

Solutions Manual for Financial Accounting 11th Libby

Chapter 2

Investing and Financing Decisions and the Accounting System

ANSWERS TO QUESTIONS

1.
 - (a) The separate entity assumption requires that business transactions are separate from the transactions of the owners. For example, the purchase of a truck by the owner for personal use is not recorded as an asset of the business.
 - (b) The monetary unit assumption requires information to be reported in the national monetary unit without any adjustment for changes in purchasing power. That means that each business will account for and report its financial results primarily in terms of the national monetary unit, such as Yen in Japan and Australian dollars in Australia.
 - (c) Under the going concern assumption, businesses are assumed to operate into the foreseeable future. That is, they are not expected to liquidate.
 - (d) The historical cost principle is a measurement model that requires assets to be recorded at the cash-equivalent cost on the date of the transaction. Cash-equivalent cost is the cash paid plus the dollar value of all noncash considerations. TBEXAM.COM
2. Accounting assumptions are necessary because they reflect the scope of accounting and the expectations that set certain limits on the way accounting information is reported.
3.
 - (a) An asset is an economic resource owned or controlled by a company; it has measurable value and is expected to benefit the company by producing cash inflows or reducing cash outflows in the future.
 - (b) A current asset is an asset that will be used or turned into cash within one year.
 - (c) A liability is a measurable obligation resulting from a past transaction; it is expected to be settled in the future by transferring assets or providing services.
 - (d) A current liability is a short-term obligation that will be paid in cash (or other current assets) within the current operating cycle or one year, whichever is longer.
 - (e) Additional paid-in capital is the owner-provided financing to the business that represents the amount of contributed capital less the par value of the stock.
 - (f) Retained earnings are the cumulative earnings of a company that are not distributed to the owners and are reinvested in the business.

4. An account is a standardized format used by organizations to accumulate the dollar effects of transactions on each financial statement item.
5. The accounting equation is: $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$
6. A business transaction is:
 - (a) an exchange of resources (assets) and obligations (debts) between a business and one or more outside parties, and
 - (b) a measurable internal event that directly affects the entity but where there is no exchange with external parties.

An example of situation (a) is the sale of goods or services to customers.

An example of situation (b) is the use of equipment in operations.

7. Debit is the left side of a journal entry and T-account and credit is the right side of a journal entry and T-account. A debit is an increase in assets and a decrease in liabilities and stockholders' equity. A credit is the opposite -- a decrease in assets and an increase in liabilities and stockholders' equity.
8. Transaction analysis is the process of studying a transaction to determine its economic effect on the entity in terms of the accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$

The two principles underlying the process are:

 - * every transaction affects at least two accounts.
 - * the accounting equation must remain in balance after each transaction.

The three steps in transaction analysis are:

 - (1) determine what the company **received**: identify and classify accounts and the direction and amount of the effects.
 - (2) determine what the company **gave**: identify and classify accounts and the direction and amount of the effects.
 - (3) determine that the accounting equation ($A = L + SE$) remains in balance.
9. The equalities that must be maintained in transaction analysis are:
 - (a) $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$
 - (b) $\text{Debits} = \text{Credits}$
10. A journal entry is an accounting method for expressing the effects of a transaction on accounts in a debits-equal-credits format. The title(s) of the account(s) to be debited is (are) listed first and the title(s) of the account(s) to be credited is (are) listed underneath the debited accounts. The debited amounts are placed in a left-hand column and the credited amounts are placed in a right-hand column.

11. The T-account is a tool for summarizing transaction effects for each account, determining balances, and drawing inferences about a company's activities. It is a simplified representation of a ledger account with a debit column on the left and a credit column on the right.
12. The current ratio is computed as current assets divided by current liabilities. It measures a company's liquidity -- the ability of the company to pay its short-term obligations with current assets. A ratio above 1.0 normally suggests that the company has sufficient current assets to settle short-term obligations. Sophisticated cash management systems allow many companies to minimize funds invested in current assets and have a current ratio below 1.0. However, a ratio that is too high in relation to other competitors in the industry may indicate inefficient use of resources.
13. Investing activities on the statement of cash flows include the buying and selling of productive assets and investments. Financing activities include borrowing and repaying debt, issuing and repurchasing stock, and paying dividends.

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MULTIPLE CHOICE

- | | |
|------|-------|
| 1. d | 6. c |
| 2. d | 7. a |
| 3. a | 8. d |
| 4. a | 9. b |
| 5. d | 10. a |

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(Time in minutes)

Mini-exercises		Exercises		Problems		Alternate Problems		Cases and Projects	
No.	Time	No.	Time	No.	Time	No.	Time	No.	Time
1	3	1	8	1	20	1	20	1	15
2	3	2	15	2	25	2	25	2	15
3	4	3	8	3	40	3	40	3	15
4	4	4	10	4	15	4	15	4	20
5	4	5	10	5	40	5	40	5	15
6	5	6	10					6	20
7	3	7	10					7	30
8	3	8	15					8	20
9	6	9	20					9	*
10	6	10	20						
11	6	11	20						
12	6	12	20			Continuing Problem			
13	4	13	20			1	40		
14	4	14	30						
		15	20						
		16	20						
		17	10						
		18	10						
		19	10						
		20	10						
		21	15						

* Due to the nature of these cases and projects, it is very difficult to estimate the amount of time students will need to complete the assignment. 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. For example, when our goal is to sharpen research skills, we devote class time to discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

MINI-EXERCISES

M2-1.

- F (1) Going concern assumption
- H (2) Historical cost principle
- G (3) Credits
- A (4) Assets
- I (5) Account

M2-2.

- D (1) Journal entry
- C (2) $A = L + SE$, and Debits = Credits
- A (3) Assets = Liabilities + Stockholders' Equity
- I (4) Liabilities
- B (5) Income statement, balance sheet, statement of stockholders' equity, and statement of cash flows

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M2-3.

- (1) N
- (2) N
- (3) Y
- (4) Y
- (5) Y
- (6) N

M2-4.

- CL (1) Accounts Payable
- CA (2) Accounts Receivable
- NCA (3) Buildings
- CA (4) Cash
- SE (5) Common Stock
- NCA (6) Land
- CA (7) Merchandise Inventory
- CL (8) Income Taxes Payable
- NCA (9) Long-Term Investments
- NCL (10) Notes Payable (due in three years)
- CA (11) Notes Receivable (due in six months)
- CA (12) Prepaid Rent
- SE (13) Retained Earnings
- CA (14) Supplies
- CL (15) Utilities Payable
- CL (16) Wages Payable

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M2-5.

- SE (1) Additional Paid-in Capital
- NCA (2) Buildings and Leased Assets
- CL (3) Current Lease Liabilities
- CL (4) Dividends Payable
- NCA (5) Equipment
- NCA (6) Intangible Assets
- NCL (7) Long-Term Lease Liabilities
- CL (8) Notes Payable (due in six months)
- CA (9) Prepaid Insurance
- CA (10) Short-Term Investments
- CA (11) Trade Accounts Receivable
- SE (12) Treasury Stock
- CL (13) Unearned Revenue

M2-6.

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
a.	Cash +30,000		Notes payable +30,000		
b.	Cash -10,000				
	Notes receivable +10,000				
c.	Cash +500			Common stock +10	
				Additional paid-in capital +490	
d.	Cash -5,000		Notes payable +10,000		
	Equipment +15,000				
e.			Dividends payable +2,000	Retained earnings -2,000	

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M2-7.

	Debit	Credit
Assets	<i>Increase</i>	<i>Decrease</i>
Liabilities	<i>Decrease</i>	<i>Increase</i>
Stockholders' equity	<i>Decrease</i>	<i>Increase</i>

M2-8.

	Increase	Decrease
Assets	<i>Debit</i>	<i>Credit</i>
Liabilities	<i>Credit</i>	<i>Debit</i>
Stockholders' equity	<i>Credit</i>	<i>Debit</i>

M2-9.

a.	Cash (+A)	30,000	
	Notes payable (+L)		30,000
b.	Notes receivable (+A)	10,000	
	Cash (–A)		10,000
c.	Cash (+A)	500	
	Common stock (+SE)		10
	Additional paid-in capital (+SE)		490
d.	Equipment (+A)	15,000	
	Cash (–A)		5,000
	Notes payable (+L)		10,000
e.	Retained earnings (–SE)	2,000	
	Dividends payable (+L)		2,000

M2-10.

Cash			Notes Receivable			Equipment		
Beg.	900		Beg.	1,000		Beg.	15,100	
(a)	30,000	10,000 (b)	(b)	10,000		(d)	15,000	
(c)	500	5,000 (d)						
	<u>16,400</u>			<u>11,000</u>			<u>30,100</u>	
Notes Payable			Dividends Payable					
	3,000 Beg.			0 Beg.				
	30,000 (a)			2,000 (e)				
	<u>10,000</u> (d)							
	<u>43,000</u>			<u>2,000</u>				
Common Stock			Additional Paid-in Capital			Retained Earnings		
	1,000 Beg.			3,000 Beg.			10,000 Beg.	
	10 (c)			490 (c)		(e)	2,000	
	<u>1,010</u>			<u>3,490</u>			<u>8,000</u>	

M2-11.

TBEXAM.COM JonesSpa Corporation Trial Balance January 31		
	Debit	Credit
Cash	16,400	
Notes receivable	11,000	
Equipment	30,100	
Notes payable		43,000
Dividends payable		2,000
Common stock		1,010
Additional paid-in capital		3,490
Retained earnings		8,000
Totals	<u>57,500</u>	<u>57,500</u>

M2-12.

**JonesSpa Corporation
Balance Sheet
At January 31**

Assets*Current assets:*

Cash	\$ 16,400
Notes receivable	11,000
Total current assets	27,400

Equipment	30,100
	\$ 57,500

Total Assets**Liabilities***Current liabilities:*

Notes payable	\$ 43,000
Dividends payable	2,000
Total current liabilities	45,000

Stockholders' Equity

Common stock	1,010
Additional paid-in capital	3,490
Retained earnings	8,000
Total stockholders' equity	12,500

Total Liabilities &**Stockholders' Equity****\$ 57,500**

M2-13.

Current Ratio =

	Current Assets	÷	Current Liabilities	
2018	\$280,000	÷	\$155,000	= 1.806
2019	\$270,000	÷	\$ 250,000	= 1.080

This ratio indicates that Matteo's Taco Company has sufficient current assets to settle current liabilities, but that the ratio has also decreased between 2018 and 2019 by .726 (40%). Matteo's Taco Company ratio of 1.080 is lower than Chipotle's 2019 ratio of 1.609, indicating that Matteo's Taco Company appears to have weaker liquidity than Chipotle. Because the restaurant industry typically has high immediate cash inflows from customers, both companies can maintain a lower current ratio.

M2-14.

- (a) F
- (b) I
- (c) F
- (d) I

Transaction (e) for the declaration of cash dividends creates an obligation. Thus, it would not be included on the statement of cash flows because no cash was paid in January.

EXERCISES

E2-1.

- E (1) Transaction
- F (2) Going concern assumption
- B (3) Balance sheet
- P (4) Liabilities
- K (5) Assets = Liabilities + Stockholders' Equity
- M (6) Notes payable
- L (7) Common stock
- H (8) Historical cost principle
- I (9) Account
- Q (10) Dual effects
- O (11) Retained earnings
- A (12) Current assets
- C (13) Separate entity assumption
- X (14) Par value
- D (15) Debits
- J (16) Accounts receivable
- N (17) Monetary unit assumption
- R (18) Stockholders' equity

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E2-2.

Req. 1

	<u>Received</u>	<u>Given</u>
(a)	Cash (A)	Common stock and Additional paid-in capital (SE)
(b)	Equipment (A) <i>[or Delivery truck]</i>	Cash (A)
(c)	<i>No exchange transaction</i>	—
(d)	Equipment (A) <i>[or Computer equipment]</i>	Notes payable (current) (L)
(e)	Building (A) <i>[or Construction in progress]</i>	Cash (A)
(f)	Intangibles (A) <i>[or Copyright]</i>	Cash (A)
(g)	Retained earnings (SE) <i>[Received a reduction in the owners' claims to the company's assets]</i>	Dividends payable (L) <i>[a promise to pay]</i>
(h)	Land (A)	Cash (A)
(i)	Intangibles (A) <i>[or Patents]</i>	Cash (A) and Notes payable (current) (L)
(j)	<i>No exchange transaction</i>	—
(k)	Investments (A)	Cash (A)
(l)	Cash (A)	Notes payable (current) (L)
(m)	Notes payable (L) <i>[Received a reduction in its promise to pay]</i>	Cash (A)

Req. 2

The truck in (b) would be recorded as an asset of \$18,000. The land in (h) would be recorded as an asset of \$50,000. These are applications of the historical cost principle.

Req. 3

The agreement in (c) involves no exchange or receipt of cash, goods, or services and thus is not a transaction. Since transaction (j) occurs between the owner and others, there is no effect on the business because of the separate entity assumption.

E2-3.

<u>Account</u>	<u>Balance Sheet Classification</u>	<u>Debit or Credit Balance</u>
(1) Accounts Receivable	CA	Debit
(2) Retained Earnings	SE	Credit
(3) Accrued Expenses Payable	CL	Credit
(4) Prepaid Expenses	CA	Debit
(5) Common Stock	SE	Credit
(6) Long-Term Investments	NCA	Debit
(7) Plant, Property, and Equipment	NCA	Debit
(8) Accounts Payable	CL	Credit
(9) Short-Term Investments	CA	Debit
(10) Long-Term Debt	NCL	Credit
(11) Inventories	CA	Debit
(12) Additional Paid-in Capital	SE	Credit
(13) Current Lease Obligations	CL	Credit
(14) Operating Lease Right-of-Use Assets	NCA	Debit
(15) Treasury Stock	SE	Debit

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E2-4.

<u>Event</u>	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
a.	Cash	+40,000			Common stock +1,000
					Additional paid-in capital +39,000
b.	Operating lease right-of-use assets	+15,000	Long-term lease liabilities	+12,000	
	Cash	-3,000			
c.	Cash	+10,000	Notes payable	+10,000	
d.	Note receivable	+800			
	Cash	-800			
e.	Land	+13,000	Notes payable	+9,000	
	Cash	-4,000			

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E2-5.

Req. 1 (dollars in millions)

Event	Assets	=	Liabilities	+	Stockholders' Equity
a.	Buildings +303 Equipment +1,202 Cash – 432		Notes payable (long-term) +1,073		
b.	Cash +885			Common stock +10 Additional paid-in capital +875	
c.			Dividends payable +1,491	Retained earnings –1,491	
d.	Short-term investments +2,426 Cash –2,426				
e.	No effects				
f.	Cash +2,379 Short-term investments –2,379				
g.	Cash +6,134		Notes payable (long-term) +6,134		
h.	Cash –3,067			Treasury stock –3,067	

Req. 2

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

E2-6.

a.	Cash (+A)	40,000	
	Common stock (+SE)*		1,000
	Additional paid-in capital (+SE)		39,000
b.	Operating lease right-of-use assets (+A)	15,000	
	Cash (-A)		3,000
	Long-term lease liabilities (+L)		12,000
c.	Cash (+A)	10,000	
	Notes payable (+L)		10,000
d.	Notes receivable (+A)	800	
	Cash (-A)		800
e.	Land (+A)	13,000	
	Cash (-A)		4,000
	Notes payable (+L)		9,000

*Common stock at par value: 1,000 shares x \$1 par value = \$1,000

Additional paid-in capital is the excess over market: 1,000 shares x \$39 excess = \$39,000

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E2-7.

Req. 1 (dollars in millions)

a.	Buildings (+A)	303	
	Equipment (+A)	1,202	
	Cash (-A)		432
	Notes payable (+L)		1,073
b.	Cash (+A)	885	
	Common stock (+SE)		10
	Additional paid-in capital (+SE)		875
c.	Retained earnings (-SE)	1,491	
	Dividends payable (+L)		1,491
d.	Short-term investments (+A)	2,426	
	Cash (-A)		2,426
e.	No journal entry required.		
f.	Cash (+A)	2,379	
	Short-term investments (-A)		2,379
g.	Cash (+A)	6,134	
	Notes payable (+L)		6,134
h.	Treasury stock (-SE)	3,067	
	Cash (-A)		3,067

Req. 2

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

E2-8.

Req. 1

a.	Cash (+A)	30,000	
	Notes payable (+L)		30,000
b.	Cash (+A) (500 shares x \$30 market value per share).....	15,000	
	Common stock (+SE) (500 shares x \$0.10 par value) .		50
	Additional paid-in capital (+SE) (difference).....		14,950
c.	Operating lease right-of-use assets (+A)	115,000	
	Cash (-A)		3,000
	Long-term lease liabilities (+L)		112,000
d.	Equipment (+A)	20,000	
	Cash (-A)		4,000
	Notes payable (+L)		16,000
e.	Notes receivable (+A)	1,000	
	Cash (-A)		1,000
f.	Notes payable (-L)	2,000	
	Cash (-A)		2,000
g.	Short-term investments (+A).....	10,000	
	Cash (-A)		10,000

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E2-9.

Req. 1

Cash		Notes Receivable		Equipment	
Beg.	0	Beg.	0	Beg.	0
(a)	70,000	(f)	2,500	(c)	18,000
(e)	3,000				
	<u>66,000</u>		<u>2,500</u>		<u>18,000</u>

Land		Operating Lease Right-of-Use Assets		Notes Payable	
Beg.	0	Beg.	0		0 Beg.
(e)	15,000	(b)	150,000		13,500 (c)
	<u>15,000</u>		<u>150,000</u>		<u>13,500</u>

Long-term Lease Liabilities		Common Stock		Additional Paid-in Capital	
	0 Beg.		0 Beg		0 Beg.
	150,000 (b)		5,040 (a)*		64,960 (a)
			100 (e)		17,900 (e)
	<u>150,000</u>		<u>5,140</u>		<u>82,860</u>

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*6 investors x 8,400 shares each = 50,400 shares issued

50,400 shares issued x \$0.10 par value per share = \$5,040 for common stock

Req. 2

Assets \$ 251,500 = Liabilities \$ 163,500 + Stockholders' Equity \$ 88,000

Req. 3

The agreement in (d) involves no exchange or receipt of cash, goods, or services and thus is not a transaction. Since transaction (g) occurs between the owner and others, there is no effect on the business due to the separate entity assumption.

E2-10.

Req. 1

Cash		Notes Receivable		Equipment	
Beg.	0	Beg.	0	Beg.	0
(a)	60,000	(c)	2,500	(b)	36,000
	9,000 (b)				
	2,500 (c)				
	12,000 (e)				
	<u>36,500</u>		<u>2,500</u>		<u>36,000</u>
Land		Notes Payable		Common Stock	
Beg.	0		0 Beg.		0 Beg.
(a)	35,000	(e)	12,000		300 (a)*
			27,000 (b)		
	<u>35,000</u>		<u>15,000</u>		<u>300</u>
Additional Paid-in Capital					
	0 Beg.				
	94,700 (a)*				
	<u>94,700</u>				

* Common Stock: 3 investors x 1,000 shares each = 3,000 shares issued
 3,000 shares issued x \$0.10 par value per share = \$300 for common stock
 Additional Paid-in Capital: \$95,000 received - \$300 par value = \$94,700

Req. 2

Assets \$ 110,000 = Liabilities \$ 15,000 + Stockholders' Equity \$ 95,000

Req. 3

Since transaction (d) is a personal purchase, not purchased by Precision Builders, there is no effect on the business due to the separate entity assumption.

Req. 4

Market value per share = Total assets received ÷ Number of shares issued
 = \$95,000 ÷ 3,000 shares issued
 = \$31.67 per share

E2-11.

Req. 1

Transaction**Brief Explanation**

- | | |
|---|---|
| 1 | Issued common stock to shareholders for \$15,000 cash. (FastTrack Sports Inc. is a corporation because it issues stock. Par value of the stock was \$0.10 per share because \$1,500 common stock amount divided by 15,000 shares issued equals \$0.10 per share). |
| 2 | Borrowed \$75,000 cash and signed a short-term note for this amount. |
| 3 | Leased assets for \$135,000; paid \$5,000 cash and signed a long-term operating right-of-use lease for the balance. |
| 4 | Loaned \$1,000 cash; borrower signed a short-term note for this amount (Note Receivable). |
| 5 | Purchased store fixtures for \$9,500 cash. |
| 6 | Repaid \$4,000 cash on the notes payable. |

Ending balances are reflected in the balance sheet in Requirement 2.

Req. 2

FastTrack Sports Inc.
Balance Sheet
At January 7

Assets*Current Assets*

Cash	\$ 70,500
Notes receivable	<u>1,000</u>
Total Current Assets	71,500

Store fixtures	9,500
Operating lease right-of-use assets	<u>135,000</u>

Total Assets	<u>\$216,000</u>
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Liabilities*Current Liabilities*

Notes payable	\$ 71,000
Total Current Liabilities	<u>71,000</u>
Long-term lease liabilities	<u>130,000</u>
Total Liabilities	201,000

Stockholders' Equity

Common stock	1,500
Additional paid-in capital	<u>13,500</u>
Total Stockholders' Equity	<u>15,000</u>

Total Liabilities & Stockholders' Equity	<u>\$216,000</u>
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E2-12.

Req. 1

Transaction	Brief Explanation
1	Issued common stock to shareholders for \$45,000 cash. (Volz Cleaning is a corporation because it issues stock. Par value is \$2.00 per share; \$6,000 common stock amount divided by 3,000 shares issued equals \$2.00 per share).
2	Purchased a delivery truck for \$35,000; paid \$8,000 cash and gave a \$27,000 long-term note payable for the balance.
3	Loaned \$2,000 cash; borrower signed a short-term note for this amount.
4	Purchased short-term investments for \$7,000 cash.
5	Sold short-term investments at cost for \$3,000 cash.
6	Purchased computer equipment for \$4,000 cash.

Req. 2

Volz Cleaning, Inc.
Balance Sheet
At March 31

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Assets		Liabilities	
Current Assets		Notes payable	\$27,000
Cash	\$27,000	Total Liabilities	<u>27,000</u>
Investments	4,000		
Notes receivable	2,000		
Total Current Assets	<u>33,000</u>	Stockholders' Equity	
Computer equipment	4,000	Common stock	6,000
Delivery truck	35,000	Additional paid-in capital	39,000
		Total Stockholders' Equity	<u>45,000</u>
Total Assets	<u>\$72,000</u>	Total Liabilities & Stockholders' Equity	<u>\$72,000</u>

E2-13.

a.	Cash (+A)	70,000	
	Building (+A)	250,000	
	Common stock (+SE)		5,000
	Additional paid-in capital (+SE)		315,000
b.	No transaction has occurred because there has been no exchange or receipt of cash, goods, or services.		
c.	Cash (+A)	18,000	
	Notes payable (long-term) (+L)		18,000
d.	Equipment (+A)	11,000	
	Cash (–A)		1,500
	Notes payable (short-term) (+L)		9,500
e.	Notes receivable (short-term) (+A)	2,000	
	Cash (–A)		2,000
f.	Store fixtures (+A)	15,000	
	Cash (–A)		15,000

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E2-14.

		(in millions)	
a.	Cash (+A)	202	
	Common stock (+SE)		8
	Additional paid-in capital (+SE)		194
b.	No transaction has occurred because there has been no exchange or receipt of cash, goods, or services.		
c.	Cash (+A)	1,419	
	Note receivable (–A)		1,419
d.	Cash (+A)	4,291	
	Notes payable (+L)		4,291
e.	Cash (+A)	73,959	
	Short-term investments (–A)		73,959
f.	Equipment (+A)	6,540	
	Cash (–A)		6,540
g.	Treasury stock (–SE)	4,846	
	Cash (–A)		4,846
h.	Notes payable (–L)	4,377	
	Cash (–A)		4,377

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E2-15.

Req. 1

Assets \$ 10,500 = Liabilities \$ 3,000 + Stockholders' Equity \$ 7,500

Req. 2

a.	Cash (+A)	4,000	
	Notes payable (noncurrent) (+L)		4,000
b.	Cash (+A)	1,500	
	Short-term investments (–A)		1,500
c.	Cash (+A)	1,500	
	Property and equipment (–A)		1,500
d.	Retained earnings (–SE)	800	
	Dividends payable (+L)		800
e.	Dividends payable (–L)	800	
	Cash (–A)		800

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Req. 3

Cash		Short-Term Investments		Property and Equipment	
Beg.	5,000	Beg.	2,500	Beg.	3,000
(a)	4,000		1,500 (b)		1,500 (c)
(b)	1,500				
(c)	1,500				
	800 (e)				
End.	<u>11,200</u>	End.	<u>1,000</u>	End.	<u>1,500</u>
Notes Payable (current)		Dividends Payable		Notes Payable (noncurrent)	
	2,200 Beg.		0 Beg.		
		(e)	800		4,000 (a)
	<u>2,200</u> End.		<u>800</u> (d)		<u>4,800</u> End.
			0 End.		
Common Stock		Additional Paid-in Capital		Retained Earnings	
	500 Beg.		4,000 Beg.		3,000 Beg.
	<u>500</u>		<u>4,000</u>	(d)	800
					<u>2,200</u>

E2-15. (continued)

Req. 4

Higgins Company Trial Balance For the Year Ended December 31		
	Debit	Credit
Cash	11,200	
Short-term investments	1,000	
Property and equipment	1,500	
Notes payable (<i>current</i>)		2,200
Dividends payable		0
Notes payable (<i>noncurrent</i>)		4,800
Common stock		500
Additional paid-in capital		4,000
Retained earnings		2,200
Totals	13,700	13,700

Req. 5

Higgins Company Balance Sheet At December 31	
Assets	
<i>Current Assets:</i>	
Cash	\$11,200
Short-term investments	1,000
Total current assets	12,200
Property and equipment	1,500
Total assets	\$13,700
Liabilities and Stockholders' Equity	
<i>Current Liabilities:</i>	
Notes payable	\$ 2,200
Total current liabilities	2,200
Notes payable	4,800
Total liabilities	7,000
<i>Stockholders' Equity</i>	
Common stock	500
Additional paid-in capital	4,000
Retained earnings	2,200
Total stockholders' equity	6,700
Total liabilities and stockholders' equity	\$13,700

E2-15. (continued)

Req. 6

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$11,200 + \$1,000}{\$2,200} = \frac{\$12,200}{\$2,200} = \mathbf{5.55}$$

This ratio indicates that, for every \$1 of current liabilities, Higgins maintains approximately \$5.55 of current assets. Higgins' ratio is higher than the industry average of 1.50, indicating that Higgins maintains a lower level of short-term debt compared to its current assets and has higher liquidity. However, maintaining such a high current ratio also suggests that the company may not be using its resources efficiently. Increasing short-term obligations would lower Higgins' current ratio, but this strategy alone would not help its efficiency. Higgins should consider investing more of its cash in order to generate future returns.

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E2-16.

Req. 1a.

Cash		Short-Term Notes Receivable		Land	
Beg.	0	Beg.	0	Beg.	0
(a)	40,000	(e)	4,000	(b)	16,000
	4,000 (c)				4,000 (e)
	1,000 (d)				
	<u>35,000</u>		<u>4,000</u>		<u>12,000</u>

Equipment		Short-Term Notes Payable		Long-Term Notes Payable	
Beg.	0		0 Beg.		0 Beg.
(c)	20,000		16,000 (b)		16,000 (c)
(d)	1,000				
	<u>21,000</u>		<u>16,000</u>		<u>16,000</u>

Common Stock		Additional Paid-in Capital	
	0 Beg.		0 Beg.
	10,000 (a)		30,000 (a)
	<u>10,000</u>		<u>30,000</u>

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Req. 1b.

Transaction (f) is not recorded by Bailey Delivery Company because it violates the separate entity assumption that states that transactions of the business are to be kept separate from transactions of the owners. Helen Bailey purchase the lot for her personal use; the business is not involved.

E2-16. (continued)

Req. 2

Bailey Delivery Company, Inc. Trial Balance December 31, 2021		
	Debit	Credit
Cash	35,000	
Short-term notes receivable	4,000	
Land	12,000	
Equipment	21,000	
Short-term notes payable		16,000
Long-term notes payable		16,000
Common stock		10,000
Additional paid-in capital		30,000
Totals	<u>72,000</u>	<u>72,000</u>

Req. 3

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Bailey Delivery Company, Inc.
Balance Sheet
At December 31, 2021

Assets*Current Assets*

Cash	\$35,000
Short-term notes receivable	<u>4,000</u>
Total Current Assets	39,000

Land	12,000
Equipment	<u>21,000</u>

Total Assets \$72,000

Liabilities*Current Liabilities*

Short-term notes payable	\$16,000
Total Current Liabilities	16,000
Long-term notes payable	<u>16,000</u>
Total Liabilities	32,000

Stockholders' Equity

Common stock	10,000
Additional paid-in capital	<u>30,000</u>
Total Stockholders' Equity	40,000

Total Liabilities & Stockholders' Equity \$72,000

E2-16. (continued)

Req. 4

	<u>Current Assets</u>	÷	<u>Current Liabilities</u>	=	<u>Current Ratio</u>
2021	\$39,000	÷	\$16,000	=	2.44
2022	\$52,000	÷	\$23,000	=	2.26
2023	\$47,000	÷	\$40,000	=	1.18

The current ratio has decreased over the years, suggesting that the company's liquidity is decreasing. Although the company still maintains sufficient current assets to settle the short-term obligations, this steep decline in the ratio may be of concern – it may be indicative of more efficient use of resources or it may suggest the company is having cash flow problems.

Req. 5

The management of Bailey Delivery Company has already been financing the company's development through additional short-term debt, from \$16,000 in 2021 to \$40,000 in 2023. This suggests the company is taking on increasing risk. Additional lending to the company, particularly short-term, may be too much risk for the bank to absorb. Should the bank lend the \$50,000, Bailey Delivery Company's current ratio would be 1.08 (97,000 ÷ 90,000) immediately after the financing. Based solely on the current ratio, the bank's vice president should consider not providing the loan to the company as it currently stands. Of course, additional analysis would provide better information for making a sound decision.

E2-17.

Transaction	Brief Explanation
(a)	Issued 100,000 shares of common stock (par value \$0.02 per share) to shareholders in exchange for \$20,000 cash and \$5,000 of tools and equipment.
(b)	Loaned \$1,800 cash; borrower signed a note receivable for this amount.
(c)	Purchased a building for \$40,000; paid \$10,000 cash and signed a \$30,000 note payable for the balance.
(d)	Sold tools and equipment for \$900 cash (their original cost).

E2-18.

Req. 1

	<u>Increases with...</u>	<u>Decreases with...</u>
Equipment	Purchases of equipment	Sales of equipment
Notes receivable	Additional loans to others	Collection of loans
Notes payable	Additional borrowings	Payments of debt

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Req. 2

Equipment			Notes Receivable			Notes Payable		
1/1	500		1/1	150			100	1/1
	250	<u>650</u>		<u>245</u>	225	<u>110</u>	170	
12/31	<u>100</u>		12/31	<u>170</u>			<u>160</u>	12/31

	Beginning balance	+	"+"	–	"–"	=	Ending balance
Equipment	\$500	+	\$250	–	\$?	=	\$100
					?	=	<u>650</u>
Notes receivable	150	+	?	–	225	=	170
					?	=	<u>245</u>
Notes payable	100	+	170	–	?	=	160
					?	=	<u>110</u>

E2-19.

Activity	Type of Activity	Effect on Cash
(a) Capital expenditures	I	—
(b) Repurchases of common stock from investors	F	—
(c) Sale of short-term investments	I	+
(d) Issuance of common stock	F	+
(e) Purchases of short-term investments	I	—
(f) Dividends paid on common stock.	F	—

E2-20.

Activity	Type of Activity	Effect on Cash
(a) Additional borrowing from banks	F	+
(b) Purchase of investments	I	—
(c) Sale of assets and investments (assume sold at cost)	I	+
(d) Issuance of stock	F	+
(e) Purchases of property, plant, and equipment	I	—
(f) Payment of debt principal	F	—
(g) Dividends paid	F	—
(h) Receipt of principal payment on a note receivable	I	+

E2-21.

- | | |
|--|---|
| 1. Current assets | In the asset section of a classified balance sheet. |
| 2. Debt principal repaid | In the financing activities section of the statement of cash flows. |
| 3. Significant accounting policies | Usually the first note after the financial statements. |
| 4. Cash received from sales of noncurrent assets | In the investing activities section of the statement of cash flows. |
| 5. Dividends paid | In the financing activities section of the statement of cash flows. |
| 6. Short-term obligations | In the current liabilities section of a classified balance sheet. |
| 7. Date of the statement of financial position | In the heading of the balance sheet. |

PROBLEMS

P2-1.

		Balance Sheet Classification	Debit or Credit Balance
(1)	Notes and Loans Payable (short-term)	CL	Credit
(2)	Materials and Supplies	CA	Debit
(3)	Common Stock	SE	Credit
(4)	Intangible Assets	NCA	Debit
(5)	Income Taxes Payable	CL	Credit
(6)	Long-Term Debt	NCL	Credit
(7)	Property, Plant, and Equipment	NCA	Debit
(8)	Retained Earnings	SE	Credit
(9)	Notes and Accounts Receivable (short-term)	CA	Debit
(10)	Investments (long-term)	NCA	Debit
(11)	Cash and Cash Equivalents	CA	Debit
(12)	Accounts Payable and Accrued Liabilities	CL	Credit
(13)	Crude Oil, Products and Merchandise	CA	Debit
(14)	Additional Paid-in Capital	SE	Credit

P2-2.

Req. 1

East Hill Home Healthcare Services was organized as a corporation. Only a corporation issues shares of common stock to its owners in exchange for their investment, as in transaction (a).

Req. 2 (On next page)

Req. 3

The transaction between the two stockholders (Event e) was not included in the tabulation. Since the transaction in (e) occurs between the owners, there is no effect on the business due to the separate entity assumption.

Req. 4

$$(a) \quad \text{Total assets} = \$119,500 + \$18,000 + \$5,000 + \$510,500 + \$160,000 + \$65,000 \\ = \$878,000$$

$$(b) \quad \text{Total liabilities} = \$108,000 + \$180,000 \\ = \$288,000$$

$$(c) \quad \text{Total stockholders' equity} = \text{Total assets} - \text{Total liabilities} \\ = \$878,000 - \$288,000 = \$590,000$$

$$(d) \quad \text{Cash balance} = \$50,000 + \$90,000 - \$9,000 + \$3,500 - \$18,000 - \$5,000 + 8,000 \\ = \$119,500$$

$$(e) \quad \text{Total current assets} = \text{Cash } \$119,500 + \text{Short-Term Investments } \$18,000 + \text{Notes Receivable } \$5,000 = \$142,500$$

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$119,500 + \$18,000 + \$5,000}{\$108,000} = \frac{\$142,500}{\$108,000} = 1.32$$

For every \$1 in current liabilities, East Hill maintains approximately \$1.32 in current assets. The ratio suggests that East Hill is likely maintaining adequate liquidity and using resources efficiently.

P2-2. (continued)

Req. 2

	Assets						=	Liabilities		+	Stockholders' Equity		
	Cash	Short-Term Investments	Notes Receivable	Land	Buildings	Equipment		ST Notes Payable	LT Notes Payable		Common Stock	Additional Paid-in Capital	Retained Earnings
Beg.	50,000			500,000	100,000	50,000	=	100,000	100,000		20,000	80,000	400,000
(a)	+90,000						=				+9,000	+81,000	
(b)	-9,000			+14,000	+60,000	+15,000	=		+80,000				
(c)	+3,500			-3,500			=						
(d)	-18,000	+18,000					=						
(e)	No effect												
(f)	-5,000		+5,000				=						
(g)	+8,000						=	+8,000					
	+119,500	+18,000	+5,000	+510,500	+160,000	+65,000	=	+108,000	+180,000		+29,000	+161,000	+400,000
	\$878,000							\$288,000			\$590,000		

Req. 1 and 2

Retained Earnings	
	31,000 Beg
	31,000

P2-3. (continued)

Req. 3

No effect was recorded for (d). The agreement in (d) involves no exchange or receipt of cash, goods, or services and thus is not a transaction.

Req. 4

Jaguar Plastics Company Trial Balance At December 31		
	Debit	Credit
Cash	12,000	
Investments (short-term)	13,000	
Accounts receivable	3,000	
Inventory	20,000	
Notes receivable (long-term)	6,000	
Equipment	49,000	
Factory building	114,000	
Operating lease right-of-use assets	158,000	
Intangible assets	8,000	
Accounts payable		15,000
Accrued liabilities payable		4,000
Notes payable (short-term)		16,000
Notes payable (long-term)		103,000
Long-term lease liabilities		76,000
Common stock		11,000
Additional paid-in capital		127,000
Retained earnings		31,000
Totals	<u>383,000</u>	<u>383,000</u>

P2-3. (continued)

Req. 5

Jaguar Plastics Company
Balance Sheet
At December 31

Assets*Current Assets*

Cash	\$ 12,000
Investments	13,000
Accounts receivable	3,000
Inventory	20,000
<i>Total Current Assets</i>	<u>48,000</u>

Notes receivable	6,000
Equipment	49,000
Operating lease right-of-use assets	158,000
Factory building	114,000
Intangible assets	8,000

Total Assets \$383,000

Liabilities*Current Liabilities*

Accounts payable	\$ 15,000
Accrued liabilities payable	4,000
Notes payable	16,000
<i>Total Current Liabilities</i>	<u>35,000</u>

Notes payable	103,000
Long-term lease liabilities	76,000
<i>Total Liabilities</i>	<u>214,000</u>

Stockholders' Equity

Common stock	11,000
Additional paid-in capital	127,000
Retained earnings	31,000
<i>Total Stockholders' Equity</i>	<u>169,000</u>

Total Liabilities & Stockholders' Equity \$383,000

Req. 6

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$48,000}{\$35,000} = 1.37$$

This ratio indicates that Jaguar Plastics has sufficient liquidity to pay short-term liabilities with current assets. For every \$1 of current liabilities, Jaguar Plastics maintains \$1.37 of current assets.

P2-4.

<u>Transaction</u>	<u>Type of Activity</u>	<u>Effect on Cash</u>
(a)	I	—
(b)	I	—
(c)	I	—
(d)	NE	NE
(e)	F	+
(f)	F	+
(g)	I	—
(h)	I	—
(i)	I	+

P2-5. (dollars in millions)

Req. 1

a.	Cash (+A).....	18,266	
	Long-term debt (+L)		18,266
b.	Long-term investments (+A)	4,200	
	Short-term investments (+A)	16,800	
	Cash (–A).....		21,000
c.	Property, plant, and equipment (+A).....	10,981	
	Cash (–A).....		9,571
	Short-term debt (+L).....		1,410
d.	Cash (+A).....	1,469	
	Common stock (+SE)		1
	Additional paid-in capital (+SE)		1,468
e.	Cash (+A).....	18,810	
	Short-term investments (–A)		18,810
f.	Retained earnings (–SE)	11,126	
	Dividends payable (+L)		11,126

P2-5. (continued)

Req. 2

Cash		Short-Term Investments		Accounts Receivable	
Beg.	48,844	Beg.	51,713	Beg.	22,926
(a)	18,266	(b)	16,800		
(d)	1,469		18,810 (e)		
(e)	18,810		<u>49,703</u>		<u>22,926</u>
	<u>56,818</u>				
Long-Term Investments		Inventories		Other Current Assets	
Beg.	105,341	Beg.	4,106	Beg.	35,230
(b)	4,200		<u>4,106</u>		<u>35,230</u>
	<u>109,541</u>				
Accounts Payable		Property, Plant, and Equipment		Other Noncurrent Assets	
	46,236 Beg.	Beg.	37,378	Beg.	32,978
	<u>46,236</u>	(c)	10,981		
			<u>48,359</u>		<u>32,978</u>
Short-term Debt		Accrued Expenses		Unearned Revenue	
	10,260		43,700 Beg.		5,522 Beg.
	1,410 (c)		<u>43,700</u>		<u>5,522</u>
	<u>11,670</u>				
Long-term Debt		Dividends Payable		Other Noncurrent Liabilities	
	91,807 Beg.		0 Beg.		50,503 Beg.
	18,266 (a)		11,126 (f)		
	<u>110,073</u>		<u>11,126</u>		<u>50,503</u>
Common Stock		Additional Paid-in Capital		Retained Earnings	
	1 Beg		45,173 Beg.		45,314 Beg.
	1 (d)		1,468 (d)	(f)	11,126
	<u>2</u>		<u>46,641</u>		<u>34,188</u>

P2-5. (continued)

Req. 3

Apple Inc. Trial Balance At September 26, 2020 (in millions)		
	Debit	Credit
Cash	56,818	
Short-term Investments	49,703	
Accounts receivable	22,926	
Inventories	4,106	
Other current assets	35,230	
Long-term investments	109,541	
Property, plant, and equipment	48,359	
Other noncurrent assets	32,978	
Accounts payable		46,236
Accrued expenses		43,700
Unearned revenue		5,522
Dividends payable		11,126
Short-term debt		11,670
Long-term debt		110,073
Other noncurrent liabilities		50,503
Common stock		2
Additional paid-in capital		46,641
Retained earnings		34,188
Totals	<u>359,661</u>	<u>359,661</u>

P2-5. (continued)

Req. 4

Apple Inc.
Balance Sheet
At September 26, 2020
(in millions)

ASSETS**Current Assets:**

Cash	\$ 56,818
Short-term investments	49,703
Accounts receivable	22,926
Inventories	4,106
Other current assets	35,230
Total current assets	168,783
Long-term investments	109,541
Property, plant, and equipment, net	48,359
Other noncurrent assets	32,978

Total assets**\$359,661****LIABILITIES AND STOCKHOLDERS' EQUITY****Current Liabilities:**

Accounts payable	\$ 46,236
Accrued expenses	43,700
Unearned revenue	5,522
Dividends payable	11,126
Short-term debt	11,670
Total current liabilities	118,254
Long-term debt	110,073
Other noncurrent liabilities	50,503
Total liabilities	278,830

Stockholders' Equity:

Common stock	2
Additional paid-in capital	46,641
Retained earnings	34,188
Total stockholders' equity	80,831

Total liabilities and stockholders' equity**\$359,661**

P2-5. (continued)

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$168,783}{\$118,254} = 1.43$$

For every \$1 of short-term liabilities, Apple Inc. has approximately \$1.43 of current assets. This suggests that Apple has sufficient current resources to pay current liabilities. Apple has a very efficient cash management system and keeps its current resources at lower levels to maximize investment opportunities.

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ALTERNATE PROBLEMS

AP2-1.

		Balance Sheet Classification	Debit or Credit Balance
(1)	Prepaid Expenses	CA	Debit
(2)	Inventories	CA	Debit
(3)	Accounts Receivable	CA	Debit
(4)	Long-Term Debt	NCL	Credit
(5)	Treasury Stock	SE	Debit
(6)	Right-of-Use Assets	NCA	Debit
(7)	Accounts Payable	CL	Credit
(8)	Income Taxes Payable	CL	Credit
(9)	Property, Plant, and Equipment	NCA	Debit
(10)	Retained Earnings	SE	Credit
(11)	Additional Paid-in Capital	SE	Credit
(12)	Noncurrent Lease Liabilities	NCL	Credit
(13)	Accrued Liabilities	CL	Credit
(14)	Common Stock	SE	Credit

AP2-2.

Req. 1

Russeck Incorporated was organized as a corporation. Only a corporation issues shares of common stock to its owners in exchange for their investment, as Russeck did in transaction (c).

Req. 2 (On next page)

Req. 3

Since the transaction in (g) occurs between the owners and others outside the company, there is no effect on the business due to the separate entity assumption.

Req. 4

$$(a) \quad \text{Total assets} = \$56,000 + \$2,000 + \$85,000 + \$110,000 + \$310,000 = \$563,000$$

$$(b) \quad \text{Total liabilities} = \$32,000 + \$211,000 = \$243,000$$

$$(c) \quad \begin{aligned} \text{Total stockholders' equity} &= \text{Total assets} - \text{Total liabilities} \\ &= \$563,000 - \$243,000 = \$320,000 \end{aligned}$$

$$(d) \quad \begin{aligned} \text{Cash balance} &= \$120,000 + \$11,000 - \$3,000 + \$20,000 - \$5,000 - \$2,000 \\ &\quad - \$85,000 = \$56,000 \end{aligned}$$

$$(e) \quad \text{Total current assets} = \$56,000 + \$2,000 = \$58,000$$

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$56,000 + \$2,000}{\$32,000} = \frac{\$58,000}{\$32,000} = 1.81$$

This suggests that Russeck has sufficient liquidity to cover its current obligations. For every \$1 of current liabilities, Russeck has \$1.81 in current assets.

AP2-2. (continued)

Req. 2

	Assets					=	Liabilities		+	Stockholders' Equity		
	Cash	Short-Term Notes Receivable	Long-Term Investments	Equipment	Buildings		Short-Term Notes Payable	Long-Term Notes Payable		Common Stock	Additional Paid-in Capital	Retained Earnings
Beg.	120,000			70,000	310,000	=		200,000		20,000	200,000	80,000
(a)	+11,000					=		+11,000				
(b)	-3,000			+30,000		=	+27,000					
(c)	+20,000					=				+10,000	+10,000	
(d)	-5,000			+10,000		=	+5,000					
(e)	-2,000	+2,000				=						
(f)	-85,000		+85,000			=						
(g)	No effect					=						
	+56,000	+2,000	+85,000	+110,000	+310,000	=	+32,000	+211,000		+30,000	+210,000	+80,000
	\$563,000						\$243,000			\$320,000		

AP2-3. (dollars in thousands)

Req. 1 and 2

Cash		
Beg.	20,824	
(a)	1,020	3,400 (b)
(d)	4,020	2,980 (e)
(g)	310	1,830 (f)
	<u>17,964</u>	

Accounts Receivable		
Beg.	14,247	
	<u>14,247</u>	

Inventories		
Beg.	162,389	
	<u>162,389</u>	

Prepaid Expenses and Other Current Assets		
Beg.	18,830	
	<u>18,830</u>	

Property, Plant and Equipment		
Beg.	245,246	
(f)	11,230	4,020 (d)
	<u>252,456</u>	

Intangible Assets		
Beg.	45,128	
(b)	3,400	
	<u>48,528</u>	

Long-Term Investments		
Beg.	2,108	
(e)	2,980	
	<u>5,088</u>	

Other Assets		
Beg.	1,579	
		310 (g)
	<u>1,269</u>	

Accounts Payable		
		35,485 Beg.
	<u>35,485</u>	

Unearned Revenue		
		56,714 Beg.
		<u>56,714</u>

Accrued Expenses Payable		
		30,077 Beg.
	<u>30,077</u>	

Dividends Payable		
		0 Beg.
		300 (h)
	<u>300</u>	

Long-Term Debt (current portion is \$550)		
		1,066 Beg.
		9,400 (f)
	<u>10,466</u>	

Other Long-Term Liabilities		
		23,080 Beg.
	<u>23,080</u>	

Common Stock		
		491 Beg.
		16 (a)
		<u>507</u>

Additional Paid-in Capital		
		377,913 Beg.
		1,004 (a)
	<u>378,917</u>	

Treasury Stock*		
Beg.	656,597	
	<u>656,597</u>	

Retained Earnings		
		642,122 Beg.
(h)	300	
		<u>641,822</u>

* Reported as a reduction in Stockholders' Equity (similar to Chipotle in Exhibit 2.1).

AP2-3. (continued)

Req. 3

No effect was recorded for (c). Ordering goods involves no exchange or receipt of cash, goods, or services and thus is not a transaction.

Req. 4

Ethan Allen Interiors Inc. Trial Balance At September 30 (in thousands of dollars)		
	Debit	Credit
Cash	17,964	
Accounts receivable	14,247	
Inventories	162,389	
Prepaid expenses and other current assets	18,830	
Property, plant and equipment	252,456	
Intangible assets	48,528	
Long-term investments	5,088	
Other assets	1,269	
Accounts payable		35,485
Unearned revenue		56,714
Accrued expenses payable		30,077
Dividends payable		300
Long-term debt (current portion, \$550)		10,466
Other long-term liabilities		23,080
Common stock		507
Additional paid-in capital		378,917
Treasury stock	656,597	
Retained earnings		641,822
Totals	<u>1,177,368</u>	<u>1,177,368</u>

AP2-3. (continued)

Req. 5

Ethan Allen Interiors Inc.
Balance Sheet
At September 30
(in thousands of dollars)

Assets*Current assets*

Cash	\$ 17,964
Accounts receivable	14,247
Inventories	162,389
Prepaid expenses and other current assets	18,830
<i>Total current assets</i>	<u>213,430</u>

Property, plant and equipment	252,456
Intangible assets	48,528
Long-term investments	5,088
Other assets	1,269
Total Assets	<u><u>\$520,771</u></u>

Liabilities*Current liabilities*

Accounts payable	\$ 35,485
Unearned revenue	56,714
Accrued expenses payable	30,077
Dividends payable	300
Current portion of long-term debt	550
<i>Total current liabilities</i>	<u>123,126</u>

Long-term debt	9,916
Other long-term liabilities	23,080
Total liabilities	<u>156,122</u>

Stockholders' Equity

Common stock (\$0.01 par value)	507
Additional paid-in capital	378,917
Treasury stock	(656,597)
Retained earnings	641,822
Total Stockholders' Equity	<u>364,649</u>

Total Liabilities and Stockholders' Equity	<u><u>\$520,771</u></u>
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Req. 6

$$\text{Current Ratio} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}} = \frac{\$213,430}{\$123,126} = 1.733$$

Ethan Allen maintains a relatively high current ratio, indicating that the company has almost \$2 in current assets to pay each dollar of current obligations.

AP2-4. (dollars in thousands)

<u>Transaction</u>	<u>Type of Activity</u>	<u>Effect on Cash</u>
(a)	F	+1,020
(b)	I	-3,400
(c)	NE	NE
(d)	I	+4,020
(e)	I	-2,980
(f)	I	-1,830
(g)	I	+310
(h)	NE	NE

AP2-5

Req. 1

a.	Cash (+A)	18,296	
	Long-term debt (+L)		18,296
b.	Long-term investments (+A)	4,760	
	Short-term investments (+A)	19,040	
	Cash (-A)		23,800
c.	Property, plant, and equipment (+A)	11,043	
	Cash (-A)		9,603
	Short-term notes payable (+L)		1,440
d.	Cash (+A)	1,500	
	Common stock (+SE)		1
	Additional paid-in capital (+SE)		1,499
e.	Cash (+A)	19,038	
	Short-term investments (-A)		19,038
f.	Retained earnings (-SE)	11,156	
	Dividends payable (+L)		11,156

AP2-5. (continued)

Req. 2

Cash		Short-Term Investments		Accounts Receivable	
Beg.	14,004	Beg.	11,361	Beg.	17,656
(a)	18,296	(b)	19,040		
(d)	1,500		19,038 (e)		
(e)	19,038		<u>11,363</u>		<u>17,656</u>
	<u>19,435</u>				
Long-Term Investments		Inventories		Other Current Assets	
Beg.	131,546	Beg.	2,131	Beg.	24,107
(b)	4,760		<u>2,131</u>		<u>24,107</u>
	<u>136,306</u>				
Accounts Payable		Property, Plant, and Equipment		Other Noncurrent Assets	
	30,520 Beg.	Beg.	20,844	Beg.	12,658
	<u>30,520</u>	(c)	11,043		
			<u>31,887</u>		<u>12,658</u>
Short-term Notes Payable		Accrued Expenses		Unearned Revenue	
	6,376		18,653 Beg.		8,587 Beg.
	1,440 (c)		<u>18,653</u>		<u>8,587</u>
	<u>7,816</u>				
Long-term Debt		Dividends Payable		Other Noncurrent Liabilities	
	29,303 Beg.		0 Beg.		
	18,296 (a)		11,156 (f)		
	<u>47,599</u>		<u>11,156</u>		
Common Stock		Additional Paid-in Capital		Retained Earnings	
	1 Beg		25,112 Beg.		87,598 Beg.
	1 (d)		1,499 (d)	(f)	11,156
	<u>2</u>		<u>26,611</u>		<u>76,442</u>

AP2-5. (continued)

Req. 3

Kiwi Inc. Trial Balance At June 30, 2023 (in thousands)		
	Debit	Credit
Cash	19,435	
Short-term Investments	11,363	
Accounts receivable	17,656	
Inventories	2,131	
Other current assets	24,107	
Long-term investments	136,306	
Property, plant, and equipment	31,887	
Other noncurrent assets	12,658	
Accounts payable		30,520
Accrued expenses		18,653
Unearned revenue		8,587
Short-term notes payable		7,816
Dividends payable		11,156
Long-term debt		47,599
Other noncurrent liabilities		28,157
Common stock		2
Additional paid-in capital		26,611
Retained earnings		76,442
Totals	<u>255,543</u>	<u>255,543</u>

AP2-5. (continued)

Req. 4

Kiwi Inc.
Balance Sheet
At June 30, 2023
(in thousands)

ASSETS**Current assets:**

Cash	\$ 19,435
Short-term investments	11,363
Accounts receivable	17,656
Inventories	2,131
Other current assets	24,107

Total current assets	74,692
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Long-term investments	136,306
-----------------------	---------

Property, plant, and equipment	31,887
--------------------------------	--------

Other noncurrent assets	12,658
-------------------------	--------

Total assets	\$255,543
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LIABILITIES AND STOCKHOLDERS' EQUITY**Current liabilities:**

Accounts payable	\$ 30,520
Accrued expenses	18,653
Unearned revenue	8,587
Dividends payable	11,156
Short-term notes payable	7,816

Total current liabilities	76,732
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Long-term debt	47,599
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Other noncurrent liabilities	28,157
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Total liabilities	152,488
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Stockholders' equity:

Common stock	2
Additional paid-in capital	26,611
Retained earnings	76,442

Total stockholders' equity	103,055
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Total liabilities and stockholders' equity	\$255,543
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AP2-5. (continued)

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$74,692}{\$76,732} = 0.97$$

For every \$1 of short-term liabilities, Kiwi Inc. has approximately \$0.97 of current assets. This suggests that Kiwi has nearly sufficient current resources to pay current liabilities. It is likely that Kiwi has a very efficient cash management system and keeps its current resources at lower levels to maximize investment opportunities.

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CONTINUING PROBLEM

CON2-1.

Req. 1

	<u>Debit</u>	<u>Credit</u>
a. Cash (+A)	25,000	
Equipment (+A)	36,000	
Common stock (+SE)		200
Additional paid-in capital (+SE)		60,800
b. Land (+A)	18,000	
Buildings (+A)	72,000	
Cash (-A)		10,000
Notes payable (<i>noncurrent</i>) (+L)		80,000
c. Equipment (+A)	6,500	
Cash (-A)		2,500
Notes payable (<i>current</i>) (+L)		4,000
d. No transaction – no exchange; just a promise of service by the receptionist for a promise to pay cash for the service by PPSS.		
e. Notes payable (<i>noncurrent</i>) (-L)	1,000	
Cash (-A)		1,000
f. Short-term investments (+A)	5,000	
Cash (-A)		5,000
g. No transaction – ordering goods involves no exchange or receipt of cash, goods, or services (a promise to deliver for a promise to pay when delivered – an exchange of promises is not a transaction).		

CON2-1. (continued)

Req. 2

Cash		
Beg.	0	
(a)	25,000	10,000 (b)
		2,500 (c)
		1,000 (e)
		5,000 (f)
	<u>6,500</u>	

Short-term Investments		
Beg.	0	
(f)	<u>5,000</u>	
	<u>5,000</u>	

Equipment		
Beg.	0	
(a)	36,000	
(c)	<u>6,500</u>	
	<u>42,500</u>	

Land		
Beg.	0	
(b)	<u>18,000</u>	
	<u>18,000</u>	

Buildings		
Beg.	0	
(b)	<u>72,000</u>	
	<u>72,000</u>	

Notes Payable (current)		
	0 Beg.	
	<u>4,000</u> (c)	
	<u>4,000</u>	

Notes Payable (noncurrent)		
	0 Beg.	
(e)	<u>1,000</u>	80,000 (b)
		<u>79,000</u>

Common Stock		
	0 Beg.	
	<u>200</u> (a)	
	<u>200</u>	

Additional Paid-in Capital		
	0 Beg.	
	<u>60,800</u> (a)	
	<u>60,800</u>	

CON2-1. (continued)

Req. 3

Penny's Pool Service & Supply, Inc. Trial Balance March 31		
	Debit	Credit
Cash	6,500	
Short-term investments	5,000	
Equipment	42,500	
Land	18,000	
Buildings	72,000	
Notes payable (<i>current</i>)		4,000
Notes payable (<i>noncurrent</i>)		79,000
Common stock		200
Additional paid-in capital		60,800
Totals	<u>144,000</u>	<u>144,000</u>

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CON2-1. (continued)

Req. 4

Penny's Pool Service & Supply, Inc.
Balance Sheet
March 31

Assets*Current Assets:*

Cash	\$ 6,500
Short-term investments	5,000
Total current assets	11,500
Equipment	42,500
Land	18,000
Buildings	72,000
Total assets	<u>\$144,000</u>

Liabilities and Stockholder's Equity*Current Liabilities:*

Notes payable	\$ 4,000
Total current liabilities	4,000
Notes payable	79,000
Total liabilities	83,000

Stockholder's Equity:

Common stock (\$0.05 par value)	200
Additional paid-in capital	60,800
Total stockholder's equity	61,000
Total liabilities and stockholder's equity	<u>\$144,000</u>

Req. 5

	Type of Activity (I, F, or NE)	Effect on Cash Flows (+ or - and amount)
(a)	F	+ 25,000
(b)	I	- 10,000
(c)	I	- 2,500
(d)	NE	NE
(e)	F	- 1,000
(f)	I	- 5,000
(g)	NE	NE

CON2-1. (continued)

Req. 6

	<u>Current Assets</u>	÷	<u>Current Liabilities</u>	=	<u>Current Ratio</u>
On March 31	\$11,500	÷	\$4,000	=	2.875

With a current ratio of 2.875, PPSS has liquidity with sufficient current assets to settle short-term obligations. However, this may change as the inventory is received in April and operations begin requiring paying cash for inventory purchases from suppliers, advertising, utilities, employee salary, and other operating needs, and paying notes payable when due. One of the most significant problems for new small businesses is generating sufficient cash from operations to pay obligations and maintain liquidity.

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CASES AND PROJECTS

ANNUAL REPORT CASES

CP2-1.

1. b.
2. d.
3. b.
4. c.
5. c. Computation: Current assets \$20,756 / Current liabilities \$20,125 = 1.03

CP2-2.

1. \$282
2. \$164,965
3. 0.97 Computation: Current assets \$90,067 / Current liabilities \$92,645 = 0.97
4. No
5. b.

CP2-3.

1. Current ratios →

Target = 1.03 Computation: Current assets \$20,756 / Current liabilities \$20,125

Walmart = 0.97 Computation: Current assets \$90,067 / Current liabilities \$92,645

2. b.

3. a.

4. c.

5. d.

	2021	2020	2020 computation
Target	1.03	0.89	CA \$12,902 / CL \$14,487
Walmart	0.97	0.79	CA \$61,806 / CL \$77,790

FINANCIAL REPORTING AND ANALYSIS CASES**CP2-4.**

Dollars are in thousands:

1. (a) Chipotle's total assets for the quarter ended June 30, 2020 are \$5,370,129.

- (b) Current liabilities increased over six months from \$666,593 at December 31, 2019, to \$723,178 on June 30, 2020.

$$(c) \text{ Current Ratio at 6/30/20} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$1,150,343}{\$723,178} = 1.591$$

Chipotle's current ratio decreased from the level of 1.609 on December 31, 2019 (as discussed in the chapter) to 1.591 on June 30, 2020. This indicates that, between December 31, 2019, and June 30, 2020, Chipotle decreased its liquidity slightly. Current assets increased by 7.3% while current liabilities increased by a greater percentage of 8.5%. When the denominator increases at a higher rate than the numerator, the ratio decreases.

2. (a) For the six months ended June 30, 2020, Chipotle spent \$165,455 on the purchase of leasehold improvements, property, and equipment.

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- (b) The total cash flows used in financing activities was a cash outflow of \$104,203, over half of which was from the \$54,501 repurchase of Chipotle's stock from investors (called "treasury stock").

CP2-5.

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 an individual organization, separate and apart from its owners. The improper inclusion of this asset as part of Frances Sabatier's business:

- Overstates total assets by \$300,000; total assets should be \$105,000 rather than \$405,000, and
- Overstates stockholders' equity that should be only \$5,000, rather than \$305,000.

Since current assets and current liabilities were not affected, the current ratio remains the same. However, other ratios involving long-term assets and/or stockholders' equity will be affected.

CP2-6.

Dollars are in thousands:

1. The company is a corporation because its owners are referred to as “stockholders.”

$$2. \quad \text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$

$$\$12,703,389 = \$3,999,003 + \$8,704,386$$

$$3. \quad \frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{Current Ratio}$$

2019	\$7,620,075	\$ 832,476	9.154
2018	\$7,111,036	\$1,516,311	4.690

In 2019, for every \$1 of current liabilities, Twitter maintained approximately \$9.15 of current assets, suggesting that Twitter is highly liquid and has the ability to pay its short-term obligations with current assets in the upcoming year. Since 2018, the current ratio has increased from 4.69. The interpretation of this ratio would be more useful given information on the company's current ratio compared to the current ratio for the industry and/or competitors and additional years of data to observe trends.

4. Accounts payable (–L)	161,148	
Cash (–A)		161,148

5. Until 2019, Twitter reported an Accumulated Deficit, suggesting that the company was not profitable through 2018. It appears that Twitter was profitable in 2019, based on a positive amount in Retained Earnings of \$11,586. Note that the Accumulated Deficit account in 2018 represented the cumulative losses of the firm since the business began, assuming no dividends were declared (likely given its deficit position). The current year's retained earnings represents the cumulative earnings of the company that are not distributed to the stockholders and are reinvested in the business.

In addition, Twitter appears profitable in the most recent year because the company's Accumulated Deficit became retained earnings (due to further profits). It is possible to determine the amount of net income by using the following equation, assuming no dividends were declared:

(in thousands)

Beginning	For the Year			Ending
Accum. Deficit	+	Net Income(Loss)	– Dividends declared	= Retained Earnings
\$(1,454,073)	+	\$?	– \$ 0	= \$11,586

Thus, net income for the most recent year was \$1,465,659.

CRITICAL THINKING CASES

CP2-7.

Req. 1

LettuceDoThis.Com, Inc.
Balance Sheet
December 31

Assets

Current Assets:

Cash	\$ 1,000
Accounts receivable	8,000
Inventory	8,000

Total current assets	17,000
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Furniture and fixtures	52,000
------------------------	--------

Delivery truck (net)	12,000
----------------------	--------

Buildings (net)	60,000
-----------------	--------

Total assets	\$141,000
---------------------	-----------

Liabilities

Current Liabilities:

Accounts payable	\$ 16,000
Payroll taxes payable	13,000

Total current liabilities	29,000
----------------------------------	--------

Notes payable (due in three years)	15,000
------------------------------------	--------

Mortgage payable	50,000
------------------	--------

Total liabilities	94,000
--------------------------	--------

Stockholders' Equity

Common stock	4,000
--------------	-------

Additional paid-in capital	76,000
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Accumulated deficit	(33,000)
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Total stockholders' equity	47,000
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Total liabilities and stockholders' equity	\$141,000
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CP2-7. (continued)

Req. 2

Dear _____,

I corrected the balance sheet for LettuceDoThis.Com, Inc. Primarily, I reduced the amount reported for buildings to \$60,000, which is the historical cost less any depreciation. Estimated market value is not a generally accepted accounting principle for recording property, plant, and equipment. The \$38,000 difference (\$98,000 – \$60,000) reduces total assets and reduces retained earnings. In fact, retained earnings becomes negative suggesting that there may have been several years of operating losses.

Before making a final decision on investing in this company, you should examine the past three years of *audited* income statements and the past two years of *audited* balance sheets to identify positive and negative trends for this company. You can also compare this company's current ratio to that of the industry to assess trends in liquidity, and compare how this company's long-term debt as a proportion of stockholders' equity has changed over time. You should also learn as much about the industry as you can by reviewing recent articles on economic and technological trends that may have an impact on this company.

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CP2-8.

1. The most obvious parties harmed by the fraud at Celadon Group, Inc., were the stockholders and creditors. Stockholders were purchasing shares of stock that were inflated due to the fraud. Creditors were lending funds to the company based on inflated income statement and balance sheet information. When the fraud was discovered, the stock price dropped causing the stockholders to lose money on their investments. In addition, the creditors have a lower probability of receiving full payment on their loans.

Those who were helped initially by the fraud included the former executives who were able to receive substantial bonuses based on the inflated results of operations. However, several of the top executives at Celadon and its subsidiaries have been charged with fraud and other violations.

2. Celadon likely set certain financial goals and tied the former executives' bonuses to meeting the goals. Adopting targets is a good tool for monitoring progress toward goals and identifying problem areas, such as rising costs or sagging sales. Better decision making can result by heading off potential problems before they grow too large. However, setting unrealistic financial targets, especially in poor economic times, can result in those responsible for meeting the targets circumventing appropriate procedures and policies for their own benefit.

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YOU AS ANALYST: ONLINE COMPANY RESEARCH (an individual or team project)

CP2-9.

The solution to this project will depend on the company(ies) and/or accounting period selected for analysis.

BUSINESS ANALYTICS AND DATA VISUALIZATION IN EXCEL AND TABLEAU

The solutions to these exercises are auto graded on Connect, as assigned by the instructor.