

**EXERCISE 5-6 (30–35 minutes)**

**GARFIELD COMPANY**  
**Balance Sheet**  
**July 31, 2010**

<u>Assets</u>			
<b><u>Current assets</u></b>			
Cash.....		<b>\$66,000*</b>	
Accounts receivable.....	<b>\$46,700**</b>		
Less: Allowance for doubtful accounts.....	<u>3,500</u>	<b>43,200</b>	
Inventories.....		<u>65,300***</u>	
<b>Total current assets.....</b>			<b>\$174,500</b>
 <b><u>Long-term investments</u></b>			
Bond sinking fund .....			<b>12,000</b>
 <b><u>Property, plant, and equipment</u></b>			
Equipment .....		<b>112,000</b>	
Less: Accumulated depreciation— equipment .....		<u>28,000</u>	<b>84,000</b>
 <b><u>Intangible assets</u></b>			
Patents.....			<u>21,000</u>
<b>Total assets .....</b>			<b><u>\$291,500</u></b>

\*(\$69,000 – \$12,000 + \$9,000)

\*\*(\$52,000 – \$5,300)

\*\*\*(\$60,000 + \$5,300)

**EXERCISE 5-6 (Continued)**

**Liabilities and Stockholders' Equity**

**Current liabilities**

Notes and accounts payable.....	\$ 52,000****	
Taxes payable .....	<u>9,000</u>	
Total current liabilities.....		61,000

<b><u>Long-term liabilities</u></b> .....		<u>75,000</u>
Total liabilities .....		136,000

<b><u>Stockholders' equity</u></b> .....		<u>155,500</u>
Total liabilities and stock- holders' equity .....		<u>\$291,500</u>

\*\*\*\*(\$44,000 + \$8,000)

**EXERCISE 5-12 (30–35 minutes)**

**VIVALDI CORPORATION**

**Balance Sheet**

**December 31, 2010**

<u>Assets</u>		
<b><u>Current assets</u></b>		
Cash.....	\$197,000	
Trading securities.....	153,000	
Accounts receivable.....	\$435,000	
Less: Allowance for doubtful accounts.....	(25,000)	410,000
Inventories.....		<u>597,000</u>
Total current assets.....		1,357,000
 <b><u>Long-term investments</u></b>		
Investments in bonds.....	299,000	
Investments in stocks.....	<u>277,000</u>	
Total long-term investments.....		576,000
 <b><u>Property, plant, and equipment</u></b>		
Land.....	260,000	
Buildings.....	1,040,000	
Less: Accum. depreciation.....	(352,000)	688,000
Equipment.....	600,000	
Less: Accum. depreciation.....	(60,000)	<u>540,000</u>
Total property, plant, and equipment.....		1,488,000
 <b><u>Intangible assets</u></b>		
Franchise.....	160,000	
Patent.....	<u>195,000</u>	
Total intangible assets.....		<u>355,000</u>
Total assets.....		<u><u>\$3,776,000</u></u>

## EXERCISE 5-12 (Continued)

### Liabilities and Stockholders' Equity

#### Current liabilities

Accounts payable .....	\$ 455,000	
Short-term notes payable.....	90,000	
Dividends payable .....	136,000	
Accrued liabilities .....	<u>96,000</u>	
<b>Total current liabilities.....</b>		<b>\$ 777,000</b>

#### Long-term debt

Bonds payable .....	1,000,000	
Long-term notes payable .....	<u>900,000</u>	
<b>Total long-term liabilities.....</b>		<b><u>1,900,000</u></b>
<b>Total liabilities .....</b>		<b>2,677,000</b>

#### Stockholder's equity

Paid-in capital		
Common stock (\$5 par) .....	\$1,000,000	
Paid-in capital in excess of par .....	<u>80,000</u>	1,080,000
Retained earnings* .....		<u>210,000</u>
<b>Total paid-in capital and     retained earnings .....</b>		<b>1,290,000</b>
Less: Treasury stock .....		<u>191,000</u>
<b>Total stockholders' equity.....</b>		<b><u>1,099,000</u></b>
<b>Total liabilities and     stockholders' equity .....</b>		<b><u>\$3,776,000</u></b>

**EXERCISE 5-12 (Continued)**

**\*Computation of Retained Earnings:**

<b>Sales .....</b>	<b>\$7,900,000</b>
<b>Investment revenue .....</b>	<b>63,000</b>
<b>Extraordinary gain .....</b>	<b>80,000</b>
<b>Cost of goods sold .....</b>	<b>(4,800,000)</b>
<b>Selling expenses.....</b>	<b>(2,000,000)</b>
<b>Administrative expenses.....</b>	<b>(900,000)</b>
<b>Interest expense .....</b>	<b><u>(211,000)</u></b>
<b>Net income .....</b>	<b><u>\$ 132,000</u></b>

<b>Beginning retained earnings.....</b>	<b>\$ 78,000</b>
<b>Net income .....</b>	<b><u>132,000</u></b>
<b>Ending retained earnings.....</b>	<b><u>\$ 210,000</u></b>

**Or ending retained earnings can be computed as follows:**

<b>Total stockholders' equity.....</b>	<b>\$1,099,000</b>
<b>Add: Treasury stock.....</b>	<b>191,000</b>
<b>Less: Paid-in capital .....</b>	<b><u>1,080,000</u></b>
<b>Ending retained earnings.....</b>	<b><u>\$ 210,000</u></b>

**Note to instructor: There is no dividends account. Thus, the 12/31/10 retained earnings balance already reflects any dividends declared.**

**EXERCISE 5-14 (25–35 minutes)**

**CONNECTICUT INC.**  
**Statement of Cash Flows**  
**For the Year Ended December 31, 2010**

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<b>Cash flows from operating activities</b>		
Net income .....		<b>\$34,000</b>
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation expense .....	<b>\$ 6,000</b>	
Increase in accounts receivable .....	<b>(3,000)</b>	
Increase in accounts payable .....	<u><b>5,000</b></u>	<u><b>8,000</b></u>
Net cash provided by operating activities .....		<b>42,000</b>
<b>Cash flows from investing activities</b>		
Purchase of equipment .....		<b>(17,000)</b>
<b>Cash flows from financing activities</b>		
Issuance of common stock .....	<b>20,000</b>	
Payment of cash dividends .....	<u><b>(13,000)</b></u>	
Net cash provided by financing activities .....		<u><b>7,000</b></u>
Net increase in cash .....		<b>32,000</b>
Cash at beginning of year .....		<u><b>13,000</b></u>
Cash at end of year .....		<u><b>\$45,000</b></u>

**PROBLEM 5-2**

**MONTOYA, INC.  
Balance Sheet  
December 31, 2010**

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**Assets**

**Current assets**

Cash.....	\$ 360,000	
Trading securities.....	121,000	
Notes receivable.....	445,700	
Income taxes receivable.....	97,630	
Inventories.....	239,800	
Prepaid expenses.....	<u>87,920</u>	
<b>Total current assets.....</b>		<b>\$1,352,050</b>

**Property, plant, and equipment**

Land.....		\$ 480,000	
Building.....	\$1,640,000		
Less: Accum. depreciation— building.....	<u>270,200</u>	1,369,800	
Equipment.....	1,470,000		
Less: Accum. depreciation— equipment.....	<u>292,000</u>	<u>1,178,000</u>	3,027,800

**Intangible assets**

Goodwill.....		<u>125,000</u>	
<b>Total assets.....</b>			<b><u>\$4,504,850</u></b>

## PROBLEM 5-2 (Continued)

### Liabilities and Stockholders' Equity

#### Current liabilities

Accounts payable .....	\$ 490,000	
Notes payable to banks .....	265,000	
Payroll taxes payable .....	177,591	
Taxes payable .....	98,362	
Rent payable .....	<u>45,000</u>	
<b>Total current liabilities .....</b>		<b>\$1,075,953</b>

#### Long-term liabilities

Unsecured notes payable (long-term) .....		\$1,600,000	
Bonds payable .....	\$300,000		
Less: Discount on bonds payable .....	<u>15,000</u>	285,000	
Long-term rental obligations .....		<u>480,000</u>	<u>2,365,000</u>
<b>Total liabilities .....</b>			<b>3,440,953</b>

#### Stockholders' equity

Capital stock			
Preferred stock, \$10 par; 20,000 shares authorized, 15,000 shares issued .....	\$150,000		
Common stock, \$1 par; 400,000 shares authorized, 200,000 issued .....	<u>200,000</u>	\$350,000	
Retained earnings (\$1,063,897 – \$350,000) .....		<u>713,897</u>	
<b>Total stockholders' equity         (\$4,504,850 – \$3,440,953) .....</b>			<u><b>1,063,897</b></u>
<b>Total liabilities and         stockholders' equity .....</b>			<u><b>\$4,504,850</b></u>

<b>PROBLEM 5-5</b>
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**SARGENT CORPORATION**  
**Balance Sheet**  
**December 31, 2010**

<u>Assets</u>			
<b><u>Current assets</u></b>			
Cash.....		\$150,000	
Trading securities (at fair value).....		80,000	
Accounts receivable.....	\$ 170,000		
Less: Allowance for doubtful accounts.....	10,000	160,000	
Inventories, at lower of cost (determined using FIFO) or market.....		180,000	
Total current assets.....			\$ 570,000
<b><u>Long-term investments</u></b>			
Investments in common stock (at fair value) .....		270,000	
Bond sinking fund .....		250,000	
Cash surrender value of life insurance.....		40,000	
Land held for future use.....		270,000	830,000
<b><u>Property, plant, and equipment</u></b>			
Land .....		500,000	
Buildings .....	1,040,000		
Less: Accum. depreciation— building.....	360,000	680,000	
Equipment .....	450,000		
Less: Accum. depreciation— equipment .....	180,000	270,000	1,450,000
<b><u>Intangible assets</u></b>			
Franchise.....		165,000	
Goodwill.....		100,000	265,000
Total assets .....			\$3,115,000

## PROBLEM 5-5 (Continued)

### Liabilities and Stockholders' Equity

#### Current liabilities

Accounts payable .....	\$ 140,000		
Notes payable .....	80,000		
Taxes payable .....	40,000		
Unearned revenue.....	<u>5,000</u>		
<b>Total current liabilities.....</b>			<b>\$ 265,000</b>

#### Long-term liabilities

Notes payable .....	\$ 120,000		
7% bonds payable, due 2018.....	\$1,000,000		
Less: Discount on bonds payable.....	<u>40,000</u>	<u>960,000</u>	<u>1,080,000</u>
<b>Total liabilities .....</b>			<b>1,345,000</b>

#### Stockholders' equity

<b>Capital stock</b>			
<b>Preferred stock, no par value;</b>			
200,000 shares authorized,			
70,000 issued and outstanding .....			
	450,000		
<b>Common stock, \$1 par value;</b>			
400,000 shares authorized,			
100,000 issued and outstanding .....			
	100,000		
<b>Paid-in capital in excess of par on</b>			
<b>common stock (100,000 X</b>			
<b>[\$10.00 – \$1.00]) .....</b>			
	<u>900,000</u>	<u>1,450,000</u>	
Retained earnings.....		<u>320,000</u>	
<b>Total stockholders' equity.....</b>			<b><u>1,770,000</u></b>
<b>Total liabilities and</b>			
<b>stockholders' equity .....</b>			
			<b><u>\$3,115,000</u></b>

<b>PROBLEM 5-7</b>
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(a)

**AERO INC.**  
**Statement of Cash Flows**  
**For the Year Ended December 31, 2010**

<b>Cash flows from operating activities</b>		
Net income .....		<b>\$35,000</b>
<b>Adjustments to reconcile net income to net cash provided by operating activities</b>		
Depreciation expense .....	\$12,000	
Loss on sale of investments .....	5,000	
Increase in accounts payable (\$40,000 – \$30,000) .....	10,000	
Increase in accounts receivable (\$42,000 – \$21,200) .....	<u>(20,800)</u>	<u>6,200</u>
Net cash provided by operating activities .....		<b>41,200</b>
<b>Cash flows from investing activities</b>		
Sale of investments .....	27,000	
Purchase of land .....	<u>(38,000)</u>	
Net cash used by investing activities .....		<b>(11,000)</b>
<b>Cash flows from financing activities</b>		
Issuance of common stock .....	30,000	
Payment of cash dividends .....	<u>(10,000)</u>	
Net cash provided by financing activities .....		<u>20,000</u>
Net increase in cash .....		<b>50,200</b>
Cash at beginning of year .....		<u>20,000</u>
Cash at end of year .....		<u><b>\$70,200</b></u>
<b>Noncash investing and financing activities</b>		
Land purchased through issuance of \$30,000 of bonds		

**PROBLEM 5-7 (Continued)**

(b)

**AERO INC.  
Balance Sheet  
December 31, 2010**

<u>Assets</u>		<u>Liabilities and Stockholders' Equity</u>	
Cash	\$ 70,200	Accounts payable	\$ 40,000
Accounts receivable	42,000	Bonds payable	71,000 (3)
Plant assets (net)	69,000 (1)	Common stock	130,000 (4)
Land	<u>108,000 (2)</u>	Retained earnings	<u>48,200 (5)</u>
	<u>\$289,200</u>		<u>\$289,200</u>

(1) \$81,000 – \$12,000

(2) \$40,000 + \$38,000 + \$30,000

(3) \$41,000 + \$30,000

(4) \$100,000 + \$30,000

(5) \$23,200 + \$35,000 – \$10,000

(c) An analysis of Aero's free cash flow indicates it is negative as shown below:

**Free Cash Flow Analysis**

Net cash provided by operating activities .....	\$ 41,200
Less: Purchase of land .....	(38,000)
Dividends .....	(10,000)
Free cash flow .....	<u>\$ ( 6,800)</u>

## **PROBLEM 5-7 (Continued)**

Its current cash debt coverage is 1.18 to 1  $\left( \frac{\$41,200}{\$35,000^*} \right)$ . Overall, it appears that its liquidity position is average and overall financial flexibility should be improved.

$$*(\$30,000 + \$40,000) \div 2$$

- (d) This type of information is useful for assessing the amount, timing, and uncertainty of future cash flows. For example, by showing the specific inflows and outflows from operating activities, investing activities, and financing activities, the user has a better understanding of the liquidity and financial flexibility of the enterprise. Similarly, these reports are useful in providing feedback about the flow of enterprise resources. This information should help users make more accurate predictions of future cash flow. In addition, some individuals have expressed concern about the quality of the earnings because the measurement of the income depends on a number of accruals and estimates which may be somewhat subjective. As a result, the higher the ratio of cash provided by operating activities to net income, the more comfort some users have in the reliability of the earnings.

## CA 5-3

1. Unclaimed payroll checks should be shown as a current liability if these are claims by employees.
2. Trading securities should be reported at fair value, not cost.
3. Bad Debt Reserve is an improper terminology; Allowance for Doubtful Accounts is considered more appropriate. The amount of estimated uncollectibles should be disclosed.
4. Next-in, First-out (NIFO) is not an acceptable inventory valuation method.
5. Heading "Tangible assets" should be changed to "Property, Plant and Equipment" also label for corresponding \$630,000 should be changed to "net property, plant, and equipment."
6. Land should not be depreciated.
7. Buildings and equipment and their related accumulated depreciation balances should be separately disclosed.
8. The valuation basis for stocks should be disclosed (fair value or equity) and the description should be Available for Sale Securities or Investment in X Company.
9. Treasury stock is not an asset and should be shown in the stockholders' equity section as a deduction.
10. Discount on bonds payable is not an asset and should be shown as a deduction from bonds payable.
11. Sinking fund should be reported in the long-term investments section.