VROOM INC.: A FINANCING AND INVESTING EXERCISE

JOURNAL ENTRIES

Entry	Transaction	Debit	Credit
O/B	(given)		
	Cash	215,652	
	Accounts receivable	23,265	
	Trading investment, stock	30,000	
	Office under lease	81,827	
	Accumulated depreciation – office under lease		9,546
	Lease interest payable		1,862
	Bond interest payable		656
	Lease obligation, office		63,827
	5% bond payable		38,968
	Common stock		48,000
	Contributed capital, common stock		820
	Preferred stock		44,000
	Retained earnings		143,065

DEBT FINANCING

Operating Line of Credit

No transaction for securing line of credit ($20,000)

Entry	Transaction	Debit	Credit
1.	Cash	11,000	
	Bank indebtedness (or operating line of credit)		11,000
2.	Bank indebtedness (or operating line of credit)	6,000	
	Interest expense	41	
	Cash		6,041
Alt.	Cash	4,959	
1–2	Interest expense	41	
	Bank indebtedness (or operating line of credit)		5,000
3.	Interest expense	21	
	Interest payable		21
Alt.	Cash	4,959	
1–3	Interest expense	62	
	Bank indebtedness (or operating line of credit)		5,000
	Interest payable		21

Entry	Transaction	Debit	Credit
	Office Finance Lease		
4.	Lease obligation, office	14,808	
	Lease interest expense	1,330	
	Lease interest payable	1,862	
	Cash		18,000
	May 1, 2020: Office lease payment		
	Cash payment: 18,000		
	Interest payable: 1,862		
	Interest expense: 63,827 × 5% × 5/12 = 1,330		
	Lease obligation, office: 18,000 – 1,330 – 1,862 = 14,808		
5.	Depreciation expense	16,365	
	Accumulated depreciation, office under lease		16,365
	November 30, 2020: Depreciate office under lease at fiscal year-end		
	Depreciation expense: 81,827 ÷ 5 years = 16,365		
6.	Lease interest expense	1,430	
	Lease interest payable		1,430
	November 30, 2020: Accrue interest at fiscal year-end on lease obligation, office		
	T/B office lease obligation: 63,827 – 14,808 = 49,019		
	Interest expense: 49,019 × 5% × 7/12 = 1,430		
	5.5% Bond Payable		
7.	Bond interest payable	656	
	Bond interest expense	566	
	5% bond payable		97
	Cash		1,125
	February 15, 2020: Coupon payment		
	Carrying value August 15, 2019: (38,968 − 137) = **38,831**		
	Bond interest expense: **38,831** × 7% × 2.5/12 = 566		
	Partial coupon payment: 45,000 × 5% × 2.5/12 = 469		
	Amortization: 566 − 469 = 97		
	Total coupon payment: 45,000 × 5% × 6/12 = 1,125		
	Bond int. pay.: 1,125 − 469 = 656		
8.	Bond interest expense	1,367	
	5% bond payable		242
	Cash		1,125
	August 15, 2020: Coupon payment		
	Bond interest expense: (**38,968** + 97) × 7% × 6/12 = 1,367		
	Coupon payment: 45,000 × 5% × 6/12 = 1,125		
	Amortization: 1,367 − 1,125 = 242		

Entry	Transaction	Debit	Credit
9.	Bond interest expense	115	
	5% bond payable		21
	Cash		94
	September 1, 2020: Amortize recalled bonds (100% recall)		
	Bond interest expense: (**38,968** + 97 + 242) × 7% × 0.5/12 = 115		
	Coupon payment: 45,000 × 5% × 0.5/12 = 94		
	Amortization: 115 − 94 = 21		
10.	5% bond payable	39,328	
	Gain on bond recall (revenue)		2,540
	Cash		36,788
	September 1, 2020: Recall bonds		
	n = 17 periods, i = 8% ÷ 2 = 4%		
	Book value: **38,968** + 97 + 242 + 21 = 39,328		
	PV of FV: 45,000 × 0.51337 = 23,102		
	PV of coupon payments: 45,000 × 5% × 6/12 × 12.16567 = 13,686		
	Cash paid: 23,102 + 13,686 = 36,788		
	Gain on recall: 39,328 – 36,788 = 2,540		
Alt.	Bond interest expense	115	
9–10	5% bond payable	39,307	
	Gain on bond recall (revenue)		2,540
	Cash		36,882

EQUITY FINANCING

No transaction for share issuance (common shares $60,000 and/or preferred shares $44,000.)

Entry	Transaction	Debit	Credit
11.	Retained earnings (or dividends declared)	8,000	
	Dividends payable		8,000
	January 5, 2020: Dividend declaration date		
	Preferred stock dividend: 1,000 shares × 4 × 2 years = 8,000		
12.	Retained earnings (or dividends declared)	800	
	Dividends payable		800
	January 5, 2020: Dividend declaration date		
	Dividend payable: 4,000 shares × 0.20 = 800		
13.	Dividends payable	8,800	
	Cash		8,800
	January 20, 2020: Dividend distribution date		

Entry	Transaction	Debit	Credit
14.	Common stock	4,800	
	Contributed capital, common stock	820	
	Retained earnings	370	
	Cash		5,990
	February 15, 2020: Common stock repurchase and retirement		
	Cash paid: (4,000 shares × 14.50 × 10%) + 190 = 5,990		
	BV of all common stocks: 48,000		
	BV of stocks repurchased: 48,000 × 10% = 4,800		
	Deficit: 5,990 − 4,800 = 1,190		
	Retained earnings: 1,190 − 820 (contributed capital) = 370		

Common Shares

O/B	4,000
400	Feb. 15/20
T/B	3,600

Preferred Shares

O/B	1,000

Entry	Transaction	Debit	Credit
15.	Trademark (asset)	5,000	
	Cash		3,000
	Common stock		2,000
	June 1, 2020: Purchased asset with cash and common stock		
	Common stock: 5,000 − 3,000 = 2,000		
16.	Preferred stock	8,800	
	Common stock		8,800
	September 7, 2020: Preferred stock conversion		
	Preferred stock: 44,000 *(T/B in preferred stock)* × 20% = 8,800		
	Number of preferred shares: 1,000 shares × 20% = 200 shares		
	Number of common shares: 200 shares × 3 = 600 shares		

Common Shares

O/B	4,000
400	Feb. 15/20
Jun. 1/20	150
Sept. 7/20	600
T/B	4,350

Preferred Shares

O/B	1,000
200	Sep. 7/20
T/B	800

No transaction for preferred share dividend (3,200).

Entry	Transaction	Debit	Credit
17.	Retained earnings (or dividends declared)	1,712	
	Stock dividend distributable		1,712
	November 20, 2020: Dividend declaration date		
	Number of shares distributed: 4,350 shares × 2% = 87 new shares		
	Stock dividend distributable: 87 shares × 19.68 = 1,712		
	No transaction for dividend distribution.		
	No transaction for fiscal year end market evaluation.		
TRADING INVESTMENTS			
Trading Investments, Stock			
18.	Cash	150	
	Dividend revenue		150
	Dividend revenue: 1 × 150 shares = 150		
19.	Proceeds receivable (asset)	7,025	
	Loss on sale (expense)	4,975	
	Trading investment, stock		12,000
	November 18, 2020: Sale of trading investment, stock		
	Cash received: (150 shares × 40% × 120) – 175 = 7,025		
	Book value: 30,000 *(T/B in T/I, stock)* × 40% = 12,000		
	Loss on sale: 12,000 – 7,025 = 4,975		
	No transaction for stock split.		
20.	Unrealized loss (expense)	7,650	
	Trading investment, stock		7,650
	November 30, 2020: FYE valuation, trading investment, stock		
	Number of shares: [150 (O/B) – 60 (sold)] × 4 (stock split) = 360 shares		
	Market value: 360 shares × 28.75 = 10,350		
	Book value: 18,000 *(T/B in T/I, stock)*		
	Unrealized loss: 18,000 – 10,350 = 7,650		

Note: BV = book value; FYE = fiscal year end; FV = face value; O/B = opening balance; PV = present value; T/B = trial Balance; T/I = trading Investment.
Source: Created by author.

VROOM FAQ

Question 1:

Why is there no transaction for securing the line of credit of $20,000?

Answer 1:

When a company is securing a line of credit from a bank, they are not physically receiving anything; this is not considered an economic event. Only withdrawals and any repayments are recorded. In other words, there is only an entry when cash is changing hands between two parties.

Question 2:

How was I supposed to know to pay the preferred shareholders? The case did not say they would be paid out this year. Additionally, why was two years' worth of dividends paid?

Answer 2:

On January 5, 2020, a dividend was declared to the common shareholders. Whenever a dividend is declared to common shareholders, you must first consider whether the preferred shareholders have been paid yet this fiscal year. If they have not, then they must be paid prior to the common shareholders, even if the case does not explicitly say that the preferred shares dividend was declared.

The preferred shares have a *cumulative* characteristic, meaning that the preferred shareholders are entitled to receive any dividends that were not paid out in previous years. Footnote 4 states that no dividends were declared in F2019. Therefore, dividends for F2019 and F2020 must be paid out.

Question 3:

In Transaction #14, why did we not debit Contributed Capital by the entire $1,190 deficit, but instead only by $820?

Answer 3:

The Contributed Capital account cannot have a debit account. Per Exhibit 1, the opening balance of the Contributed Capital account was $820. The balance of this account can only be brought down to nil, and no further, and therefore it was debited by $820. The remaining deficit amount will always be debited to Retained Earnings.

Question 4:

In Transaction #7, why do we use the carrying value of August 15 to determine the bond interest expense?

Answer 4:

When calculating the interest expense for a bond, the carrying value as at *the last interest payment date* is always used. The case will always provide the information required to calculate this amount. In Vroom, Footnote 3 stated that the bond had been amortized by $137 between the last interest payment date (August 15, 2019) and fiscal year end (November 30, 2019). This amortization amount was then subtracted from the bond payable amount as at FYE 2019 to determine the carrying value on August 15, 2019.