#2

Case 2-7

UPSIDE-DOWN SKI SCHOOL

Case Objectives

1. Understand the nature of assets, liabilities, and owner's equity of an economic entity; understand various value measurements (e.g., historical cost, current value) that may be associated with those items; and construct a balance sheet that reflects those items.
2. Understand the nature of net income (profit) and its two major components, revenue and expenses; and understand how the accrual basis of accounting recognizes revenues and expenses and matches those items in measuring net income.

Decision: After adjusting the statements for the given transactions, should the loan officer grant the loan based on the given criteria?

Mr. Often Glib opened the Upside-Down Ski School in early February 2000. He wants to buy a patent from its inventor and needs $70,000 to cover the cost of the patent. His plan is to make a visit to Metropolis Commercial Bank, where his company has its account. He is confident that he can convince the Metropolis' loan officer, Jacqueline Cash, that his company is worthy of the proposed one-year loan based upon its strong balance sheet. Moreover, he projects that his company will make "millions" from the patent, thus providing more than adequate cash flow to repay the loan. The patent would allow the ski school to provide year-round training by means of a virtual reality ski simulation.

At a meeting held on January 4, 2001, Ms. Cash informed Mr. Glib that the bank's policy is to consider loans only to businesses with solid balance sheets. Specifically, balance sheets must show total liabilities to be less than 50 percent of total assets before the loan. A further test of loan eligibility is that liabilities must be less than 65 percent of the assets after the loan. In response, Mr. Glib presents the company's most recent balance sheet dated December 31, 2000.

Upside-Down Ski School
Balance Sheet (Unaudited)
December 31, 2000

Assets			Liabilities and Owner's Equity		
Current Assets			Current Liabilities		
Cash		$ 30,000	Accounts Payable		$ 40,000
Accounts Receivable		70,000	Bank Loan Payable		100,000
Advertising		50,000			
Total Current Assets		$ 150,000	Total Current Liabilities		140,000
Fixed Assets			Owner's Equity		
Land	$ 150,000		Contributed Capital	$ 150,000	
Equipment	150,000		Retained Earnings	160,000	
Total Fixed Assets		$ 300,000	Total Owner's Equity		310,000
Total Assets		$ 450,000	Total Liabilities and Owner's Equity		$ 450,000