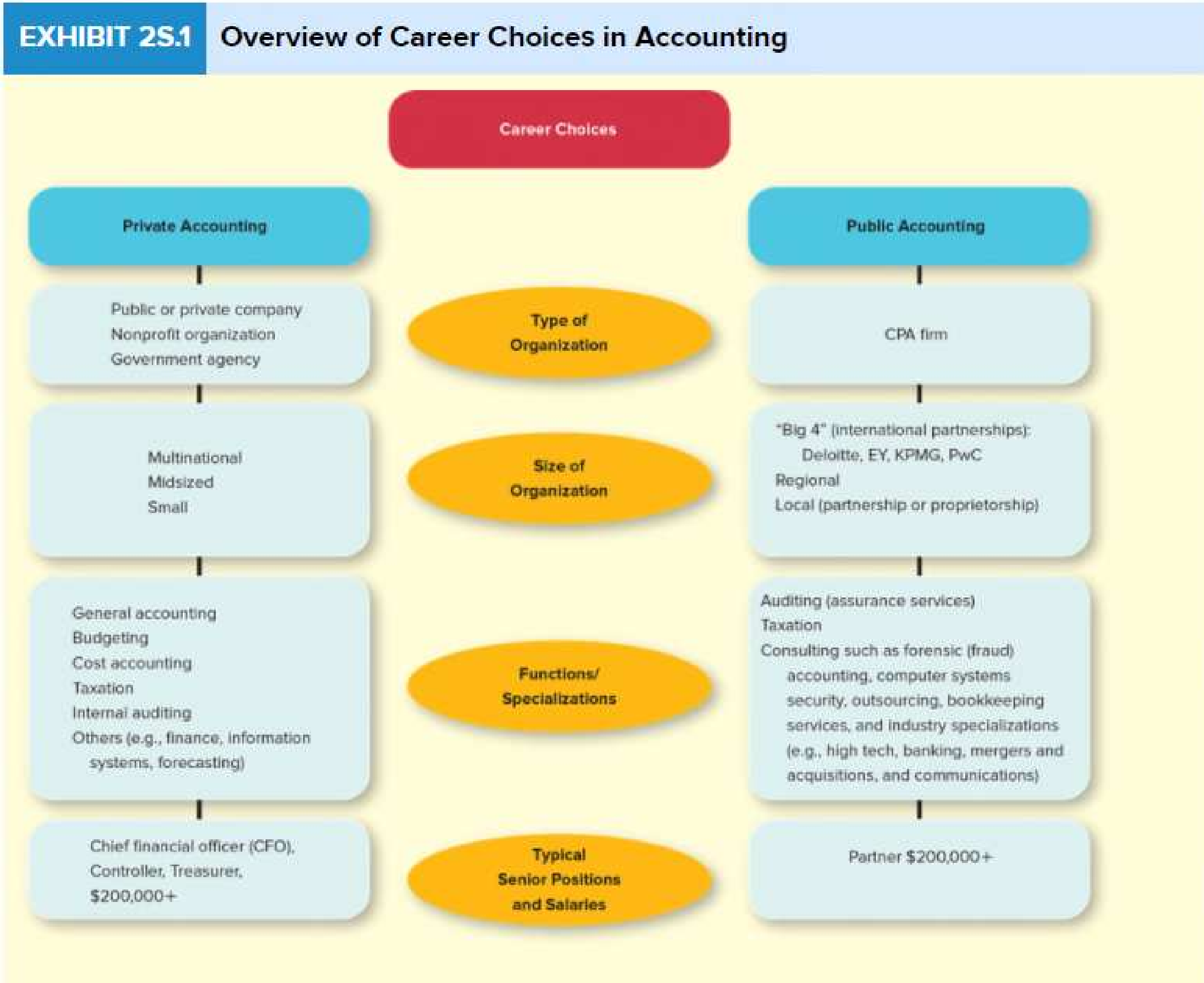
Chapter 2 Supplement A

Accounting Careers

Learning Objective 2-S1

Describe examples of common career paths in accounting.

Career Choices in Accounting



Chapter 2
Solved Exercises

M2-13, M2-15, M2-17, M2-19, E2-4, E2-6

M2-13 Identifying Transactions and Preparing Journal Entries

J.K. Builders was incorporated on July 1. Prepare journal entries for the following events from the first month of business. If the event is not a transaction, write "no transaction."

a. Received $70,000 cash invested by owners and issued common stock.
b. Bought an unused field from a local farmer by paying $60,000 cash. As a construction site for smaller projects, it is estimated to be worth $65,000 to J.K. Builders.
c. A lumber supplier delivered lumber supplies to J.K. Builders for future use. The lumber supplies would have normally sold for $10,000, but the supplier gave J.K. Builders a 10% discount. J.K. Builders has not yet received the $9,000 bill from the supplier.

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

$10,000 × 10% = $1,000; $10,000 - $1,000 = $9,000

M2-13 Identifying Transactions and Preparing Journal Entries Continued

d. Borrowed $25,000 from the bank with a plan to use the funds to build a small workshop in August. The loan must be repaid in two years.
e. One of the owners sold $10,000 worth of his common stock to another shareholder for $11,000.

d. Cash (+A)	25,000	
Notes Payable (long-term) (+L)		25,000

e. No transaction

Event (e) is a transaction between two independent individuals and does not involve the company, J.K. Builders.

M2-15 Identifying Transactions and Preparing Journal Entries

At the beginning of August, Joel Henry founded Bookmart.com, which sells new and used books online. He is passionate about books but does not have a lot of accounting experience. Help Joel by preparing journal entries for the following events. If the event is not a transaction, write "no transaction."

a. The company purchased equipment for $4,000 cash. The equipment is expected to be used for ten or more years.
b. Joel's business bought $7,000 worth of inventory from a publisher. The company will pay the publisher within 45-60 days.

		Debit	Credit
a.	Equipment (+A)	4,000	
	Cash (-A)		4,000
b.	Inventory (+A)	7,000	
	Accounts Payable (+L)		7,000

M2-15 Identifying Transactions and Preparing Journal Entries Continued

c. Joel's friend Sam lent $4,000 to the business. Sam had Joel write a note promising that Bookmart.com would repay the $4,000 in four months. Because they are good friends, Sam is not going to charge Joel interest.
d. The company paid $1,500 cash for books purchased on account earlier in the month.
e. Bookmart.com repaid the $4,000 loan established in *c*.

		Debit	Credit
c.	Cash (+A)	4,000	
	Notes Payable (short-term) (+L)		4,000
d.	Accounts Payable (-L)	1,500	
	Cash (-A)		1,500
e.	Notes Payable (short-term) (-L)	4,000	
	Cash (-A)		4,000

M2-17 Identifying Transactions and Preparing Journal Entries

Sweet Shop Co. is a chain of candy stores that has been in operation for the past 10 years. Prepare journal entries for the following events, which occurred at the end of the most recent year. If the event is not a transaction, write "no transaction."

a. Ordered and received $12,000 worth of cotton candy machines from Candy Makers Inc., which Sweet Shop Co. will pay for in 45 days.
b. Sent a check for $6,000 to Candy Makers, Inc. for partial payment of the cotton candy machines from (*a*).
c. Received $400 from customers who bought candy on account in previous months.

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

M2-17 Identifying Transactions and Preparing Journal Entries, continued

d. To help raise funds for store upgrades estimated to cost $20,000, Sweet Shop Co. issued 1,000 common shares for $15 each to existing stockholders.
e. Sweet Shop Co. bought ice cream trucks for $60,000 total, paying $10,000 cash and signing a long-term note for $50,000.

		Debit	Credit
d.	Cash (+A)	15,000	
	Common Stock (+SE)		15,000

1,000 common shares × $15 each = $15,000

		Debit	Credit
e.	Equipment (+A)	60,000	
	Cash (-A)		10,000
	Notes Payable (long-term) (+L)		50,000

M2-19 Identifying Transactions and Preparing Journal Entries

Katy Williams is the manager of Blue Light Arcade. The company provides entertainment for parties and special events. Prepare journal entries for the following events relating to the year ended December 31. If the event is not a transaction, write "no transaction."

a. Blue Light Arcade received $50 cash on account for a birthday party held two months ago.
b. Agreed to hire a new employee at a monthly salary of $3,000. The employee starts work next month.
c. Paid $2,000 for a table top hockey game purchased last month on account.

a. Cash (+A)	50	
Accounts Receivable (-A)		50

b. No Transaction

The employee has yet to provide any services to the company

c. Accounts Payable (-L)	2,000	
Cash (-A)		2,000

M2-19 Identifying Transactions and Preparing Journal Entries Continued

Prepare journal entries for the following events relating to the year ended December 31. If the event is not a transaction, write "no transaction."

d. Repaid a $5,000 bank loan that had been outstanding for 6 months. (Ignore interest).
e. The company purchased an air hockey table for $2,200, paying $1,000 cash and signing short-term note for $1,200.

d. Notes Payable (short-term) (-L)	5,000	
Cash (-A)		5,000
e. Equipment (+A)	2,200	
Cash (-A)		1,000
Notes Payable (short-term) (+L)		1,200

E2-4 Determining Financial Statement Effects of Several Transactions

The following events occurred for Favata Company:

a. Received $10,000 cash from owners and issued stock to them.

b. Borrowed $7,000 cash from a bank and signed a note due later this year.

c. Bought and received $800 of equipment on account.

d. Purchased land for $12,000; paid $1,000 in cash and signed a long-term note for $11,000.

e. Purchased $3,000 of equipment, paying $1,000 in cash and charged the rest on account.

Required:

For each of the events (a) through (e), perform transaction analysis and indicate the account, amount, and direction of the effect (+ for increase and - for decrease) on the accounting equation. Check that the accounting equation remains in balance after each transaction.

	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Cash	+10,000	=				Common Stock	+10,000

E2-5 Recording Journal Entries

The following events occurred for Favata Company:

a. Received $10,000 cash from owners and issued stock to them.
b. Borrowed $7,000 cash from a bank and signed a note due later this year.
c. Bought and received $800 of equipment on account.
d. Purchased land for $12,000; paid $1,000 in cash and signed a long-term note for $11,000.
e. Purchased $3,000 of equipment, paying $1,000 in cash and charged the rest on account.

Required:

For each of the events, prepare journal entries, checking that debits equal credits.

		Debit	Credit
a.	Cash (+A)	10,000	
	Common Stock (+SE)		10,000
b.	Cash (+A)	7,000	
	Notes Payable (short-term) (+L)		7,000
c.	Equipment (+A)	800	
	Accounts Payable (+L)		800

E2-5 Recording Journal Entries, continued

The following events occurred for Favata Company:

a. Received $10,000 cash from owners and issued stock to them.
b. Borrowed $7,000 cash from a bank and signed a note.
c. Bought and received $800 of equipment on account.
d. Purchased land for $12,000; paid $1,000 in cash and signed a long-term note for $11,000.
e. Purchased $3,000 of equipment, paying $1,000 in cash and charged the rest on account.

Required:

For each of the events, prepare journal entries, checking that debits equal credits.

		Debit	Credit
d.	Land (+A)	12,000	
	Cash (-A)		1,000
	Notes Payable (long-term) (+L)		11,000
e.	Equipment (+A)	3,000	
	Cash (-A)		1,000
	Accounts Payable (+L)		2,000

End of Chapter 2