

Test 2 - Problem Solutions

Problem 1 (5 points)

The following information is taken from the income statement of the Castillo Inc. for the most recent year. Castillo uses a multi-step income statement.

Cost of Goods Sold	500,000
Income Tax Expense	50,000
Interest Expense	100,000
Net Sales	900,000
Operating Expenses	200,000

Using the information provided compute each of the following. Show your work and circle your answer.

1. Gross Profit

Sales	900,000
Cost of Goods Sold	<u>500,000</u>
Gross Profit	400,000

2. Income from Operations

Sales	900,000
Cost of Goods Sold	<u>500,000</u>
Gross Profit	400,000
Operating Expenses	<u>200,000</u>
Income from Operations	200,000

3. Net Income

Sales	900,000
Cost of Goods Sold	<u>500,000</u>
Gross Profit	400,000
Operating Expenses	<u>200,000</u>
Income from Operations	200,000
Interest Expense	100,000
Income Tax Expense	<u>50,000</u>
Net Income	50,000

Problem 2 (5 points)

On September 1, Brownsville Supply had an inventory of 20 backpacks at a cost of \$25 each. The company uses a perpetual inventory system. During September, the following transactions and events occurred.

Sept. 4	Purchased 40 backpacks at \$25 each from Lincoln, terms 2/10, n/30.
6	Received credit of \$100 for the return of 4 backpacks purchased from Lincoln on Sept. 4 that were defective.
9	Sold 20 backpacks purchased from Lincoln for \$40 each to Jaxon Books, terms 2/10, n/30.
14	Paid Lincoln in full, less discount.
19	Received payment from Books in full, less the discount.

Journalize the September transactions for Brownsville Supply.

Date	Accounts	Debit	Credit
9-4	Inventory (40 X \$25)	1,000	
	Accounts Payable		1,000
9-6	Accounts Payable	100	
	Inventory		100
9-9	Accounts Receivable (20 X \$40)	800	
	Sales		800
	Cost of Goods Sold (20 X \$25)	500	
	Inventory		500
9-14	Accounts Payable (1,000 - 100)	900	
	Cash (900 X .98)		882
	Inventory		18
9-19	Cash (800 X .98)	784	
	Sales Discounts	16	
	Accounts Receivable		800

Problem 3 (10 points)

Southsoutheast's Gift Store's inventory and purchase information for July is as follows:

July 1	Beginning inventory	400 @ \$4.50
July 10	Purchase	600 @ \$5.00
July 31	Ending inventory	400

Consider each of the following questions independently.

1. Southsoutheast's Gift Store uses the FIFO cost flow assumption. Calculate its ending inventory at July 31. Show your computations and circle your answer.

$$400 \times \$5 = \$2,000$$

2. Southsoutheast's Gift Store uses the LIFO cost flow assumption. Calculate its ending inventory at July 31. Show your computations and circle your answer.

$$400 \times \$4.50 = \$1,800$$

3. Southsoutheast's Gift Store uses the averaging cost flow assumption. Calculate its ending inventory at July 31. Show your computations and circle your answer.

$$\begin{array}{r} 400 @ 4.50 = 1,800 \\ 600 @ 5.00 = 3,000 \\ \hline 1,000 \qquad 4,800 \end{array}$$

$$\frac{4,800}{1,000} = 4.80$$

$$400 \times \$4.80 = \$1,920$$

Problem 4 (10 points)

Using the code letters below, indicate how each of the items listed would be handled in preparing a bank reconciliation. Enter the appropriate code letter in the space to the left of each item.

Code	Description
A	Add to cash balance per books
B	Deduct from cash balance per books
C	Add to cash balance per bank
D	Deduct from cash balance per bank
E	Does not affect the bank reconciliation

D 1. Outstanding checks.

B 2. Bank service charge.

C 3. Deposit in transit.

B 4. Bank returns deposited check marked NSF.

B 5. A deposit for \$236 was correctly recorded by the bank but was incorrectly entered in the books for \$263.

Problem 5 (10 points)

On December 31, 2006, when its Allowance for Doubtful Accounts had a credit balance of \$1,500, Balic Company estimates that 7% of its accounts receivable balance of \$90,000 will become uncollectible. On March 3, 2007, Balic Company determined that Janet Tray's account of \$950 was uncollectible. On May 15, 2007, Tray paid the amount previously written off.

Prepare the journal entries for December 31, 2006, March 3, 2007 and May 15, 2007.

Date	Accounts	Debit	Credit
12/31/06	Bad Debts Expense	4,800	
	Allowance for Doubtful Accounts		4,800
	\$90,000 X .07 = \$6,300		
	\$6,300 - \$1,500 = \$4,800		
3/3/07	Allowance for Doubtful Accounts	950	
	Accounts Receivable		950
5/15/07	Accounts Receivable	950	
	Allowance for Doubtful Accounts		950
	Cash	950	
	Accounts Receivable		950