Foundations of Accounting & Finance

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Lecture – 13

Classification of Balance Sheet Items: Maynard Company A

Introduction

Let us solve another case from the prescribed textbook. This case involves Maynard Company A and B, with case A discussed in Chapter 2 and Case B in Chapter 3 in the text book. The objective of this case is to prepare both a balance sheet and an income statement. Similar to our analysis of Lone Pine Café, Maynard Company B deals with income statement, while Maynard Company A will be deal with balance sheet. We will start by preparing the balance sheet and then move on to the income statement.

Maynard Company A

Diane Maynard made the following request of a friend:

My bookkeeper has quit, and I need to see the balance sheet of my company. He has left behind a book with the numbers already entered in it. Would you be willing to prepare balance sheets for me? Also, any comments you care to make about the numbers would be appreciated. The Cash account is healthy, which is a good sign, and he has told me that the net income in June was $19,635.

The book contained a detailed record of transactions, and from it the friend was able to copy off the balances at the beginning of the month and at the end of the month as shown in Exhibit 1. Diane Maynard owned all the stock of Maynard Company. At the end of June, Diane Maynard paid herself an $11,700 dividend and used the money to repay her loan from the company.

First Question: Prepare the balance sheets as the 01 and 30, June in proper formats

Let us answer only the first question. Two balance sheets opening and closing balance sheet as on 30th of June. All the accounting balances are provided in Exhibit I. It is a very simple task. All I have to do is to classify them into asset and liability. But before we do get into it, I am going to explain about one more aspect of assets and liabilities.

Exhibit 1 - Account balances		
	Jun-01	Jun-30
Accounts payable	$ 8,517	21,315
Accounts receivables	21,798	26,505
Accrued wages payable	1,974	2,202
Accumulated depreciation on building	1,56,000	1,57,950
Accumulated depreciation on equipment	5,304	5,928
Bank notes payable	8,385	29,250
Building	5,85,000	5,85,000
Capital stock	3,90,000	3,90,000
Cash	34,983	66,660
Equipment (at cost)	13,260	36,660
Land	89,700	89,700
Merchandise inventory	29,835	26,520
Note receivable, Diane Maynard	11,700	-
Other non-current assets	4,857	5,265
Other noncurrent liabilities	2,451	2,451
Prepaid insurance	3,150	2,826
Retained earnings	2,21,511	2,29,446
Supplies on hand	5,559	6,630
Taxes payable	5,700	7224

Classification of Assets and Liabilities

When discussing assets or liabilities, we typically categorize them into two broad classifications: long-term and short-term. Short-term, also known as current, and long-term, referred to as non-current, encompass various types of assets and liabilities.

1) Current and Long-Term liabilities

Liabilities can be of short-term or long-term. Short-term liabilities are those due within a year, while long-term liabilities extend beyond this timeframe. However, the distinction between short-term and long-term is not accurately defined by a one-year or 365 deadlines rather it is the judgement of the accountant or the policy of the entity. Organizations may need to exercise judgment in classifying payments as immediate or long-term based on individual circumstances.

2) Current and Long-Term Assets

Similarly, assets are categorized as short-term, current, or non-current. Non-current assets are those that do not frequently change form. For example, a building's physical structure remains unchanged despite depreciation, distinguishing it from assets like cash, which fluctuates regularly. Assets that undergo frequent changes, such as receivables, are considered short-term or current assets.

In financial reporting, it's essential to present assets and liabilities with these classifications, highlighting whether they are current or long-term. This structured approach ensures clarity and accuracy in understanding a company's financial position.

Assets and Liabilities Classification in the Maynard Case

In the Maynard Company case, I have classified assets into current assets and non-current assets, and liabilities into current liabilities and non-current liabilities as depicted in table 1. This classification is crucial for understanding the financial position accurately. Why is it necessary? For instance, all short-term liabilities, or current liabilities, must be funded by current assets. It's straightforward: the money I receive from sales made last month is used to pay for purchases that is due currently. Therefore, my current liabilities are covered by my current assets.

Now, let's examine this aspect further. I am preparing both the balance sheet as of June 01 and as of June 30 simultaneously. We will focus solely on the balance sheet for now; the income statement will be addressed shortly. Let's proceed step by step.

1) **Accounts Payable**

Accounts payable represent the amounts owed for purchases made. It's considered a current liability because these obligations typically have a credit period of less than a year, often around 90 days, 60 days, or 45 days. Further, the balance of accounts payable fluctuates continuously as purchases are made and payments are processed. In the Maynard case, the accounts payable amount was $8,517 on June 01 and $21,315 on June 30. These figures indicate the outstanding amounts owed for purchases made during the respective periods.

2) **Accounts Receivable**

Accounts receivable represent the amounts owed to a company for sales made. Similar to accounts payable, it's classified as a current asset because these amounts are expected to be received in the short term. The balance of accounts receivable is dynamic, changing continuously as sales are made and payments are received throughout the operating period. In the Maynard case, the accounts receivable amount was $21,798 on June 01 and $26,505 on June 30. These figures reflect the outstanding amounts owed to the company for sales made during the respective periods.

3) **Accrued Wages Payable**

Accrued wages payable refers to the wages owed to employees for work already performed but not yet paid. This represents a current liability because the obligation to pay arises from services rendered within a short timeframe, typically within the current accounting period. In the Maynard case, the accrued wages payable amounted to $1,974 on June 01 and $2,202 on June 30. These figures represent the accumulated wages owed to employees for their services rendered up to those dates, but not yet disbursed.

4) **Accumulated Depreciation on Building and Equipment**

Accumulated depreciation refers to the total depreciation expense charged on an asset from the time of its acquisition until the present date. Let us illustrate this with an example:

Suppose we have purchased a building for $10,000 at the beginning of Year 1. At the start of Year 2, after one year of usage, its value on the balance sheet would be $10,000 minus the depreciation expense incurred during the first year, say $1,000, resulting in a net value of $9,000. This depreciation expense of $1,000 represents the accumulated depreciation for the first year.

Moving to Year 3, if the building still has a original (gross) value of $10,000 and the accumulated depreciation from the previous years is $2,000 (Year 1: $1,000 + Year 2: $1,000), the depreciation for Year 3 would be $ 1000 and the accumulated depreciation for year 4 would be $ 3,000

In the Maynard case, we have both accumulated depreciations on the building and equipment:

1. **Accumulated Depreciation on Building:** For example, on June 01, the building's value was $585,000, and the accumulated depreciation was $156,000. By June 30, the accumulated depreciation had increased to $157,950. This increase indicates depreciation of the building for the month of June.

2. **Accumulated Depreciation on Equipment:** Similarly, on June 01, the equipment's value was $13,260, and the accumulated depreciation was $5,304. By June 30, the accumulated depreciation had increased by $5,928, reflecting additional depreciation during the month.

These accumulated depreciation figures are essential for determining the net value, or the book value, of the assets. Subtracting the accumulated depreciation from the original cost provides the net book value of the assets. This net value is crucial for assessing the true worth of the assets and for financial reporting purposes.

5) **Bank Notes Payable**

Bank notes payable refer to the amount owed to a bank, typically for loans or discounts provided by the bank. This is considered a current liability since it represents money that must be repaid within a short period, usually within one year. In financial statements, bank notes payable is classified as current liabilities unless specified otherwise. Long-term liabilities, on the other hand, are debts or obligations due beyond the next operating cycle or one year, and they are explicitly labelled as such if applicable. Therefore, bank notes payable is categorized as short-term liabilities, indicating that they are expected to be settled within the near future, typically within the current operating cycle or fiscal year.

6) Capital stock

Capital stock, colloquially referred to as "stock," represents the total amount of capital or equity invested by shareholders in a company. While the term "stock" is often associated with the price of shares, in this context, it refers to the overall ownership stake in the company. In this particular case, the capital stock amounts to $390,000, indicating the total equity contributed by shareholders. It represents the collective investment made by shareholders in the company.

7) Cash

Cash, a current asset, represents the liquid funds available to the company. In this case, the cash balance at the beginning of the period is $34,983, and at the end of the period, it amounts to $66,660. This indicates an increase in cash over the specified period.

8) Merchandise inventory

Merchandise inventory refers to the raw materials or goods held by a company for sale. It is classified as a current asset because it constantly fluctuates due to ongoing production and sales activities. The merchandise inventory at the beginning of the period amounts to $29,835, and at the end of the period, is $26,520. These figures reflect the changes in inventory levels over the specified period.

9) Notes receivable from Dan Maynard

Notes receivable is from Dan Maynard's company. Yes, Dan Maynard himself or herself is different; his company is an independent entity. In this case Dan Maynard owes the money to the company. It is essential to understand the entity concept: Dan Maynard as an individual is distinct from his or her company. As of June 01, Dan Maynard's company is owed $11,700. However, by June 30, the debt has been settled, reducing the balance to zero. When referring to "notes receivable from Dan Maynard," it means that the company is expecting to receive this amount. Therefore, it represents a current asset for Maynard Company, as they anticipate receiving the payment from Dan Maynard.

10) Other non-current assets and non-current liabilities

The other non-current asset in this case initially amounts to $4,857 and then increases to $5,265. As for other non-current liabilities, they remain constant at $2,451 throughout the period.

11) Prepaid Insurance

The company paid for insurance coverage in advance but has not utilized it yet, making it an obvious asset. Specifically, it is a current asset since it is typically utilized within a year. Even if it is a 5-year prepaid insurance, it is still categorized as a current asset because long-term premiums are uncommon due to the difficulty in assessing long-term risks. In this case, prepaid insurance amounts to approximately $3,150 initially and then decreases to about $2,826 with the passing of one month essentially indicating the value of the benefit of one month's insurance.

12) Retained earnings

Retained earnings represent the portion of profits that is retained by the company rather than distributed to shareholders. It belongs to the capital providers, so it needs to be added to the capital stock. In this case, retained earnings amount to $221,511 initially and then increase to $229,446 after the addition of the profit for the current period. Total shareholders' equity is always the sum of capital stock and retained earnings.

13) Supplies on hand

Supplies on hand are considered a current asset. These are items such as lubricants and other materials owned by the company. The value of supplies on hand is $5,559 initially and increases to $6,630 with acquisitions during the period.

14) Taxes payable

"Taxes payable" refers to the amount of taxes that the company owes and is considered a current liability. The value of taxes payable is $5,700 initially and increases to $7,224 with addition of taxes due for the month of June.

15) Land

"Land" is classified as a long-term, non-current asset. The value of the land on the books is $89,700.

Balance of Assets and Liabilities

The assets total $638,538 as of June 01 and $681,888 as of June 30. Liabilities and equity are both $638,538 as of June 01 and $681,888 as of June 30. The balance of assets and liabilities are equal. Now, we can proceed to analyze the income statement for Maynard Company B. If you approach in a similar manner as was done in Lone Pine Cafe, it should provide a helpful framework.

Table 1 : Balance Sheets as of June 1 and June 30

MAYNARD COMPANY Balance Sheets as of June 1 and June 30				
	As of June I		As of June 30	
Assets				
Current Assets:				
Accounts receivable	21,798		26,505	
cash	34,983		66,660	
Merchandise inventory	29,835		26,520	
Notes from Diane Maynard	11,700		-	
pre paid insurance	3,150		2,826	
supplies on hand	5,559		6,630	
Total current assets		1,07,025		1,29,141
Noncurrent assets:				
Building	5,85,000		5,85,000	
Less Accumulated depreciation	1,56,000		1,57,950	
		4,29,000		4,27,050
Equipment @ cost	13,260		36,660	
Less Accumulated depreciation	5,304		5,928	
		7,956		30,732
LAND		89,700		89,700
other non current assets		4,857		5,265
Total noncurrent assets		5,31,513		5,52,747
Total assets		6,38,538		6,81,888
Liabilities and Shareholders' Equity				
Current liabilities:				
Accounts payable	8,517		21,315	
Accrued wages payable	1,974		2,202	
bank notes payable	8,385		29,250	
taxes payable	5,700		7,224	
Total current liabilities		24,576		59,991
Other noncurrent liabilities		2,451		2,451
Total liabilities		27,027		62,442
Shareholders' Equity:				
Capital stock	3,90,000		3,90,000	
retained earnings	2,21,511		2,29,446	
Total shareholder's equity		6,11,511		6,19,446
Total liabilities and shareholders' equity		6,38,538		6,81,888