

## PROBLEM # 1

January 2, 1994 is the first day of operations for Small World Day Care. The following summarizes the 1994 events for Small World Day Care:

- (1) On 1/2/94 common stock was issued to equity investors for \$20,000.
- (2) A loan of \$20,000 was received on 1/2/94. The loan, plus interest at 10%, is to be repaid on 1/2/95.
- (3) Paid \$24,000 for furniture and equipment on 1/3/94.
- (4) During 1994, \$30,000 was paid for miscellaneous operating activities. All of these cash payments were for services used in 1994 except for food and supplies. On 12/31/94, \$1,500 of food and supplies were on hand.
- (5) During 1994, Small World charged the parents of their clients \$40,000 for services provided. However, on 12/31/94, the parents still owed \$15,000 for those services provided.
- (6) The furniture and equipment is being depreciated over 4 years using the straight-line depreciation method. (Annual depreciation expense is \$6,000.)
- (7) Small World pays cash dividends to the owners equal to 40% of net income on 12/31/94.

**INSTRUCTIONS:** Use the accounting equation or T accounts to process the necessary transactions for 1994. Then complete the 1994 income statement, statement of retained earnings, and cash flow statement. (Ignore income taxes.)

Solution:

Assets	=	Liabilities	+	Owners' Equity
+20,000 cash				+20,000 invest. by owner
+20,000 cash		+20,000 note payable		
+24,000 furniture & equipment				
-24,000 cash				
-30,000 cash				-28,500 operating expenses
+ 1,500 supplies				
+40,000 accounts receivable				+40,000 revenue
+25,000 cash				
-25,000 accounts receivable				
6,000 accumulated depreciation				-6,000 depreciation expense
		+ 2,000 interest pay.		-2,000 interest expense
- 1,400 cash				-1,400 dividends

**PROBLEM # 1 FINANCIAL STATEMENTS**

Small World Day Care  
Income Statement  
For the year ending 12/31/94

Fees Revenue		\$ 40,000
Expenses:		
Miscellaneous	\$ 28,500	
Interest	2,000	
Depreciation	<u>6,000</u>	
Total Expenses		<u>36,500</u>
Net Income		<u>\$ 3,500</u>

Small World Day Care  
Statement of Retained Earnings  
For the year ending 12/31/94

Retained Earnings 1/1/94	\$ - 0 -	
Net Income	3,500	
Dividends	<u>- 1,400</u>	
Retained Earnings 12/31/94	<u>\$ 2,100</u>	

Small World Day Care  
Cash Flow Statement  
For the year ending 12/31/94

Cash Provided by Operations:		
Cash collected from customers	\$ 25,000	
Cash paid for operating expenses	(30,000)	
Cash Inflow (outflow) from Operations		\$ (5,000)
Cash Flows from Investment Activities:		
Purchase of furniture & equipment	<u>\$ 24,000</u>	\$ (24,000)
Cash flows from Financing Activities:		
Issue of stock	\$ 20,000	
Proceeds from loan	20,000	
Payment of dividends	<u>(1,400)</u>	<u>\$ 38,600</u>
Net Cash Inflow (Outflow) during 1994		<u>\$ 9,600</u>



## PROBLEM # 2

The Righter Shoe Store Company prepares monthly financial statements for its bank. The November 30 and December 31, 1997, balance sheets contained the following account information:

	<u>Nov. 30</u>		<u>Dec. 31</u>	
	DR.	CR.	DR.	CR.
Supplies (asset)	1,000		3,000	
Prepaid insurance	6,000		4,250	
Wages payable		10,000		15,000
Unearned rent revenue		2,000		1,000

The following information also is known:

- The December income statement revealed \$2,000 in supplies expense.
- No insurance payments were made in December.
- \$10,000 was paid to employees during December for wages.
- On November 1, 1997, a tenant paid Righter \$3,000 in advance rent for the period November through January. Unearned rent revenue was credited.

### REQUIRED:

- What was the cost of supplies purchased during December?
- What was the adjusting entry recorded at the end of December for prepaid insurance?
- What was the amount of wage expense that appeared on the December income statement?
- What was the amount of rent revenue earned in December?

## PROBLEM 2 ANSWERS

1. \$2,000 in expense + \$2,000 increase in supplies asset = **\$4,000**
2. Insurance expense                      1,750  
    Prepaid insurance                      1,750
3. \$10,000 in wages paid + \$5,000 increase in liability = **\$15,000**
4. **\$1,000** (reduction in unearned rent revenue)

### PROBLEM # 3

ANSWER EACH OF THE FOLLOWING QUESTIONS IN THE SPACE PROVIDED

1. On December 31, 1996, the Askew Company listed Prepaid rent of \$600 as an asset on its year-end balance sheet. On December 31, 1997, the company listed Prepaid rent of \$750 on its year-end balance sheet. If the 1997 statement of cash flows reported cash paid for rent of \$15,500, what was the amount of **rent expense** reported on the 1997 income statement?

$$\$15,500 - 150 = \mathbf{\$15,350}$$

2. On 12/4/97, Forde Company received \$3,000 from its customers for merchandise to be delivered over the next three months. As of 12/31/97, one-sixth of the merchandise had been delivered to customers. What amount should appear on the 12/31/97 balance as a liability for revenue received in advance?

$$5/6 \times \$3,000 = \mathbf{\$2,500}$$

3. Dorean's allowance for uncollectible accounts had a credit balance of \$2,500 at the end of 1996 and a credit balance of \$3,000 at the end of 1997. During 1997, \$19,000 of accounts receivable were written off as uncollectible. What was bad debt expense for 1997?

$$\$19,000 + 500 = \mathbf{\$19,500}$$

#### PROBLEM #4

The Amdahl Corporation manufactures large-scale, high performance computer systems. In a recent annual report, the balance sheet included the following information (dollars in thousands):

	Current year	Previous year
Current assets:		
Receivables, net of allowances of \$5,042 and \$6,590 in the previous year	\$504,944	\$580,640

In addition, the income statement reported sales revenue of \$2,158,755 (dollars in thousands) for the current year. All sales are made on a credit basis. The statement of cash flows indicates that cash collected from customers during the current year was \$2,230,065 (dollars in thousands). There were no recoveries of accounts receivable previously written off.

#### REQUIRED:

Compute the following (dollar amounts in thousands):

1. The amount of uncollectible receivables written off during the current year.
2. The amount of bad debt expense that Amdahl would include in its income statement for the current year.
3. The accounts receivable turnover ratio for the current year.

Solution:

1.

	Current year	Previous year
	\$504,944	\$580,640
	<u>+ 5,042</u>	<u>+ 6,590</u>
	\$509,986	\$587,230
		+ sales 2,158,755
		- collections (2,230,065)
		- ending balance <u>(509,986)</u>
		= write-offs \$ <b>5,934</b>
2.

beginning balance in allowance	\$6,590	
Less write-offs	(5,934)	
- bad debt expense	<u>?</u>	= <b>\$4,386</b>
ending balance in allowance	\$5,042	
3.  $\$2,158,755 \div (\$509,986 + 587,230/2) = \mathbf{3.93}$

## PROBLEM #5

The Causwell Company began 1997 with 10,000 units of inventory on hand. The cost of each unit was \$5.00. During 1997, an additional 30,000 units were purchased at a single unit cost, and 20,000 units remained on hand at the end of 1997 (20,000 units therefore were sold during 1997). Causwell uses a periodic inventory system. Cost of goods sold for 1997, applying the **average cost method**, is \$115,000. The company is interested in determining what cost of goods sold would have been if the FIFO or LIFO methods were used.

### REQUIRED:

1. Determine the cost of goods sold for 1997 using the **FIFO** method.
2. Determine the cost of goods sold for 1997 using the **LIFO** method.
3. Using the **average cost method**, compute the inventory turnover ratio for 1997.

### Solution:

$$\$115,000 \div 20,000 \text{ units sold} = \$5.75 \text{ average unit cost}$$

$$\$5.75 \times 40,000 \text{ total units} = \$230,000 \text{ cost of goods available for sale}$$

$$\$230,000 - \text{beginning inventory of } \$50,000 = \$180,000 \text{ in purchase}$$

$$\$180,000 \div 30,000 \text{ units} = \$6.00 \text{ per unit purchase price}$$

1. FIFO:	Cost of goods sold = 10,000 x \$5 = \$50,000
	+ 10,000 x \$6 = <u>60,000</u>
	<b>\$110,000</b>

2. LIFO:	Cost of goods sold = 20,000 units x \$6 = <b>\$120,000</b>
----------	--

3.	$\$115,000 \div (\$50,000 + 115,000)/2 = \mathbf{1.39}$
----	---