Foundations of Accounting & Finance

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Week - 03

Lecture – 10

Preparation of Balance Sheet Lone Pine Cafe A - Part II

Receivables from Ski instructors

It is mentioned that Ski instructors were permitted to charge their meals, resulting in an account of $870 being owed by them. This indicates that the ski instructors utilized the credit facilities provided by the cafe, allowing them to pay for their meals at a later date. As of March 30, the ski instructors owed the cafe $870, which constitutes as receivable from the ski instructors and is recorded as an asset for the cafe.

Despite the subsequent payment of these accounts in full, as mentioned in the statement, the focus remains on preparing the balance sheet as of March 30 and as of that day it was still due. Therefore, the cafe was owed $870 by the ski instructors as of that date, hence recorded as receivables.

Amount owed to the suppliers

Further, the statement also mentions that the Lone Pine Cafe owed suppliers a total of $1583. This indicates that the cafe had liabilities amounting to $1583, representing the amount owed to its suppliers. This amount is recorded as a liability for the cafe.

Depreciation on the assets

Mr. Simpson estimated that the depreciation on the asset amounted to $2445. The asset referred to in this context is the equipment (one can also include the cash register in the list of assets – for the purpose of ease of understanding we have restricted it only to equipment), which initially had a value of $53,200. However, due to depreciation, the value of the equipment has decreased by $2445 as is valued at $50,755 as of March 30, 2010.

Depreciation is the reduction in the value of a tangible asset due to usage and passage of time. It is accounted by allocating the cost of the tangible assets over its useful life. In this case, the equipment's value has decreased due to usage and passage of time (from November 2, 2009, to March 30, 2010) by $2445.

Although depreciation could also apply to other assets such as the cash register, since the equipment is a larger and significant asset, depreciation is specifically accounted for in the value of the equipment.

Therefore, as of March 30, the value of the equipment, as reflected in the balance sheet, is $50,755.

Value of Food and Beverages

On March 30, the value of food and beverages on hand was estimated to be $2430. This indicates the food and beverages inventory of the café which was worth $2430 and hence counted as an asset.

Regarding the inconsistency with the value of food and beverages with the opening balance sheet where the value was $2800. During the period of operation of the café there would be continued purchase of food and beverage inventory and they would also be continued use of these food and beverage, unless the inventory of food and beverage was moving in and out continuously the café possibly can't operate. Therefore, what was recorded on November 2, 2009 was the value of food and beverage on that day and what is recorded on March 30, is the value of food and beverage as on March 30, 2010.

Payment of Salaries

During the operational period, the partners agreed upon salaries, and these payments were up to date. When payments are made, the impact is on the income statement primarily and on the balance sheet in terms of reduction in cash. However, if a payment is not made and remains due, it becomes a liability, and is prominent in the balance sheet.

When all payments are settled up to date, there is no outstanding liability as on March 30, 2010. Consequently, there is no entry related to salaries on the balance sheet as of March 30, 2010.

Clothes of Mr. Anthony

The clothing left behind by Mr. Anthony was estimated to be worth 750 dollars. Now, there are multiple opinions on this matter.

One perspective suggests considering it as an asset because it is the clothing of a partner. However, it is crucial to note that it is the personal clothing left by Mr. Anthony. Therefore, it is his personal property, and does not belong to the cafe. Since the cafe does not own this clothing, it should not be recorded as part of the cafe's assets. We only record what the cafe owes and owns, and in this case, the cafe does not own the $750 worth of clothes.

Another argument is to suggest offsetting the value of the stolen cash register with the value of the clothing. However, this approach is not justified because two wrongs do not make something correct. Regardless of the circumstances, the clothing belongs to Mr. Anthony, and it is his right to decide its fate. Until he reclaims it, the cafe should keep it safe and eventually return it to him. One can't take law into one's own hands and decide with regard to offsetting. There is a legal system in place and it will be unjustified if one thinks on those lines.

In a hypothetical scenario where the clothing provided to Mr. Anthony was a special equipment provided by the cafe for working in the kitchen, it would indeed be considered an asset of the café. However, since the clothing in this case is described as personal and not provided by the cafe, it should not be treated as an asset of the cafe. Therefore, it should not be included in the balance sheet of the cafe.

Repayment of Bank Loan

The partnership repaid 2100 of its bank loan. Initially, the bank loan was 21000. With the repayment of 2100, the remaining amount owed to the bank is 18900. Therefore, the liability side of the balance sheet will reflect this amount of 18900 owed to the bank.

Purchase of operating license

The operating license purchased for $1428 was valid for one full year from the opening of the cafe. As of March 30, the license has been utilized for 5 months (November, December, January, February, and March), leaving 7 months of its value unexpired. Therefore, the remaining value of the license, which is still an asset, is estimated to be about $833. This unutilized portion of the license is recorded as an asset in the balance sheet as it can be utilized by the next operator of the café or can be sold, etc.

Effective Sources and Utilization funds

Now, let us analyse the difference in the balance sheet. The total liabilities plus equity amount to $68,483, while the total assets amount to $57,629. Why is there a difference? It's essential to understand that every transaction should find a place in at least two of the four major heads viz. income, expenditure, asset, liability plus equity. While some argue that certain entries such as salaries, sales revenue have not been considered. Please note we are not worried about recording every transaction rather our emphasis is only on what the cafe owns and owes as on March 30. In this context, what matters are the sources and utilizations of funds.

Example

A company starts with a contributed capital of $100, the initial cash is $100 on the asset side of the balance sheet. If this cash is used to purchase raw materials, the capital remains $100, but the cash is converted to raw materials, which is also an asset worth $100 and hence the balance sheet almost remains unchanged. When these raw materials are used to create finished goods, the value of the assets remains the same at $100, but now in the form of finished goods. If the finished goods are then sold for $140, the finished goods go out of the balance sheet and cash gets it with a balance of $140, effectively increasing the value of the initial capital. In this scenario, the company efficiently utilized its funds, resulting in a profit and the profit belongs to the capital provider. Hence the café owes in addition to $100 another $40 which is the profit to the capital provider and hence the profit is added to the capital as retained earnings. However, if the finished goods are sold for only $80, the finished goods go out of the balance sheet and cash balance is $80. This results in inefficient utilisation of the capital viz. the initial capital was $100 and now in the process of operating the business the value has been reduced to $80 resulting in a reduction in value which is what is called as a loss. The loss again is borne by the capital provider and is reduced from the capital brining the capital also to $80. In this case, the company made an inefficient use of its funds, resulting in a loss.

In Lone Pine Café case, the difference between the sources of funds ($68,483) and the value generated from their utilization ($57,629) indicates an inefficient utilization of funds, leading to a loss (see table 1). Each partner would receive a value equal to their contributed capital minus their share of the loss if the partnership were dissolved.

Table 1: Balance Sheet of Lone Pine as of March 30, 2010

Balance Sheet of Lone Pine as of March 30, 2010			
Utilization of funds		**Sources of funds**	
equipment	50,755	Capital of Mr & Mrs Henry Antoine	32,000
		Mrs Sandra Landers	16,000
		net loss	-10,854
		TOTAL Capital	37,146
		borrowings from the bank	18,900
F & B	2,430		
cash	311	creditors of supplies	1,583
Bank (checking account)	1,030		
operating license	833		
Cash register	1,400		
receivable from ski instructors	870		
	57,629		**57,629**