Foundations of Accounting & Finance

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Week - 03

Lecture – 09

Preparation of Balance Sheet Lone Pine Cafe A - Part I

Introduction

In the past few sessions, we have been analysing lists of transactions, recording them in either or both the income statement and the balance sheet. We have been exploring how these two statements interact and the impact of each transaction on the statements. We will continue building on this by solving two case studies from our prescribed textbook. Let us start with Lone Pine Cafe A & B. The purpose is to help you understand the concept of balance sheet and income statement better. In addition, we will attempt to solve another case study from the prescribed text viz. Maynard Company A & B in next couple of sessions.

Lone Pine Cafe A

According to the case, as on March 31st, 2010, the partnership responsible for operating Lone Pine Cafe was dissolved under unusual circumstances. As a result, there was a need to prepare a balance sheet. The case outlines the events leading to dissolution, and followed by three questions to be answered. Let us focus on the first two questions:

1) **First Question: Prepare a balance sheet as of November 02, 2009**

November 02, 2009 is when the entity called Lone Pine Cafe started its operations. Therefore, there is a need to prepare a balance sheet as of November 02, 2009 to assess what the café owns and owes on that day they began operations.

2) **Second Question: Prepare a balance sheet as of March 30, 2010**

On March 31, 2010, the partnership was forcibly dissolved and the partnership had to wind up the operations of Lone Pine Cafe. Hence, we are required to prepare a balance sheet as on the last day of operations which is March 30, 2010 to again assess what the café owes and owns. This balance sheet will provide insight into the financial position just before its dissolution.

First Question: Detailed Analysis

1) **Capital Contribution**

To address the question number one, we will start by preparing the balance sheet for Lone Pine Cafe as of November 02, 2009. The objective is to list all the assets, liabilities, and equity of the cafe as of this date. The partnership was formed by Mr. and Mrs. Henry Antoine and Mrs. Sandra Landers, who had previously worked together in a Portland, Oregon restaurant. On November 01, 2009, each partner contributed $16,000 in cash to the partnership and agreed to share profits proportionally based on their contributed capital, with each partner owning one-third.

Mr. and Mrs. Henry Antoine's contributions came from their savings, while Mrs. Sandra Landers' contribution was from the proceeds of an insurance policy. Further, on the same day, the partnership signed a one-year lease for the Lone Pine Cafe located in a nearby recreation area, with a monthly rent of $1,500. This facility attracted the partners because of the living accommodations on the floor above the restaurant.

To summarize the financial transactions:

- Each of the three partners contributed $16,000 in cash, totalling $48,000.
- This cash represents the cafe's assets and the partners' ownership stake (capital) in the cafe.

Now, the effect on balance sheet as of November 02, 2009:

- Assets: Cash: $48,000 as cash is received by the business and is now owned by the business.
- Equity:
    - Mr. and Mrs. Henry Antoine's capital: $32,000 (combined contribution)
    - Mrs. Sandra Landers' capital: $16,000
    - Total Equity: $48,000 this is the money contributed by the partners as capital and the business owes the capital (capital as on date of dissolution) back to the partners on the day it is dissolved.

The balance sheet indicates that the Lone Pine Cafe's assets equal its equity, as there are no other liabilities mentioned. This indicates that all contributions made by the partners are reflected as the cafe's assets.

2) One year lease agreement

On November 01, the partnership signed a one-year lease for Lone Pine Cafe, situated in a nearby recreation area, with a monthly rent of $1,500. The decision to lease this facility was influenced by its attractive features, including living accommodations.

It's important to note that signing the lease constitutes a contractual agreement, but it does not result in an immediate financial transaction. The monthly rent of $1,500 is payable at the end of each month, and not at the beginning of the month. Therefore, as of November 01, 2009, there is no financial impact on the balance sheet of Lone Pine Cafe because the rent payment is not yet due.

Since the lease agreement represents a commitment rather than an actual expense, it will not be reflected in the balance sheet until the rent becomes due at the end of the month. As such, the balance sheet as of November 01t, 2009, will not include any entries related to the lease agreement for Lone Pine Cafe.

3) Borrowings From Bank by Partners

The partners borrowed $21,000 from a local bank. This borrowing increases the liability of the partnership by $21,000. Simultaneously, the cash balance of the partnership also increases by the same amount as the cash received from the bank is owned by the cafe, resulting in a total cash balance of $69,000.

4) Utilization of Bank Borrowings

The statement mentions that the partners used this borrowed amount of $21,000, along with $35,000 from the partnership funds, to acquire the previous operator of the cafe. Therefore, the total cash utilized for this purpose amounted to $56,000.

Breaking down the utilization of this $56,000, it is noted that $53,200 was allocated for purchasing equipment, while $2,800 was used for purchasing food and beverage inventory. Consequently, the balance sheet reflects a decrease in the cash balance by $56,000, as this amount was utilized to acquire these assets. Further, purchase of the equipment and food and beverage inventory are assets of the cafe.

5) Purchase of local operating license

The partnership spent $1,428 to acquire a local operating license, valid for one year starting from November 01. This transaction results in a reduction of cash balance by $1,428. The acquisition of the operating license adds value to the partnership's assets as it provides them the right to operate. Therefore, the balance sheet reflects an increase in assets by $1,428 due to the acquisition of the operating license.

6) Purchase of new cash register

The partnership also spent $1,400 to acquire a new cash register. This transaction resulted in a decrease in the cash balance by $1,400, reflecting expenditure cash outflow to acquire the cash register, which is considered an asset for the business.

7) Deposit into checking accounts

Further, the remainder of the cash balance which includes the capital contributed by the partners and the loan received was deposited into a checking account. After the acquisition of the assets the remaining cash balance was $10,172. This amount was deposited in the checking account the bank balance is part of the partnership's assets.

First Question: Summary

As per the question, the balance sheet of Lone Pine Café as of November 02, 2009, is now ready (see Table 1). The balance sheet was prepared based on the assets and liabilities as of November 01. This approach aligns with standard accounting practices, where the closing balances of assets and liabilities on a day become the opening balances on the next day.

Table 1: Balance sheet of Lone Pine as of Nov 02, 2009

Balance sheet of Lone Pine as of Nov 02, 2009			
Assets		**Liabilities & Equity**	
equipment	53,200	Capital of Mr & Mrs Henry Antoine	32,000
		Mrs Sandra Landers	16,000
		borrowings from the bank	21,000
F & B	2,800		
~~cash~~			
Bank (checking account)	10,172		
operating license	1,428		
Cash register	1,400		
	69,000		**69,000**

Second Question: Detailed Analysis

Now, let us move on to the next question: Prepare a balance sheet as of March 30, 2010, the day the entity was wound up. All we need to do is determine the assets and liabilities of the entity on March 30, 2010. Please note that the capital contributed by the partners remains unchanged as of now. The asset heads remain the same viz. equipment, food and beverage, bank account, operating license, and other assets. The primary consideration is determining the value of each of these assets.

Opening of Restaurant

Shortly after November 01, the partners opened the restaurant. Mr. Antonio took on the role of a chef, while Mrs. Antonio and Landers served customers. Mr. Antonio also managed food and beverage orders, operated the cash register, and handled the checking account. The restaurant operated throughout the winter season from 2009 to 2010, but it was not very successful.

On the morning of March 31, Mrs. Antonio discovered that both Mr. Antonio and Mrs. Landers had disappeared. Mrs. Landers had taken all her possessions, while Mr. Antonio left behind most of his belongings. Notably, the new cash register and its contents were also missing. However, no other partnership assets were missing.

Mrs. Antonio concluded that the partnership was dissolved. The court subsequently affirmed the dissolution, as on the March 30. Mrs. Antonio decided to continue operating the cafe but felt that a thorough accounting needed to be done. Consequently, she sought assistance from Donald Simpson, who was knowledgeable about accounting.

Value of Cash Register and Checking account

In response to Simpson's questions, Antonio stated that the cash register contained $311, and the checking account balance was $1030. The checking account balance was indeed an asset. Regarding the cash register, there is a debate on whether it should be considered an asset or not.

The argument for considering the cash register as an asset is based on the date of preparing the balance sheet. Since the balance sheet is prepared as of March 30, 2010, and the cash register was present at the end of the business day on March 30, it should be recorded as an asset owned by the cafe. Despite being stolen between March 30, night and the early morning of March 31, it was still present as at the close of business on March 30. Further, until the asset is officially written off, it remains as an asset owned by the cafe. Even if the cash register is stolen, it remains an asset until it is legally declared as written off.

To illustrate this point, consider the scenario of a stolen car. Even if a car is stolen, it still belongs to the owner as it is registered on the owner’s name until it is formally written off. In summary, until the cash register is officially written off, it should be recorded as an asset owned by the cafe. Supposing the cash register is found on April 01, who will the rightful owner of it, obviously it will be the café as it is not written off. Therefore, until the asset is written off from the assets it remains as an asset of the business despite it being currently stolen.