Chapter 2
Investing and Financing Decisions and the Statement of Financial Position

Revised: April 27, 2014

ANSWERS TO QUESTIONS

1. The primary objective of financial reporting for external users is to provide useful financial information about a business to help external parties, primarily investors and creditors, make sound financial decisions. 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 an economic resource controlled by an entity as a result of a past transaction or event and from which future economic benefits may be obtained.

   (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 debt or obligation of the entity as a result of a past transaction, which will be paid with assets or services.

   (d) A current liability is a liability that will be paid in cash (or other current assets) or satisfied by providing service within the coming year.

   (e) Contributed capital is cash (and sometimes other assets) provided to the business by owners.

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

3. To be useful, information must be relevant; that is, it must be timely and have predictive and/or feedback value. Relevant information is any information that is likely to change an investor's decision. However, if the information is not a faithful representation of the economic phenomena it is supposed to represent (complete, neutral and free from material error) it will not be trusted, and thus will not be useful.

4. (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 unit-of-measure assumption requires information to be reported in the national monetary unit. That means that each business will account for and report its financial results primarily in terms of the national monetary unit, such as Euros in Germany and Australian dollars in Australia.

   (c) Under the continuity or 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 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 non-cash considerations.

5. 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.

6. The current ratio is computed as current assets divided by current liabilities. It measures the ability of the company to pay its short-term obligations with current assets. A high ratio normally suggests good liquidity, but a ratio that is too high may include inefficient use of resources. The general rule was a ratio between 1.0 and 2.0 (twice as many current assets as current liabilities), but sophisticated cash management systems allow many companies to minimize funds invested in current assets and have a current ratio below 1.0.

7. 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.

8. Historical cost reflects the market value of an asset at the time of acquisition. However, the continued reporting of historical cost subsequent to acquisition does not reflect any change in market value. Accountants continue to report historical costs on statements of financial position because they are more verifiable and objective measures than market values.

9. The fundamental accounting model is provided by the equation:
Assets = Liabilities + Shareholders' Equity

10. A business transaction is (a) external - an exchange of resources (assets) and obligations (debts) between a business and one or more outside parties, and (b) internal - certain events that have a direct and measurable effect on the business. An example of the first situation (a) is the sale of goods or services. An example of the second situation (b) is a loss incurred due to a fire.

11. Debit is the left side of a T-account and credit is the right side of a T-account. Debits increase asset accounts, and decrease liability and shareholders' equity accounts. Credits decrease asset accounts, and increase liability and shareholders' equity accounts.

12. 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 + Shareholders' 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.

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

13. The equalities in accounting are:
(a) Assets = Liabilities + Shareholders' Equity
(b) Debits = Credits

14. 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. The title of the account(s) to be credited is (are) listed underneath the debited account(s), and the account title(s) and amount(s) credited is (are) indented to the right.

15. 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.

16. 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 shares, and paying dividends.

17. Bookkeeping is only one part of accounting. A bookkeeper records the routine transactions in most businesses and may maintain the records of a small business. An accountant is a highly trained professional, competent in the design of information systems, analysis of complex transactions, interpretation of financial data, financial reporting, auditing, taxation, and management consulting.

Authors' Recommended Solution Time
(Time in minutes)

Exercises		*Problems*		*Alternate Problems*		*Cases and Projects*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	10 E	1	15 E	1	15 E	1	20 M
2	5 E	2	25 M	2	35 M	2	25 M
3	10 E	3	40 M	3	45 M	3	20 M
4	10 E	4	15 M	4	15 M	4	30 M
5	10 E	5	60 D	5	60 D	5	30 M
6	10 E	6	15 M	6	15 M	6	20 M
7	10 E	7	30 M	7	30 M	7	45 M
8	10 E	8	40 M	8	25 M	8	30 M
9	10 E					9	30 D
10	15 R					10	*
11	20 M						
12	10 M						
13	15 E						
14	20 M						
15	10 M						
16	10 M						
17	10 E						
18	10 M						

E = Easy M = Moderate D = Difficult

* 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.

EXERCISES

E2–1

E (1) Transaction

F (2) Continuity assumption

B (3) Statement of Financial Position

O (4) Liabilities

K (5) Assets = Liabilities + Shareholders' Equity

L (6) Note payable

H (7) Historical cost principle

I (8) Account

P (9) Dual effects

N (10) Retained earnings

A (11) Current assets

C (12) Separate-entity assumption

D (13) Debits

M (15) Unit-of-measure assumption

Q (16) Shareholders' equity

E2–2

G (1) Relevance

E (2) Confirmatory value

H (3) Verifiability

B (4) Faithful representation

D (5) Predictive value

F (6) Comparability

E2–3 (1) Y; (2) N; (3) Y; (4) N; (5) N; (6) Y.

E2–4

Req. 1

	Given	Received	
(a)	Cash	Land	
(b)	Cash and Note payable	Patents	
(c)	Note payable	Computer equipment	
(d)	Cash	Prepayments	*Future services*
(e)	Cash	Construction in progress	*or Building*
(f)	Cash	Copyright Delivery	
(g)	Cash	truck Merchandise	
(h)	Tradepayables	inventory Cash	*Promise to pay*
(i)	Contributed capital	Investments	
(j)	Cash	—	
(k)	—	Retained earnings	*No exchange transaction*
(l)	Cash	Note payable	
(m)	Cash		*Reduced promise to pay*

Req. 2

The land is (a) would be recorded as an asset at $100,000. The truck in (g) would be recorded as an asset of $32,000. These are applications of the cost principle.

Req. 3

The agreement in *(k)* occurs between the owner and others. There is no effect on the business because of the separate-entity assumption.

E2–5

Account	*Statement of Financial Position Classification*	*Debit or Credit Balance*
1.	CL	Credit
2.	CA	Debit
3.	SE	Credit
4.	NCA	Debit
5.	CA	Debit
6.	NCL	Credit
7.	CA	Debit
8.	NCA	Debit
9.	SE	Credit
10.	CL	Credit
11.	CA	Debit

E2-6

	(1) Debit	**(2) Credit**	**(3) Increases**	**(4) Decreases**
Assets	Increase	Decrease	Debit	Credit
Liabilities	Decrease	Increase	Credit	Debit
Shareholders' equity	Decrease	Increase	Credit	Debit

E2–7

Event	**Assets**		=	**Liabilities**		+	**Shareholders' Equity**	
a.	Cash	+32,000					Contributed capital	+32,000
b.	Land	+18,000		Mortgage note payable	+12,000			
	Cash	–6,000						
c.	Cash	+11,000		Note payable	+11,000			
d.	Note receivable	+300						
	Cash	–300						
e.	Cash	–11,000		Note payable	–11,000			
f.	Equipment	+8,000		Notes payable	+4,000			
	Cash	–4,000						

E2–8

	Assets		= Liabilities		+ Shareholders' Equity	
a.	Property and equipment	+186.7				
	Cash	–186.7				
b.	Cash	–225.2			Contributed capital	–225.2
c.	Cash	–130.5	Dividends payable	–20.3	Retained earnings	–110.2
d.	*No effect*					
e.	Cash	–7.7	Long-term notes payable	–7.7		
f.	Cash	–175.9			Retained earnings or Income tax payable	–175.9

E2-9

a.	Cash (+A)	32,000	
	Contributed capital (+SE)		32,000
b.	Land (+A)	18,000	
	Cash (A)		6,000
	Mortgage note payable (+L)		12,000
c.	Cash (+A)	11,000	
	Note payable (+L)		11,000
d.	Note receivable (+A)	300	
	Cash (A)		300
e.	Note payable (L)	11,000	
	Cash (A)		11,000
f.	Equipment (+A)	8,000	
	Cash (A)		4,000
	Note payable (+L)		4,000

E2–10

Req. 1

a.	Cash (+A)	63,000	
	Contributed capital (+SE)		63,000
b.	Equipment (+A)	16,000	
	Cash (A)		4,000
	Short-term note payable (+L)		12,000

c. No journal entry required because no delivery of services has yet occurred.

d.	Short-term note receivable (+A)	2,500	
	Cash (–A)		2,500
e.	Cash (+A)	6,000	
	Land (+A)	15,000	
	Contributed capital (+SE)		21,000
f.	Short-term note payable (L)	12,000	
	Cash (A)		12,000

g. This transaction occurs between an owner and others, there is no effect on the business due to the separate-entity assumption.

Req. 2

Cash

Beg.		0	
(a)	63,000	4,000	(b)
(e)	6,000	2,500	(d)
		12,000	(f)
	50,500		

Short-Term Note Receivable

Beg.		0
(d)	2,500	
	2,500	

Equipment

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

Beg.	0	
(e)	15,000	
	15,000	

Note Payable

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

	0	Beg.
	63,000	(a)
	21,000	(e)
	84,000	

Req. 3

Assets = $50,500 + 2,500 + 16,000 + 15,000 = $84,000

Assets $ 84,000 = Liabilities $ 0 + Shareholders' Equity $ 84,000 .

E2–11

Req. 1

Transaction	***Brief Explanation***
1	Issued shares to investors for $15,000 cash. (FastTrack Sports Inc. is a corporation.)
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 signed a short-term note payable for the balance, $11,000.
4	Loaned $4,000 cash; the 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.
Statement of Financial Position
At January 7, 2014

Assets		***Liabilities***	
Current Assets		*Current Liabilities*	
Cash	$71,500	Note payable	$90,000
Note receivable	4,000	*Total Current Liabilities*	90,000
Total Current Assets	75,500		
Store fixtures	9,500	***Shareholders' Equity***	
Land	20,000	Contributed capital	15,000
		Total Sharsholders' Equity	
Total Assets	$105,000	***Total Liabilities and Shareholders' Equity***	$105,000

E2–12

Req. 1

Transaction	*Brief Explanation*
1	Issued shares to shareholders for $50,000 cash.
2	Purchased delivery truck for $25,000; paid $4,000 cash and gave a $21,000 note payable for the balance.
3	Loaned $4,000 cash; borrower signed a short-term interest-bearing note for this amount.
4	Purchased investments for $6,000 cash.
5	Paid $3,000 on Note Payable.
6	Sold investments at cost for $2,000 cash.
7	Issued shares to shareholders for $4,000 in exchange for computer equipment.

Req. 2

Faye's Fashions, Inc. Statement of Financial Position As at March 31, 2015

Assets		***Liabilities***	
Current Assets		Long-term note payable	$18,000
Cash	$35,000	*Total Liabilities*	18,000
Short-term investments	4,000		
Short-term note receivable	4,000		
Total Current Assets	43,000		
Noncurrent Assets		***Shareholders' Equity***	
Computer equipment	4,000	Contributed capital	54,000
Delivery truck	25,000	*Total Shareholders' Equity*	
		Total Liabilities and	
Total Assets	$72,000	***Shareholders' Equity***	$72,000

E2–13

(Amounts are in millions of euros)

a.	Dividends declared (or Retained earnings) (-SE)	937	
	Dividend payable (+L)		937
b.	Cash (+A)	19	
	Contributed capital (+SE)		19
c.	Dividends payable (L)	1,516	
	Cash (A)		1,516
d.	Cash (+A)	7,977	
	Note payable – long-term (+L)		7,977
e.	Notes receivable – short term (+A)	27	
	Cash (A)		27
f.	Equipment (+A)	6,890	
	Cash (A)		5,236
	Note payable (+L)		1,654
g.	Investments (+A)	2,073	
	Cash (A)		2,073

E2–14

Req. 1

Assets $5,500 = Liabilities $ 2,500 + Shareholders' Equity $3,000

Req. 2

Cash

	Debit	Credit
Beg.	1,000	
(b)	1,000	150 (a)
(c)	1,250	
(d)	2,000	500 (e)
End.	4,600	

Short-Term Investments

	Debit	Credit
Beg.	2,000	
		1,000 (b)
	1,000	
End.		

Property and Equipment

	Debit	Credit
Beg.	2,500	
		1,250 (c)
	1,250	
End.		

Short-Term Notes Payable

	Debit	Credit
		2,200 Beg.

Long-Term Notes Payable

	Debit	Credit
		300 Beg.
(a)	150	2,000 (d)

	2,200 End.

	2,150 End.

Contributed Capital

	1,000 Beg.
	1,000 End.

Retained Earnings

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

Req. 3

Assets $ 6,850 = Liabilities $ 4,350 + Shareholders' Equity $ 2,500

Req. 4

Massimo Company Statement
of Financial Position As at
December 31, 2014

Assets		***Liabilities***	
Current Assets		Short-term notes payable	$2,200
Cash	$4,600	Long-term notes payable	$2,150
Short-term investments	1,000	*Total Liabilities*	4,350
Total Current Assets	5,600	***Shareholders' Equity***	
Property and equipment	1,250	Contributed capital	1,000
		Retained earnings	1,500
		Total Shareholders' Equity	2,500
Total Assets	$6,850	***Total Liabilities and Shareholders' Equity***	$6,850

E2–14 (continued)

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$5{,}600}{\$2{,}200} = 2.55$$

This ratio indicates that, for every $1 of current liabilities, Massimo has $2.55 in current assets. Massimo's ratio is much higher than the industry average of 1.50, indicating that Massimo maintains a relatively high level of current assets than does the average firm in the industry. Although Massimo's current ratio is relatively high, and may be able to pay back short-term bank loans, one has to take into consideration its long-term note payable as well. Massimo's liabilities are about twice the size of its equity. As a result, lenders may demand a higher interest rate to compensate for the risk associated with lending to this company. Massimo should consider issuing shares instead.

E2–15

Transaction	***Brief Explanation***
(a)	Issued shares to shareholders in exchange for $17,000 in cash and $3,000 in tools and equipment.
(b)	Purchased a building for $50,000; paid $10,000 cash and signed a note for $40,000 .
(c)	Loaned $1,500 cash; received a note signed by the borrower.
(d)	Collected $500 from the note receivable in (c).
(e)	Paid $1,000 on note payable in (b).
(f)	Sold tools and equipment for their original cost of $800.

E2–16

Req. 1

	Increases with ...	Decreases with ...
Equipment	Purchase of equipment	Sale of equipment
Note receivable	Additional loans made to others	Collection of loans made to others
Notes payable	Additional borrowings	Payments of debt

Req. 2

Equipment

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

Note Receivable

	Debit	Credit
1/1	150	
	$\boxed{45}$	225
12/31	170	

Notes Payable

Debit	Credit	
	100	1/1
	170	
	180	12/31

	Beginning balance	+	Increases	–	Decreases	=	Ending balance
Equipment	$500	+	250		X	=	$100
					X	=	650
Note receivable	150	+	X		225	=	170
					X	=	245
Note payable	100	+	170		X	=	180
					X	=	90

E2–17

Activity	Type of Activity	Effect on Cash
(a) Issuance of shares	F	+
(b) Purchase of property, plant, and equipment	I	
(c) Issuance of long-term debt	F	+
(d) Principal repayment of long-term debt	F	
(e) Purchase of investments	I	
(f) Repurchase of shares	F	–
(g) Proceeds from disposition of property, plant, and equipment	I	+

E2–18

Hilton Hotels Corporation
Partial Statement of Cash Flows
For the year ended December 31, 2014

Investing Activities	
Purchase of investments	$ (139)
Purchase and renovation of properties	(370)
Sale of property	230
Receipt of payment on a note receivable	125
Cash flow from investing activities	$ (154)
Financing Activities	
Additional borrowing from creditors	$ 992
Payment of debt principal	(24)
Issuance of shares	60
Cash flow from financing activities	$ 1,028

PROBLEMS

P2–1

Account	*Statement of Financial Position Classification*	*Debit or Credit Balance*
(1)	CA	Debit
(2)	NCL	Credit
(3)	SE	Credit
(4)	CL	Credit
(5)	CA	Debit
(6)	SE	Credit
(7)	NCA	Debit
(8)	CL	Credit
(9)	CL	Credit
(10)	CL	Credit
(11)	NCA	Debit
(12)	NCA	Debit
(13)	CA	Debit
(14)	NCL	Credit

P2–2

Req. 1

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

Req. 2 (on next page)

Req. 3

The transaction between the two shareholders (event *e*) was not included in the tabulation. Since the transaction in *(e)* occurs between the shareholders, 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 shareholders' 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

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

This suggests that for every $1 in current liabilities, East Hill maintains $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**	**Contributed Capital**	**Retained Earnings**
Beg.	50,000			500,000	100,000	50,000	=	100,000	100,000	100,000	400,000
(a)	+90,000						=			+90,000	
(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	+190,000	+400,000
	$870,000							$280,000		$590,000	

P2–3

Req. 1 and 2

Cash

Beg.	21,000		
(b)	12,000	6,000	(a)
(f)	12,000	7,000	(c)
(j)	1,000	9,000	(d)
		5,000	(e)
		3,000	(g)
		9,000	(h)
End.	7,000		

Investments (Short-term)

Beg.	2,000		
(d)	9,000		
End.	11,000		

Trade Receivables

Beg.	3,000		
End.	3,000		

Inventories

Beg.	24,000		
End.	24,000		

Notes Receivable (Long-term)

Beg.	1,000		
(c)	7,000		
End.	8,000		

Equipment

Beg.	48,000		
(a)	18,000	1,000	(j)
End.	65,000		

Factory Building

Beg.	90,000		
(h)	25,000		
End.	115,000		

Intangibles

Beg.	3,000		
(g)	3,000		
End.	6,000		

Trade Payables

		15,000	Beg.
		15,000	End.

Accrued Liabilities

		2,000	Beg.
		2,000	End.

Short-Term Borrowings

		7,000	Beg.
(e)	5,000	12,000	(a)
		12,000	(f)
		26,000	End.

Notes Payable (Long-term)

		48,000	Beg.
		16,000	(h)
		64,000	End.

Contributed Capital

		90,000	Beg.
		12,000	(b)
		102,000	End.

Retained Earnings

		30,000	Beg.
		30,000	End.

Req. 3

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

P2–3 (continued)

Req. 4

Injection Plastics Company
Statement of Financial Position
As at December 31, 2015

Assets		***Liabilities***	
Current Assets		*Current Liabilities*	
Cash	$ 7,000	Trade payables	$ 15,000
Investments	11,000	Accrued liabilities	2,000
Trade receivables	3,000	Short-term Borrowings	26,000
Inventories	24,000	*Total Current Liabilities*	43,000
Total Current Assets	45,000	*Non-current Liabilities*	
		Notes payable	64,000
Non-current Assets		*Total Liabilities*	107,000
Notes receivable	8,000	***Shareholders' Equity***	
Equipment	65,000	Contributed capital	102,000
Factory building	115,000	Retained earnings	30,000
Intangibles	6,000	*Total Shareholders' Equity*	132,000
Total Assets	$239,000	***Total Liabilities and Shareholders' Equity***	$239,000

Req. 5

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$45{,}000}{\$43{,}000} = 1.05$$

This suggests that for every $1 in current liabilities, Injection Plastics Company has $1.05 in current assets. Analysis of the current assets indicates that inventory makes up about 50 percent of these assets. This may present a potential problem if demand for this inventory drops causing the company to sell it at less than its carrying amount. Otherwise, the company should be able to settle its short-term obligations as they become due.

P2–4

Transaction	Type of Activity	Effect on Cash
(a)	I	–
(b)	F	+
(c)	I	–
(d)	I	–
(e)	F	–
(f)	F	+
(g)	I	–
(h)	I	–
(i)	Not applicable	Not applicable
(j)	I	+

P2–5

(Amounts are in millions of euros)

Req. 1

a.	Cash (+A)	60	
	Contributed capital (+SE)		60
b.	Cash (+A)	615	
	Financial liabilities (+L)		616
c.	Retained earnings (-SE)	1,160	
	Cash (A)		1,160
d.	Intangibles (+A)	64	
	Cash (A)		64
e.	Property, plant, and equipment (+A)	6,924	
	Cash (A)		1,514
	Financial liabilities (+L)		5,410
f.	Investments (+A)	623	
	Cash (A)		623
g.	Receivables (+A)	125	
	Cash (A)		125
h.	Cash (+A)	461	
	Investments (A)		461

P2–5 (continued)

Req. 2

Cash and Cash Equivalents

Beg.	3,181		
(a)	60	1,160	(c)
(b)	615	64	(d)
		1,514	(e)
		623	(f)
		125	(g)
(h)	461		
	831		

Receivables

Beg.	8,644		
(g)	125		
	8,769		

Other Assets (Current)

Beg.	1,514		
	1,514		

Inventorie

Beg.	6,539		
	6,539		

Investments

Beg.	319		
(f)	623	461	(h)
	481		

Property, Plant and Equipment

Beg.	9,480		
(e)	6,924		
	16,404		

Intangible Assets

Beg.	19,477		
(d)	64		
	19,541		

Other Assets

Beg.	2,767		
	2,767		

Trade Accounts Payable (Current)

		3,397	Beg.
		3,397	

Financial Liabilities (Current)

		3,721	Beg.
		3,721	

Provisions (Short Term)

		4,593	Beg.
		4,593	

Other Short-Term Liabilities

		1,502	Beg.
		1,502	

Provisions (Long-Term)

		7,524	Beg.
		7,524	

Deferred Income Taxes

		2,401	Beg.
		2,401	

Financial Liabilities (Long-term)

		7,521	Beg.
		615	(b)
		5,410	(e)
		13,546	

Other liabilities (Long-term)

		2,254	Beg.
		2,254	

Contributed Capital

		8,284	Beg.
		60	(a)
		8,344	

P2–5 (continued)

Retained Earnings

		10,724 Beg.
(c)	1,160	
		9,564

Req. 3

BAYER AG
Statement of Financial Position
at December 31, 2012
(in millions of Euros)

ASSETS	
Current assets	
Cash and cash equivalents	831
Receivables	8,769
Inventories	6,539
Other assets	1,514
Total current assets	17,653
Non-current assets	
Investments	481
Property, plant, and equipment	16,404
Intangible assets	19,541
Other assets	2,767
Total non-current assets	39,193
Total assets	56,846
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities	
Trade accounts payable	3,397
Financial liabilities	3,721
Provisions	4,593
Other short-term liabilities	1,502
Total current liabilities	13,213
Non-current liabilities	
Provisions	7,524
Deferred income taxes	2,401
Financial liabilities	13,546
Other liabilities	2,254
Total non-current liabilities	25,725
Total liabilities	38,938
Shareholders' Equity	
Contributed capital	8,344
Retained earnings	9,564
Total shareholders' equity	17,908
Total liabilities and shareholders' equity	56,846

P2–5 (continued)

Req. 4

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$17,653}{\$13,213} = 1.34$$

This suggests that for every $1 in current liabilities, Bayer has $1.34 in current assets. The ratio suggests that Bayer is likely maintaining adequate liquidity and using resources efficiently.

P2–6

BAYER AG
Partial Statement of Cash Flows
For the year ended December 31, 2012
(in millions of Euros)

INVESTING ACTIVITIES	
Purchase of investments	(623)
Sale of investments	461
Purchase of property, plant, and equipment[1]	(1,514)
Purchase of intangibles	(64)
Loan to associated company	(125)
Cash flow used in investing activities	**(1,865)**
FINANCING ACTIVITIES	
Borrowings from banks	615
Payment of dividends	(1,160)
Issuance of shares	60
Cash flow used in financing activities	**(485)**

Proof:	
Ending cash per T-account	€ 831
Less beginning balance	3,181
Decrease	€ 2,350
Cash flow used in investing activities	€(1,865)
Cash flow used in investing activities	(485)
Net decrease	€(2, 350)

[1] Only the portion of the acquisition financed by cash is disclosed in this statement.

P2–7

Req. 1

Danier Leather Inc. Statements of Financial Position As at June 30 (in thousands of dollars)

	Current Year	Prior Year
Assets		
Cash	34,332	28,698
Accounts receivable	517	385
Inventories	24,891	28,964
Prepaid expenses and other current assets	1,225	901
Total current assets	**60,965**	**58,948**
Property and equipment, net	15,738	15,458
Deferred income tax asset	1,909	1,678
Total Assets	78,612	76,084
Liabilities		
Accounts payable and accrued liabilities	10,161	11,024
Deferred revenue	1,587	1,536
Income taxes payable	0	278
Total current liabilities	11,748	12,838
Non-current liabilities	1,373	1,318
Total Liabilities	**13,121**	**14,156**
Shareholders' Equity		
Contributed capital	15,965	16,094
Retained earnings	49,526	45,834
Total Shareholders' Equity	**65,491**	**61,928**
Total Liabilities and Shareholders' Equity	**78,612**	**76,084**

Req. 2

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$60{,}965}{\$11{,}748} = 5.19$$

This ratio suggests that for every $1 in current liabilities, Danier Leather Inc. has $5.19 in current assets. Analysis of the current assets indicates that they consist mainly of cash and inventories. The amount of cash alone is about 3 times current liabilities. While this represents a high margin of safety for creditors, it also indicates that the company may not using its cash resources efficiently to generate income for shareholders.

P2–8

Req. 1

Cash

	Debit	Credit	
Beg.	0		
(a)	40,000	5,000	(c)
(h)	4,000	2,000	(e)
		6,000	(f)
		5,000	(i)
	26,000		

Short-Term Note Receivable

	Debit	Credit	
Beg.	0		
(d)	4,000	4,000	(h)
	0		

Land

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

Equipment

	Debit	Credit	
Beg.	0		
(c)	20,000		
(e)	2,000		
(f)	16,000	10,000	(f)
	28,000		

Short-Term Notes Payable

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

Long-Term Notes Payable

	Debit	Credit	
		0	Beg.
(i)	5,000	15,000	(c)
		10,000	

Contributed Capital

	Debit	Credit	
		0	Beg.
		40,000	(a)
		40,000	

P2–8 *(continued)*

Req. 2

Lee Delivery Company
Statement of Financial Position
As at End of 2014

Assets		***Liabilities***	
Current Assets		*Current Liabilities*	
Cash	$26,000	Short-term notes payable	$16,000
		Total Current Liabilities	16,000
Total Current Assets	26,000	Long-term notes payable	10,000
Non-current Assets		*Total Liabilities*	26,000
Land	12,000		
Equipment	28,000	***Shareholders' Equity***	
		Contributed capital	40,000
		Total Shareholders' Equity	40,000
Total Assets	$66,000	***Total Liabilities and Shareholders' Equity***	$66,000

2014:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$26{,}000}{\$26{,}000} = 1.00$$

Req. 3

2015:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$52{,}000}{\$23{,}000} = 2.26$$

2016:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$47{,}000}{\$40{,}000} = 1.18$$

The current ratio increased in 2015 and then decreased in 2016, 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. 4

The management of Lee Delivery Company has already been financing the company's development through additional short-term debt, from $ 16,000 in 2014 to $40,000 in 2016. This suggests the company is taking on increasing risk. Additional lending, particularly short-term, to the company may be too much risk for the bank to absorb. 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.

ALTERNATE PROBLEMS

AP2–1

Account	*Statement of Financial Position Classification*	*Debit or Credit Balance*
(1)	CA	Debit
(2)	CL	Credit
(3)	SE	Credit
(4)	NCL	Credit
(5)	CA	Debit
(6)	NCA	Debit
(7)	NCA	Debit
(8)	SE	Credit
(9)	CL	Credit
(10)	CA	Debit
(11)	CL	Credit
(12)	NCL	Credit
(13)	CA	Debit
(14)	CL	Credit

AP2–2

Req. 1 (on next page)

Req. 2

Since the transaction in *(i)* occurs between the shareholder and other person outside the company, there is no effect on the business due to the separate-entity assumption.

Req. 3

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 shareholders' 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. 4

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$35{,}000 + \$2{,}000}{\$169{,}000} = \frac{\$37{,}000}{\$169{,}000} = 0.22$$

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

AP2-2 (continued)

Req. 1

	Assets					=	Liabilities		+ Shareholders' Equity	
	Cash	Notes Receivable	Long-Term Investments	Equipment	Building		Short-Term Notes Payable	Long-Term Notes Payable	Contributed Capital	Retained Earnings
Beg.	120,000			70,000	310,000	=	140,000	60,000	220,000	80,000
(a)	+110,000					=		+110,000		
(b)	−3,000			+30,000		=	+27,000			
(c)	+100,000					=			+100,000	
(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	+320,000	+80,000
			$739,000				$339,000		$400,000	