Financial Accounting 10th edition Libby Solutions Manual

SKU: 9781259964947-SOLUTIONS

Chapter 2
Investing and Financing Decisions and the Accounting System

ANSWERS TO QUESTIONS

1. The primary objective of financial reporting for external users is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. These users are expected to have a reasonable understanding of accounting concepts and procedures. Usually, they are interested in information to assist them in projecting future cash inflows and outflows of a business.

2. (a) An asset is a probable future economic benefit owned or controlled by the entity as a result of past transactions.

   (b) A current asset is an asset that will be used or turned into cash within one year; inventory is always considered a current asset regardless of how long it takes to produce and sell the inventory.

   (c) A liability is a probable future sacrifice of economic benefits of the entity arising from present obligations as a result of a past transaction.

   (d) A current liability is a liability that will be settled by providing cash, goods, or other services within the coming year.

   (e) Additional paid-in capital is the owner-provided financing to the business that represents the excess of the amount received when the common stock was issued over the par value of the common stock.

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

3. (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) Historical cost 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.

4. 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.

5. An account is a standardized format used by organizations to accumulate the dollar effects of transactions on each financial statement item. Accounts are necessary to keep track of all increases and decreases in the fundamental accounting model.

6. The fundamental accounting model is provided by the equation:

   Assets = Liabilities + Stockholders' Equity

7. A business transaction is (a) an exchange of resources (assets) and obligations (debts) between a business and one or more outside parties, and (b) certain events that directly affect the entity such as the use over time of rent that was paid prior to occupying space and the wearing out of equipment used to operate the business. An example of the first situation is (a) the sale of goods or services. An example of the second situation is (b) the use of insurance paid prior to coverage.

8. 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 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.

9. Transaction analysis is the process of studying a transaction to determine its economic effect on the entity in terms of the accounting equation:

Assets = Liabilities + 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 two steps in transaction analysis are:

(1) identify and classify accounts and the direction and amount of the effects.
(2) determine that the accounting equation (A = L + SE) remains in balance.

10. The equalities in accounting are:

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

11. The 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 and the title 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.

12. 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.

13. 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.

14. 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.

MULTIPLE CHOICE

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

(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	5	5	10	5	40			5	15
6	3	6	10	6	20			6	20
7	3	7	10					7	30
8	6	8	15					8	20
9	6	9	20					9	*
10	6	10	20						
11	6	11	20						
12	4	12	20			*Continuing Problem*			
13	4	13	20						
		14	30			1	40		
		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 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
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

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

M2–5.

	Assets		=	Liabilities		+	Stockholders' Equity	
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

M2–6.

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

M2–7.

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

M2–8.

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

M2–9.

Cash

	Debit	Credit	
Beg.	900		
(a)	30,000	10,000	(b)
(c)	500	5,000	(d)
	16,400		

Notes Receivable

	Debit	Credit	
Beg.	1,000		
(b)	10,000		
	11,000		

Equipment

	Debit	Credit	
Beg.	15,100		
(d)	15,000		
	30,100		

Notes Payable

	Debit	Credit	
		3,000	Beg.
		30,000	(a)
		10,000	(d)
		43,000	

Dividends Payable

	Debit	Credit	
		0	Beg.
		2,000	(e)
		2,000	

Common Stock

	Debit	Credit	
		1,000	Beg.
		10	(c)
		1,010	

Additional Paid-in Capital

	Debit	Credit	
		3,000	Beg.
		490	(c)
		3,490	

Retained Earnings

	Debit	Credit	
		10,000	Beg.
(e)	2,000		
		8,000	

M2-10.

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	57,500	57,500

M2–11.

JonesSpa Corporation
Balance Sheet
At January 31

Assets		***Liabilities***	
Current assets:		*Current liabilities:*	
Cash	$ 16,400	Notes payable	$ 43,000
Notes receivable	11,000	Dividends payable	2,000
Total current assets	27,400	Total current liabilities	45,000
		Stockholders' Equity	
Equipment	30,100	Common stock	1,010
		Additional paid-in capital	3,490
		Retained earnings	8,000
		Total stockholders' equity	12,500
Total Assets	$ 57,500	***Total Liabilities & Stockholders' Equity***	$ 57,500

M2–12.

Current Ratio =

	Current Assets	÷	**Current Liabilities**		
2016	280,000	÷	155,000	=	1.806
2017	270,000	÷	250,000	=	1.080

This ratio indicates that Sal's Taco Company has sufficient current assets to settle current liabilities, but that the ratio has also decreased between 2016 and 2017 by .726 (40%). Sal's Taco Company ratio of 1.080 is lower than Chipotle's 2017 ratio of 1.944, indicating that Sal's Taco Company appears to have weaker liquidity than Chipotle. Because the restaurant industry typically has high cash inflows from customers, both companies can maintain a lower current ratio.

M2–13.

(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
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
W	(18)	Faithful representation
T	(19)	Relevance
R	(20)	Stockholders' equity

E2–2.

Req. 1

	Received	Given
(a)	Cash (A)	Common stock and Additional paid-in capital (SE)
(b)	Equipment (A) *[or Delivery truck]*	Cash (A)
(c)	*No exchange transaction*	—
(d)	Equipment (A) *[or Computer equipment]*	Notes payable *(current)* (L)
(e)	Building (A) *[or Construction in progress]*	Cash (A)
(f)	Intangibles (A) *[or Copyright]*	Cash (A)
(g)	Retained earnings (SE) *[Received a reduction in the amount available for payment to stockholders]*	Dividends payable (L)
(h)	Land (A)	Cash (A)
(i)	Intangibles (A) *[or Patents]*	Cash (A) and Notes payable *(current)* (L)
(j)	*No exchange transaction*	—
(k)	Investments (A)	Cash (A)
(l)	Cash (A)	Notes payable *(current)* (L)
(m)	Notes payable (L) *[Received a reduction in its promise to pay]*	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.

	Account	***Balance Sheet Classification***	***Debit or Credit Balance***
(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

E2–4.

Event	**Assets**		=	**Liabilities**		+	**Stockholders' Equity**	
a.	Cash	+40,000					Common stock	+1,000
							Additional paid-in capital	+39,000
b.	Equipment	+15,000		Accounts payable	+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						

E2–5.

Req. 1 (dollars in millions)

Event	Assets		=	Liabilities		+	Stockholders' Equity	
a.	Buildings	+303		Notes payable (long-term)	+1,073			
	Equipment	+1,202						
	Cash	– 432						
b.	Cash	+695					Common stock	+10
							Additional paid-in capital	+685
c.				Dividends payable	+1,159		Retained earnings	–1,159
d.	Short-term investments	+5,928						
	Cash	-5,928						
e.	No effects							
f.	Cash	+2,423						
	Short-term investments	–2,423						

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.

		Debit	Credit
a.	Cash (+A)	40,000	
	Common stock (+SE)*		1,000
	Additional paid-in capital (+SE)		39,000
b.	Equipment (+A)	15,000	
	Cash (–A)		3,000
	Accounts payable (+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

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)	695	
	Common stock (+SE)		10
	Additional paid-in capital (+SE)		685
c.	Retained earnings (–SE)	1,159	
	Dividends payable (+L)		1,159
d.	Short-term investments (+A)	5,928	
	Cash (–A)		5,928
e.	No journal entry required.		
f.	Cash (+A)	2,423	
	Short-term investments (–A)		2,423

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

		Debit	Credit
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.	Buildings (+A)	115,000	
	Cash (–A)		23,000
	Notes payable (+L)		92,000
d.	Equipment (+A)	20,000	
	Cash (–A)		4,000
	Accounts payable (+L)		16,000
e.	Notes receivable (+A)	1,000	
	Cash (–A)		1,000
f.	Accounts payable (–L)	2,000	
	Cash (–A)		2,000
g.	Short-term investments (+A)	10,000	
	Cash (–A)		10,000

E2–9.

Req. 1

Cash

	Debit	Credit	
Beg.	0		
(a)	70,000	4,500	(b)
(d)	3,000	2,500	(e)
	66,000		

Notes Receivable

	Debit	Credit	
Beg.	0		
(e)	2,500		
	2,500		

Equipment

	Debit	Credit	
Beg.	0		
(b)	18,000		
	18,000		

Land

	Debit	Credit	
Beg.	0		
(d)	15,000		
	15,000		

Notes Payable

	Debit	Credit	
		0	Beg.
		13,500	(b)
		13,500	

Common Stock

	Debit	Credit	
		0	Beg.
		5,040	(a)*
		100	(d)
		5,140	

Additional Paid-in Capital

	Debit	Credit	
		0	Beg.
		64,960	(a)
		17,900	(d)
		82,860	

*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 $ 101,500 = Liabilities $ 13,500 + Stockholders' Equity $ 88,000

Req. 3

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

E2–10.

Req. 1

Cash

	Debit	Credit	
Beg.	0		
(a)	60,000	9,000	(b)
		2,500	(c)
		12,000	(e)
	36,500		

Notes Receivable

	Debit	Credit	
Beg.	0		
(c)	2,500		
	2,500		

Equipment

	Debit	Credit	
Beg.	0		
(b)	36,000		
	36,000		

Land

	Debit	Credit	
Beg.	0		
(a)	35,000		
	35,000		

Notes Payable

	Debit	Credit	
		0	Beg.
(e)	12,000	27,000	(b)
		15,000	

Common Stock

	Debit	Credit	
		0	Beg.
		300	(a)*
		300	

Additional Paid-in Capital

	Debit	Credit	
		0	Beg.
		94,700	(a)*
		94,700	

* 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	Purchased land for $16,000; paid $5,000 cash and gave an $11,000 short-term note payable for the balance.
4	Loaned $4,000 cash; borrower signed a short-term note for this amount (Note Receivable).
5	Purchased store fixtures for $9,500 cash.
6	Purchased land for $4,000; paid for by signing a short-term note.

Req. 2

FastTrack Sports Inc.
Balance Sheet
At January 7

Assets		***Liabilities***	
Current Assets		*Current Liabilities*	
Cash	$71,500	Notes payable	$90,000
Notes receivable	4,000	*Total Current Liabilities*	90,000
Total Current Assets	75,500		
		Stockholders' Equity	
Store fixtures	9,500	Common stock	1,500
Land	20,000	Additional paid-in capital	13,500
		Total Stockholders' Equity	15,000
Total Assets	$105,000	***Total Liabilities & Stockholders' Equity***	$105,000

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

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

E2–13.

		Debit	Credit
a.	Cash (+A)	70,000	
	Common stock (+SE)		5,000
	Additional paid-in capital (+SE)		65,000

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

		Debit	Credit
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

E2–14.

		(in millions of Euros)	
a.	Retained earnings (–SE)	2,106	
	Dividends payable (+L)		2,106
b.	No transaction has occurred because there has been no exchange or receipt of cash, goods, or services.		
c.	Dividends payable (–L)	2,212	
	Cash (–A)		2,212
d.	Cash (+A)	8,952	
	Notes payable (+L)		8,952
e.	Cash (+A)	753	
	Equipment (–A)		753
f.	Equipment (+A)	8,410	
	Cash (–A)		5,823
	Notes payable (+L)		2,587
g.	Investments (+A)	3,592	
	Cash (–A)		3,592

E2–15.

Req. 1

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

Req. 2

a.	Cash (+A)	4,000	
	Notes payable (+L)		4,000
b.	Cash (+A)	1,500	
	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

Req. 3

Cash

Beg.	5,000		
(a)	4,000		
(b)	1,500		
(c)	1,500	800	(e)
End.	11,200		

Short-Term Investments

Beg.	2,500		
		1,500	(b)
End.	1,000		

Property and Equipment

Beg.	3,000		
		1,500	(c)
End.	1,500		

Notes Payable *(current)*

		2,200	Beg.
		2,200	End.

Notes Payable *(noncurrent)*

		800	Beg.
		4,000	(a)
		4,800	End.

Dividends Payable

		0	Beg.
(e)	800	800	(d)
		0	End.

Common Stock

		500	Beg.
		500	

Additional Paid-in Capital

		4,000	Beg.
		4,000	

Retained Earnings

		3,000	Beg.
(d)	800		
		2,200	

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 *(current)*		2,200
Notes payable *(noncurrent)*		4,800
Dividends payable		0
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	
Current Assets:	
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	
Current Liabilities:	
Notes payable	$ 2,200
Total current liabilities	2,200
Notes payable	4,800
Total liabilities	7,000
Stockholders' Equity	
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.

E2–16.

Req. 1

Cash

	Debit	Credit	
Beg.	0		
(a)	40,000	4,000	(c)
		1,000	(d)
	35,000		

Short-Term Notes Receivable

	Debit	Credit	
Beg.	0		
(e)	4,000		
	4,000		

Land

	Debit	Credit	
Beg.	0		
(b)	16,000	4,000	(e)
	12,000		

Equipment

	Debit	Credit	
Beg.	0		
(c)	20,000		
(d)	1,000		
	21,000		

Short-Term Notes Payable

	Debit	Credit	
		0	Beg.
		16,000	(b)
		16,000	

Long-Term Notes Payable

	Debit	Credit	
		0	Beg.
		16,000	(c)
		16,000	

Common Stock

	Debit	Credit	
		0	Beg.
		10,000	(a)
		10,000	

Additional Paid-in Capital

	Debit	Credit	
		0	Beg.
		30,000	(a)
		30,000	

Req. 2

Bailey Delivery Company, Inc.
Trial Balance
December 31, 2018

	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	$72,000	$72,000

E2–16. (continued)

Req. 3

Bailey Delivery Company, Inc.
Balance Sheet
At December 31, 2018

Assets		***Liabilities***	
Current Assets		*Current Liabilities*	
Cash	$35,000	Short-term notes payable	$16,000
Short-term notes receivable	4,000	*Total Current Liabilities*	16,000
Total Current Assets	39,000	Long-term notes payable	16,000
		Total Liabilities	32,000
Land	12,000		
Equipment	21,000	***Stockholders' Equity***	
		Common stock	10,000
		Additional paid-in capital	30,000
		Total Stockholders' Equity	40,000
Total Assets	$72,000	***Total Liabilities & Stockholders' Equity***	$72,000

Req. 4

	Current Assets	÷	**Current Liabilities**	=	**Current Ratio**
2018	$39,000	÷	$16,000	=	2.44
2019	52,000	÷	23,000	=	2.26
2020	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 2018 to $40,000 in 2020. 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

	Increases with…	**Decreases with…**
Equipment	Purchases of equipment	Sales of equipment
Notes receivable	Additional loans to others	Collection of loans
Notes payable	Additional borrowings	Payments of debt

Req. 2

Equipment

	Debit	Credit
1/1	500	
	250	$\boxed{650}$
12/31	100	

Notes Receivable

	Debit	Credit
1/1	150	
	$\boxed{245}$	225
12/31	170	

Notes Payable

Debit	Credit	
	100	1/1
$\boxed{110}$	170	
	160	12/31

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

E2–19.

Activity	Type of Activity	Effect on Cash
(a) Capital expenditures (for property, plant, and equipment)	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) Total assets = $111,500 + $18,000 + $5,000 + $510,500 + $160,000 + $65,000
= $870,000

(b) Total liabilities = $100,000 + $180,000
= $280,000

(c) Total stockholders' equity = Total assets – Total liabilities
= $870,000 – $280,000 = $590,000

(d) Cash balance = $50,000 + $90,000 – $9,000 + $3,500 – $18,000 – $5,000
= $111,500

(e) Total current assets = Cash $111,500 + Short-Term Investments $18,000 + Notes Receivable $5,000 = $134,500

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$111{,}500+\$18{,}000+\$5{,}000}{\$100{,}000} = \frac{\$134{,}500}{100{,}000} = 1.35$$

This suggests that for every $1 in current liabilities, East Hill maintains approximately $1.35 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				=						
	+111,500	+18,000	+5,000	+510,500	+160,000	+65,000	=	+100,000	+180,000		+29,000	+161,000	+400,000

$870,000 $280,000 $590,000

P2–3.

Req. 1 and 2

Cash

Beg.	22,000		
(e)	11,000	10,000	(a)
(f)	9,000	5,000	(b)
(i)	1,000	5,000	(c)
		3,000	(g)
		8,000	(h)
	12,000		

Investments (short-term)

Beg.	3,000	
(a)	10,000	
	13,000	

Accounts Receivable

Beg.	3,000	
	3,000	

Inventory

Beg.	20,000	
	20,000	

Notes Receivable (long-term)

Beg.	1,000	
(b)	5,000	
	6,000	

Equipment

Beg.	50,000		
(c)	18,000	1,000	(i)
End.	67,000		

Factory Building

Beg.	90,000	
(h)	24,000	
End.	114,000	

Intangibles

Beg.	5,000	
(g)	3,000	
End.	8,000	

Accounts Payable

	15,000	Beg.
	15,000	

Accrued Liabilities Payable

	4,000	Beg.
	4,000	

Notes Payable *(current)*

	7,000	Beg.
	13,000	(c)
	9,000	(f)
	29,000	

Notes Payable *(noncurrent)*

	47,000	Beg.
	16,000	(h)
	63,000	

Common Stock

	10,000	Beg.
	1,000	(e)
	11,000	

Additional Paid-in Capital

	80,000	Beg.
	10,000	(e)
	90,000	

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	67,000	
Factory building	114,000	
Intangibles	8,000	
Accounts payable		15,000
Accrued liabilities payable		4,000
Notes payable (short-term)		29,000
Notes payable (long-term)		63,000
Common stock		11,000
Additional paid-in capital		90,000
Retained earnings		31,000
Totals	243,000	243,000

P2–3. (continued)

Req. 5

Jaguar Plastics Company
Balance Sheet
At December 31

Assets		***Liabilities***	
Current Assets		*Current Liabilities*	
Cash	$ 12,000	Accounts payable	$ 15,000
Investments	13,000	Accrued liabilities payable	4,000
Accounts receivable	3,000	Notes payable	29,000
Inventory	20,000	*Total Current Liabilities*	48,000
Total Current Assets	48,000	Long-term notes payable	63,000
		Total Liabilities	111,000
Notes receivable	6,000		
Equipment	67,000	***Stockholders' Equity***	
Factory building	114,000	Common stock	11,000
Intangibles	8,000	Additional paid-in capital	90,000
		Retained earnings	31,000
		Total Stockholders' Equity	132,000
Total Assets	$243,000	***Total Liabilities & Stockholders' Equity***	$243,000

Req. 6

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$48{,}000}{\$48{,}000} = 1.00$$

This ratio indicates that Jaguar Plastics has relatively low liquidity; for every $1 of current liabilities, Jaguar Plastics maintains only $1 of current assets.

P2–4.

Transaction	Type of Activity	Effect on Cash
(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 notes payable (+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

Beg.	20,289		
(a)	18,266	21,000	(b)
(d)	1,469	9,571	(c)
(e)	18,810		
	28,263		

Short-Term Investments

Beg.	53,892		
(b)	16,800	18,810	(e)
	51,882		

Accounts Receivable

Beg.	17,874		
	17,874		

Inventories

Beg.	4,855		
	4,855		

Other Current Assets

Beg.	31,735		
	31,735		

Long-Term Investments

Beg.	194,714		
(b)	4,200		
	198,914		

Property, Plant, and Equipment

Beg.	33,783		
(c)	10,981		
	44,764		

Other Noncurrent Assets

Beg.	18,177		
	18,177		

Accounts Payable

		49,049	Beg.
		49,049	

Accrued Expenses

		25,744	Beg.
		25,744	

Unearned Revenue

		7,548	Beg.
		7,548	

Short-term Notes Payable

		18,473	
		1,410	(c)
		19,883	

Dividends Payable

		0	Beg.
		11,126	(f)
		11,126	

Long-term Debt

		97,207	Beg.
		18,266	(a)
		115,473	

Other Noncurrent Liabilities

		43,251	Beg.
		43,251	

Common Stock

		1	Beg
		1	(d)
		2	

Additional Paid-in Capital

		35,866	Beg.
		1,468	(d)
		37,334	

Retained Earnings

		98,180	Beg.
(f)	11,126		
		87,054	

P2–5. (continued)

Req. 3

Apple, Inc. Trial Balance For the Year Ended September 29, 2018 (in millions)		
	Debit	**Credit**
Cash	28,263	
Short-term Investments	51,882	
Accounts receivable	17,874	
Inventories	4,855	
Other current assets	31,735	
Long-term investments	198,914	
Property, plant, and equipment	44,764	
Other noncurrent assets	18,177	
Accounts payable		49,049
Accrued expenses		25,744
Unearned revenue		7,548
Short-term notes payable		19,883
Dividends payable		11,126
Long-term debt		115,473
Other noncurrent liabilities		43,251
Common stock		2
Additional paid-in capital		37,334
Retained earnings		87,054
Totals	396,464	396,464

P2–5. (continued)

Req. 4

Apple, Inc.
Balance Sheet
At September 29, 2018
(in millions)

ASSETS	
Current Assets:	
Cash	$ 28,263
Short-term investments	51,882
Accounts receivable	17,874
Inventories	4,855
Other current assets	31,735
Total current assets	**134,609**
Long-term investments	198,914
Property, plant, and equipment	44,764
Other noncurrent assets	18,177
Total assets	**$396,464**
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Accounts payable	$49,049
Accrued expenses	25,744
Unearned revenue	7,548
Dividends payable	11,126
Short-term notes payable	19,883
Total current liabilities	**113,350**
Long-term debt	115,473
Other noncurrent liabilities	43,251
Total liabilities	272,074
Stockholders' Equity:	
Common stock	2
Additional paid-in capital	37,334
Retained earnings	87,054
Total stockholders' equity	124,390
Total liabilities and stockholders' equity	**$396,464**

P2–5. (continued)

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$134{,}609}{\$113{,}350} = 1.19$$

For every $1 of short-term liabilities, Apple Inc. has approximately $1.19 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.

P2–6. (dollars in millions)

Activity	Type of Activity	Effect on Cash
(a) Borrowed from banks	F	+ 18,266
(b) Purchased investments	I	– 21,000
(c) Purchased property, plant, and equipment	I	– 9,571
(d) Issued additional stock	F	+ 1,469
(e) Sold short-term investments	I	+ 18,810
(f) Declared dividends (does not affect cash flows)	NE	NE

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)	Cash and Equivalents	CA	Debit
(6)	Goodwill (an intangible asset)	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)	Short-Term Borrowings	CL	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 *(i)* 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) Total assets = $35,000 + $2,000 + $85,000 + $107,000 + $510,000 = $739,000

(b) Total liabilities = $169,000 + $170,000 = $339,000

(c) Total stockholders' equity = Total assets – Total liabilities
= $739,000 – $339,000 = $400,000

(d) Cash balance = $120,000 + $110,000 – $3,000 + $100,000 – $5,000 – $2,000 – $200,000 – $85,000 = $35,000

(e) Total current assets = $35,000 + $2,000 = $37,000

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$35{,}000 + \$2{,}000}{\$169{,}000} = \frac{\$37{,}000}{\$169{,}000} = 0.219$$

This suggests that Russeck may not have sufficient liquidity to cover its current obligations. Russeck should consider increasing its current assets or seeking to convert some of its short-term debt to long-term debt.

AP2–2. (continued)

Req. 2

	Assets					=	Liabilities		+	Stockholders' Equity		
	Cash	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	=	140,000	60,000		20,000	200,000	80,000
(a)	+110,000					=		+110,000				
(b)	–3,000			+30,000		=	+27,000					
(c)	+100,000					=				+10,000	+90,000	
(d)	–5,000			+10,000		=	+5,000					
(e)	–2,000	+2,000				=						
(f)	–200,000				+200,000	=						
(g)	–85,000		+85,000			=						
(h)				–3,000		=	–3,000					
(i)	No effect					=						
	+35,000	+2,000	+85,000	+107,000	+510,000	=	+169,000	+170,000		+30,000	+290,000	+80,000
			$739,000				$339,000				$400,000	

AP2–3. (dollars in thousands)

Req. 1 and 2

Cash and Cash Equivalents

Beg.	57,701		
(a)	1,020	3,400	(b)
(d)	4,020	2,980	(e)
(g)	310	1,830	(f)
	54,841		

Accounts Receivable

Beg.	12,293		
	12,293		

Inventories

Beg.	149,483		
(e)			
	149,483		

Prepaid Expenses and Other Current Assets

Beg.	23,621		
	23,621		

Property, Plant and Equipment

Beg.	270,198		
(f)	11,230	4,020	(d)
	277,408		

Intangible Assets

Beg.	45,128		
(b)	3,400		
	48,528		

Long-Term Investments

Beg.	7,330		
(e)	2,980		
	10,310		

Other Assets

Beg.	2,468		
		310	(g)
	2,158		

Accounts Payable

		16,961	Beg.
		16,961	

Unearned Revenue

		62,960	Beg.
		62,960	

Accrued Expenses Payable

		43,793	Beg.
		43,793	

Dividends Payable

		0	Beg.
		300	(h)
		300	

Long-Term Debt
(current portion is $2,731)

		14,339	Beg.
		9,400	(f)
		23,739	

Other Long-Term Liabilities

		29,273	Beg.
		29,273	

Common Stock

		490	Beg.
		16	(a)
		506	

Additional Paid-in Capital

		377,740	Beg.
		1,004	(a)
		378,744	

Treasury Stock*

Beg.	635,179		
	635,179		

Retained Earnings

		657,845	Beg.
(h)	300		
		657,545	

* Reported as a reduction in Stockholders' Equity (similar to Chipotle in Exhibit 2.2).

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 and cash equivalents	54,841	
Accounts receivable	12,293	
Inventories	149,483	
Prepaid expenses and other current assets	23,621	
Property, plant and equipment	277,408	
Intangible assets	48,528	
Long-term investments	10,310	
Other assets	2,158	
Accounts payable		16,961
Unearned revenue		62,960
Accrued expenses payable		43,793
Dividends payable		300
Long-term debt (current portion, $2,731)		23,739
Other long-term liabilities		29,273
Common stock		506
Additional paid-in capital		378,744
Treasury stock	635,179	
Retained earnings		657,545
Totals	1,213,821	1,213,821

AP2–3. (continued)

Req. 5

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

Assets	
Current assets	
Cash and cash equivalents	$ 54,841
Accounts receivable	12,293
Inventories	149,483
Prepaid expenses and other current assets	23,621
Total current assets	240,238
Property, plant, and equipment	277,408
Intangible assets	48,528
Long-term investments	10,310
Other assets	2,158
Total Assets	$578,642
Liabilities	
Current liabilities	
Accounts payable	$ 16,961
Unearned revenue	62,960
Accrued expenses payable	43,793
Dividends payable	300
Current portion of long-term debt	2,731
Total current liabilities	126,745
Long-term debt	21,008
Other long-term liabilities	29,273
Total Liabilities	177,026
Stockholders' Equity	
Common stock ($0.01 par value)	506
Additional paid-in capital	378,744
Treasury stock	(635,179)
Retained earnings	657,545
Total Stockholders' Equity	401,616
Total Liabilities and Stockholders' Equity	$578,642

Req. 6

$$\text{Current Ratio} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}} = \frac{\$240,238}{\$126,745} = 1.895$$

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)

Transaction	Type of Activity	Effect on Cash
(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

CONTINUING PROBLEM

CON2–1.

Req. 1

		Debit	Credit
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 *(noncurrent)* (+L)…..……		80,000
c.	Equipment (+A)…………………………………	6,500	
	Cash (–A)………………………………….		2,500
	Notes payable *(current)* (+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.

		Debit	Credit
e.	Notes payable *(noncurrent)* (–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)
	6,500		

Short-term Investments

Beg.	0		
(f)	5,000		
	5,000		

Equipment

Beg.	0		
(a)	36,000		
(c)	6,500		
	42,500		

Land

Beg.	0		
(b)	18,000		
	18,000		

Buildings

Beg.	0		
(b)	72,000		
	72,000		

Notes Payable
(current)

		0	Beg.
		4,000	(c)
		4,000	

Notes Payable
(noncurrent)

		0	Beg.
(e)	1,000	80,000	(b)
		79,000	

Common Stock

		0	Beg.
		200	(a)
		200	

Additional Paid-in Capital

		0	Beg.
		60,800	(a)
		60,800	

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 *(current)*		$ 4,000
Notes payable *(noncurrent)*		79,000
Common stock		200
Additional paid-in capital		60,800
Totals	$144,000	$144,000

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	$144,000
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	$144,000

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

	Current Assets	÷	Current Liabilities	=	Current Ratio
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.

CASES AND PROJECTS

ANNUAL REPORT CASES

CP2–1. (dollars in thousands)

1. The company is a corporation since it maintains common stock and contributed capital and its owners are referred to as "stockholders." (Refer to the stockholders' equity section of the balance sheet).

2. The amount listed on the balance sheet for inventories does not represent the expected selling price. It represents the historical cost of acquiring the inventory, as required by the cost principle.

3. The company's current obligations include: Accounts payable, Accrued compensation and payroll taxes, Accrued rent, Accrued income and other taxes, Unredeemed gift cards and gift certificates, Current portion of deferred lease credits, and Other liabilities and accrued expenses.

4. $$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$968{,}530}{\$485{,}221} = 2.00$$

   The current ratio measures the ability of the company to settle short-term obligations with current assets. American Eagle Outfitters' current ratio of 2.00 suggests strong liquidity with $2.00 in current assets for every $1.00 in current liabilities.

5. The company spent $169,469 to purchase property and equipment in the fiscal year ended 2/3/2018; $161,494 in the fiscal year ended 1/28/2017; and $153,256 in the fiscal year ended 1/30/2016. This information is listed as *Capital expenditures for property and equipment* in the investing activities section of the Consolidated Statement of Cash Flows.

CP2–2. (in thousands)

	Assets	=	Liabilities	+	Shareholders' Equity
1.	$1,187,607	=	$533,607	+	$ 654,000

2. No – shareholders' equity is a residual balance, which means the shareholders will receive what remains in cash and assets after the creditors have been satisfied. It is unlikely that shareholders would receive the retained earnings of $710,081 or total stockholders' equity of $654,000. In addition, nearly all assets on the balance sheet are stated at historical cost, not at market value (the amount that could be received if the assets are sold at the end of the year).

3. The company's noncurrent liabilities are Deferred lease credits of $137,618 and Other long-term liabilities of $105,125.

4. $$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$565{,}136}{\$290{,}864} = 1.94$$

5. The company had a net cash outflow from investing activities of $66,667, primarily because the company acquired additional property, plant, and equipment (capital expenditures) for $57,435. It did not have any sales of assets during the year.

CP2–3. (dollars in thousands)

1.

	Industry Average	American Eagle Outfitters	Express, Inc.
Current Ratio =	2.43	2.00	1.94

Both the American Eagle Outfitters' and Express, Inc.'s current ratios are lower than the industry average of 2.43. However, because both have a current ratio near or at 2.00, both companies are able to satisfy their current obligations with current assets.

Many retailers, such as American Eagle Outfitters, choose to rent space rather than purchase buildings for stores. Acquiring buildings often requires borrowing long-term (mortgages). Thus, the choice of renting or purchasing buildings does not have an effect on the numerator or denominator of the current ratio.

Note: The retail industry has been struggling for some time and is quite susceptible to volatile changes in the economy. When the economy is weak, these companies need a cushion of current assets to be able to continue to pay employees and suppliers when sales and cash flows are lower. Both American Eagle Outfitters and Express, Inc., appear to follow this pattern with a higher current ratio than other industries such as restaurants.

2. As indicated in the financing activities section of each company's statement of cash flows, during the most recent year, American Eagle Outfitters spent $87,682 repurchasing common stock from publicly announced repurchase programs, and spent $12,513 repurchasing stock from employees. Express, Inc., spent $17,264 repurchasing shares as part of its repurchase program and $1,599 for tax withholding obligations.

3. As indicated in the statement of cash flows in the financing activities section, American Eagle Outfitters paid $88,548 in dividends. Express, Inc., did not pay any dividends during the year.

4. On the balance sheet:

   American Eagle reports → Property and equipment, at cost, net of accumulated depreciation (all on one line).
   Express, Inc., reports → Property and equipment on one line at cost, Accumulated depreciation on the next line, and Property and equipment, net below that.

   Details of the amount of land, building, and equipment are reported by each in the notes to the financial statements. Other companies sometimes choose to report these assets separately on the balance sheet, using captions such as: Land; Buildings and building improvements; Furniture, fixtures and equipment; and Leased property and equipment.

FINANCIAL REPORTING AND ANALYSIS CASES

CP2–4.

Dollars are in thousands:

1. (a) Chipotle's total assets for the quarter ended September 30, 2017 are $2,064,377 in thousands of dollars.

   (b) Current liabilities increased over nine months from $281,793 thousand at December 31, 2016, to $323,402 thousand on September 30, 2017.

   (c) Current Ratio at 9/30/17 $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}} = \dfrac{\$655{,}936}{\$323{,}402} = 2.028$

   Chipotle's current ratio decreased from the level of 2.028 on September 30, 2017 to 1.944 on December 31, 2017 (as discussed in the chapter). This indicates that, between September 30, 2017, and December 31, 2017, Chipotle decreased its liquidity slightly. Current assets decreased by approximately $26 million while current liabilities increased by about $1 million.

2. (a) For the nine months ended September 30, 2017, Chipotle spent $165,506 on the purchase of leasehold improvements, property, and equipment.

   (b) The total cash flows used in financing activities was a cash outflow of $209,575, mostly from the $209,585 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.

Assets	=	Liabilities	+	Stockholders’ Equity
$7,412,477	=	$2,365,259	+	$5,047,218

3.

	Current Assets	÷	Current Liabilities	=	Current Ratio
2017	$5,321,884		$583,278		9.124
2016	4,652,196		584,021		7.966

In 2017, for every $1 of current liabilities, Twitter maintained approximately $9.12 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 2016, the current ratio has increased from 7.966 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)	170,969	
Cash (–A)		170,969

5. Over its years in business, it appears that Twitter has been unprofitable, based on a negative amount in Accumulated Deficit of $2,703,308. The Accumulated Deficit account represents the cumulative losses of the firm since the business began, assuming no dividends were declared (unlikely given its deficit position).

In addition, Twitter appears unprofitable in the most recent year because Accumulated Deficit increased (due to further losses). It is possible to determine the amount of net loss by using the following equation, assuming no dividends were declared:
(in thousands)

Beginning		For the Year				Ending
Accum. Deficit	+	Net Income(Loss)	–	Dividends declared	=	Accum. Deficit
$(2,619,063)	+	?	–	$ 0	=	$(2,703,308)

Thus, net loss for the most recent year was $(83,705).

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
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
Accumulated deficit	(33,000)
Total stockholders' equity	47,000
Total liabilities and stockholders' equity	$141,000

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.

CP2–8.

1. The most obvious parties harmed by the fraud at Biovail Corporation 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. The vendors who assisted in verifying false promotional allowances were also investigated.

   Those who were helped by the fraud included the former executives who were able to receive substantial bonuses based on the inflated results of operations.

2. Biovail 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.

FINANCIAL REPORTING AND ANALYSIS TEAM PROJECT

CP2–9.

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