

Case Study: Balance Sheet

by Sophia



WHAT'S COVERED

This lesson will cover the preparation of a balance sheet in the context of a case study, using a hypothetical business.

Our discussion breaks down as follows:

1. Case Study: Legacy Realty

The subject company for our case study is called Legacy Realty. Legacy Realty is a sole proprietorship, which is a type of company that is owned by one single individual, and where that individual and the business are legally treated as the same.

The purpose of Legacy Realty as a business is to own, lease, and manage its own rental properties. It purchases houses and condominiums and leases them out to tenants. They also perform their own management of their units, making repairs, performing maintenance, and collecting rent. Legacy Realty is located in Washington DC, and they have a small staff of five people.

Legacy Realty	
Type of company	Sole proprietorship
Business purpose	Own, lease, and manage rental properties
Business location(s)	Washington, D.C. Staff of 5 people

Legacy Realty needs a balance sheet to provide information about the business position. It is prepared at a moment in time, rather than covering a period of time; it is the only financial statement that is made at a specific date. The balance sheet informs about a business's resources, detailing the resources that are available or owned, in the case of assets, as well as the resources that are owed to others, in the case of liabilities. The net difference, then, on a cumulative basis, is equity, which is also detailed on the balance sheet.



HINT

Remember the balance sheet formula: assets equal liabilities plus equity.

2. Case Study: Balance Sheet

In order to begin preparing the balance sheet, we need to start with some information from the trial balance worksheet, specifically from the adjusted trial balance.

As you can see, we've prepared the trial balance, listing all of the general ledger accounts, as well as their corresponding debit and credit balances. We've also prepared the adjustments and adjustment explanations, making corrections to the accounts to match all revenues and expenses with the correct period. We've also corrected any errors or omissions that may have been made throughout the accounting period and recording process.

Accounts	Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	63,000				63,000	
Accounts Receivable	10,000				10,000	
Supplies	5,000			2,500 (a)	2,500	
Prepaid Insurance	12,000			6,000 (b)	6,000	
Buildings	500,000				500,000	
Land	50,000				50,000	
Accumulated Depreciation - Buildings				15,000 (c)		15,000
Accounts Payable		5,000		25,000 (e)		30,000
Unearned Revenue				10,000 (d)		10,000
Notes Payable		300,000				300,000
Retained earnings, 1/1/12		200,000				200,000
Owner's Drawing	10,000				10,000	
Revenue		600,000	10,000 (d)			590,000
Salaries Expense	325,000		25,000 (e)		350,000	
Repairs Expense	50,000				50,000	
Advertising Expense	10,000				10,000	
Rent Expense	50,000				50,000	
Interest Expense	20,000				20,000	
Depreciation Expense - Buildings			15,000 (c)		15,000	
Insurance Expense			6,000 (b)		6,000	
Supplies Expense			2,500 (a)		2,500	
Totals	1,105,000	1,105,000	58,500	58,500	1,145,000	1,145,000

Adjustments Explanation

(a) Adjust Supplies used

(b) Adjust Insurance incurred

(c) Record Depreciation Expense

(d) Correct incorrect Revenue recognition

(e) Accrue Salaries Expense

Using this information, we have also prepared the adjusted trial balance, accounting for all of those adjustments that were made. Similar to the trial balance, the adjusted trial balance is a listing of all of the general ledger accounts, as well as the corresponding debit or credit balances within those accounts.

This adjusted trial balance is going to be the source for the financial statements, containing all the information needed to create those statements for Legacy Realty.

Now we are ready to prepare the balance sheet for Legacy Realty. We always start with the header, which includes the company name, then "Balance Sheet," and the line "As of December 31, 2012." It is important to note that this line is different than the one on the income statement and statement of changes in owner's equity.

We also need to pull the information from all of the permanent accounts from the adjusted trial balance--the assets, liabilities, and equity.

Accounts	Adjusted Trial Balance		Legacy Realty Partners Balance Sheet As of December 31, 2012
	Dr.	Cr.	
Cash	63,000		Permanent accounts →
Accounts Receivable	10,000		
Supplies	2,500		
Prepaid Insurance	6,000		
Buildings	500,000		
Land	50,000		
Accumulated Depreciation - Buildings		15,000	
Accounts Payable		30,000	
Unearned Revenue		10,000	
Notes Payable		300,000	
Retained earnings, 1/1/12		200,000	
Owner Drawings	10,000		
Revenue		590,000	
Salaries Expense	350,000		
Repairs Expense	50,000		
Advertising Expense	10,000		
Rent Expense	50,000		
Interest Expense	20,000		
Depreciation Expense - Buildings	15,000		
Insurance Expense	6,000		
Supplies Expense	2,500		
Totals	1,145,000	1,145,000	

Starting with current assets, we list the cash, accounts receivable, supplies, and prepaid insurance, which are the total current assets. We also break out the long-term assets, which, in this case, comprise land, buildings, and the accumulated depreciation for those buildings. Therefore, total current assets plus total long-term assets equal total assets of \$616,500.

Accounts	Adjusted Trial Balance		Legacy Realty Partners Balance Sheet As of December 31, 2012
	Dr.	Cr.	
Cash	63,000		Current Assets:
Accounts Receivable	10,000		
Supplies	2,500		
Prepaid Insurance	6,000		
Buildings	500,000		
Land	50,000		Long-term Assets:
Accumulated Depreciation - Buildings		15,000	
Accounts Payable		30,000	
Unearned Revenue		10,000	
Notes Payable		300,000	
Retained earnings, 1/1/12		200,000	
Owner Drawings	10,000		
Revenue		590,000	
Salaries Expense	350,000		
Repairs Expense	50,000		
Advertising Expense	10,000		
Rent Expense	50,000		
Interest Expense	20,000		
Depreciation Expense - Buildings	15,000		
Insurance Expense	6,000		
Supplies Expense	2,500		
Totals	1,145,000	1,145,000	

Now we can move on to liabilities, starting with short-term liabilities. Short-term liabilities include accounts payable and unearned revenue. Similar to how assets are broken out by current and long-term, liabilities are also broken out by short-term and long-term. In this case, we only have a notes payable as long-term liabilities. Adding short-term and long-term liabilities provides total liabilities of \$340,000.

Accounts	Adjusted Trial Balance	
	Dr.	Cr.
Cash	63,000	
Accounts Receivable	10,000	
Supplies	2,500	
Prepaid Insurance	6,000	
Buildings	500,000	
Land	50,000	
Accumulated Depreciation - Buildings		15,000
Accounts Payable		30,000
Unearned Revenue		10,000
Notes Payable		300,000
Retained earnings, 1/1/12		200,000
Owner Drawings	10,000	
Revenue		590,000
Salaries Expense	350,000	
Repairs Expense	50,000	
Advertising Expense	10,000	
Rent Expense	50,000	
Interest Expense	20,000	
Depreciation Expense - Buildings	15,000	
Insurance Expense	6,000	
Supplies Expense	2,500	
Totals	1,145,000	1,145,000

Legacy Realty Partners Balance Sheet As of December 31, 2012		
Current Assets:		
Cash	\$ 63,000	
Accounts Receivable	10,000	
Supplies	2,500	
Prepaid Insurance	6,000	
Total Current Assets		\$81,500
Long-term Assets:		
Land	50,000	
Buildings	500,000	
Accumulated Depreciation	(15,000)	
Total Long-term Assets		\$535,000
Total Assets		\$ 616,500
Short-term Liabilities		
Accounts Payable	\$ 30,000	
Unearned Revenue	10,000	
Total Short-term Liabilities		40,000
Long-term Liabilities		
Notes Payable	300,000	
Total Liabilities		\$ 340,000

Now, remember that the balance sheet formula is assets equals liabilities plus equity. Therefore, we now have to add in our equity. We pull equity information from the statement of changes in owner's equity.

Legacy Realty Partners Statement of Changes in Owner's Equity	
Beginning balance, Jan. 1	\$ 200,000
Add: Net income	86,500
	<u>286,500</u>
Less: Drawings	10,000
Ending balance, Dec. 31	<u><u>\$ 276,500</u></u>

From this statement, we pull in the ending balance in the owner's capital account, at the end of the year, of \$276,500. This captures the beginning balance and any net income or loss, as well as any drawings or contributions that may have been made by the owners.

Accounts	Adjusted Trial Balance	
	Dr.	Cr.
Cash	63,000	
Accounts Receivable	10,000	
Supplies	2,500	
Prepaid Insurance	6,000	
Buildings	500,000	
Land	50,000	
Accumulated Depreciation - Buildings		15,000
Accounts Payable		30,000
Unearned Revenue		10,000
Notes Payable		300,000
Retained earnings, 1/1/12		200,000
Owner Drawings	10,000	
Revenue		590,000
Salaries Expense	350,000	
Repairs Expense	50,000	
Advertising Expense	10,000	
Rent Expense	50,000	
Interest Expense	20,000	
Depreciation Expense - Buildings	15,000	
Insurance Expense	6,000	
Supplies Expense	2,500	
Totals	1,145,000	1,145,000

Legacy Realty Partners Balance Sheet As of December 31, 2012	
Current Assets	
Cash	\$ 43,000
Accounts Receivable	10,000
Supplies	2,500
Prepaid Insurance	6,000
Total Current Assets	\$ 61,500
Long-term Assets	
Land	50,000
Buildings	500,000
Accumulated Depreciation	(15,000)
Total Long-term Assets	\$ 535,000
Total Assets	\$ 596,500
Short-term Liabilities	
Accounts Payable	\$ 30,000
Unearned Revenue	10,000
Total Short-term Liabilities	\$ 40,000
Long-term Liabilities	
Notes Payable	300,000
Total Liabilities	\$ 340,000
Equity	
Owner's Capital	276,500

Legacy Realty Partners Statement of Changes in Owner's Equity	
Beginning balance, Jan. 1	\$ 200,000
Add: Net income	86,500
	286,500
Less: Drawings	10,000
Ending balance, Dec. 31	\$ 276,500

Finally, we total up our liabilities and equity, which, in this case, is \$616,500. It's important to perform a check: do assets equal liabilities plus equity? They do, so our balance sheet balances.

Legacy Realty Partners			
Balance Sheet			
AS of December 31, 2012			
Current Assets:			
Cash	\$	63,000	
Accounts Receivable		10,000	
Supplies		2,500	
Prepaid Insurance		6,000	
Total Current Assets			81,500
Long-term Assets:			
Land		50,000	
Buildings		500,000	
Accumulated Depreciation		(15,000)	
Total Long-term Assets			535,000
Total Assets			\$ 616,500
Short-term Liabilities			
Accounts Payable	\$	30,000	
Unearned Revenue		10,000	
Total Short-term Liabilities			40,000
Long-term Liabilities			
Notes Payable			300,000
Total Liabilities			340,000
Equity			
Owner's Capital			276,500
Total Liabilities & Equity			\$ 616,500



SUMMARY

Today we discussed our **case study** company called **Legacy Realty**, which is in the business of owning and leasing their own rental properties. We walked through an **example of preparing a balance sheet**, starting with our adjusted trial balance and statement of changes in owner's equity-- the two sources we used in order to create our balance sheet.

Source: Adapted from Sophia instructor Evan McLaughlin.