

## EXAM 2 SOLUTION

### I. INCOME STATEMENT CLASSIFICATIONS

1. Interest Expense - *Other income and expense*
2. Freight Out - *Operating Expense*
3. Loss on sale of investments - *Other income and expense*
4. Depreciation on store equipment - *Operating expense*
5. Purchases - *Cost of goods sold*
6. Supplies expense - *Operating expense*
7. Sales Returns & Allowances - *Revenues*

### II. INCOME STATEMENT/COST OF GOODS SOLD RELATIONSHIPS

#### ALBERTO

- A. Net Purchases = **Purchases** - Purchase returns & allowances  
 $7,500 = x - 380$   
**x = 7,880**
- B. Cost of goods purchased = Net purchases + **Freight in**  
 $7,940 = 7,500 + x$   
**x = 440**
- C. **Cost of goods available for sale** = Cost of goods sold + Ending Inventory  
 $x = 7,490 + 1,450$   
**x = 8,940**

#### SUAVE

- D. Cost of goods available for sale = **Beginning Inventory** + Net Purchases + Freight In  
 $49,530 = x + 43,590 + 320$   
**x = 5,620**
- E. **Cost of goods purchased** = Net Purchases + Freight In  
 $x = 43,590 + 320$   
**x = 43,910**

### III. INVENTORY VALUATION

1. FIFO Cost of Goods Sold

100 units @ \$5 = 500

500 units @ \$8 = 4000

1000 units @ \$9 = 9000

**Sold 1600 units worth \$13,500**

2. LIFO Ending Inventory

100 units @ \$5 = 500

300 units @ \$8 = 2400

**Ending inventory of 400 units worth \$2,900**

3. Average Cost Method Cost of Goods Sold

$\$17,300 / 2,000 \text{ units} = \$8.65 \text{ per unit}$

**1,600 units sold @ \$8.65 = \$13,840 Cost of goods sold**

4. LIFO causes HIGHER cash flow and LOWER net income before taxes.  
FIFO causes LOWER cash flow and HIGHER net income before taxes.

### IV. MULTIPLE CHOICE

1. D

2. A

3. B

## V. RECEIVABLES

1. Percentage of credit sales method - Bad Debt Expense

Credit sales of \$2,200,000

2% of credit sales is **\$44,000 = Bad Debt Expense**

2. Percentage of accounts receivable - Bad Debt Expense

Ending accounts receivable of \$420,000

8% of accounts receivable \$33,600 = Ending balance of allowance for doubtful accounts

Bad debt expense = Ending balance of A/D/A - beginning balance of A/D/A

$x = \$33,600 - \$1,100$

**$x = \$32,500 = \text{Bad debt expense}$**

3. Percentage of accounts receivable - Bad debt expense

Bad debt expense = Ending balance of A/D/A - beginning balance of A/D/A

$x = \$33,600 - (-\$2,300)$

**$x = \$35,900 = \text{Bad debt expense}$**

4. Notes receivable

Interest = Principal \* rate of interest \* time to maturity

$x = \$40,000 * 6\% * (90 \text{ days} / 360 \text{ days})$

$x = \$40,000 * 6\% * 0.25$

**$x = \$600 \text{ in interest}$**

**VI. NON CURRENT ASSETS**

**A. DEPRECIABLE ASSETS**

1. Depreciation expense for Second Year - Straight line Method

$$\$165,000 - \$25,000 \text{ (salvage value)} = \$140,000 / 8\text{yrs} = \mathbf{\$17,500 \text{ depreciation expense}}$$

2. Depreciation expense for Second Year - Units of Activity Method

$$\$165,000 - \$25,000 = \$140,000 / 200,000 \text{ miles expected to be used} = \$0.70 \text{ per mile}$$
$$60,000 \text{ miles used in second year} * \$0.70 = \mathbf{\$42,000 \text{ depreciation expense}}$$

3. Depreciation expense for Second Year - Double Declining Balance Method

$$1/8 * 2 = 25\%$$

$$\text{year 1} = \$165,000 * 25\% = \$41,250$$

$$\text{year 2} = \$165,000 - 41,250 = \$123,750 * 25\% = \mathbf{\$30,937.50 \text{ depreciation expense}}$$

**B. INTANGIBLE ASSETS**

Patents	<b>Amortize</b>
Goodwill	<b>Original Cost</b>
Research and development cost	<b>Expense</b>