

Problem 7

Smithson Exploration Corporation was formed on January 1, 20X3. The company was formed by Cliff Smithson with the goal of conducting geophysical support services related to natural gas drilling operations in the Uinta Basin region of eastern Utah. The company's initial capitalization consisted of shareholder investments of \$2,000,000 and an additional bank loan of \$1,500,000.

During the first year of operation, the company purchased land, buildings, and equipment in the amount of \$400,000, \$1,000,000, and \$600,000, respectively. (Hint: In subsequent chapters you will be introduced to the concepts of depreciation relating to certain of these assets; for now you may ignore this issue).

During 20X3, the company signed contracts to deliver consulting services with a total value of \$5,000,000. By year's end, \$3,200,000 of services had been provided and billed under these agreements. The other \$1,800,000 of work will not be performed until 20X4. All amounts billed had been collected during 20X3, with the exception of December's billings in the amount of \$250,000. The Smithson's are quite confident that the December billing will be collected in the normal course of business in early 20X4.



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Expenses paid during 20X3 included rent (\$280,000), Wages (\$1,560,000), interest (\$150,000), and taxes (\$430,000). In addition, the company had incurred rent (\$20,000), Wages (\$60,000), and interest (\$12,000) related to 20X3 activity that was not yet paid as of the end of 20X3.

Smithson Exploration declared and paid dividends to shareholders in the amount of \$150,000 during 20X3. Smithson also repaid \$100,000 of the original bank loan.

- Prepare an income statement for Smithson Corporation for the year ending December 31, 20X3.
- Prepare a statement of retained earnings for Smithson Corporation for the year ending December 31, 20X3.
- Prepare calculations showing that cash is \$1,780,000 as of December 31, 20X3.
- Prepare a balance sheet for Smithson Corporation as of December 31, 20X3.

Worksheet

- and
-

SMITHSON CORPORATION			
Income Statement			
For the Year Ending December 31, 20X3			
Revenues			
Services to customers		\$	-
Expenses			
Rent	\$	-	
Wages		-	
Interest		-	
Taxes		-	-
Net income		<u>\$</u>	<u>-</u>

SMITHSON CORPORATION	
Statement of Retained Earnings	
For the Year Ending December 31, 20X3	
Beginning retained earnings	\$ -
Plus: Net income	-
	\$ -
Less: Dividends	-
Ending retained earnings	\$ -

c)

Cash received:	\$ -	
From customers (\$3,200,000 – \$250,000)	-	
From stockholders	-	\$ -
From lenders		
Cash payments:		
For rent	\$ -	
For Wages	-	
For interest	-	
For taxes	-	
For dividends	-	
For land, building, equipment	-	
For repayment of loans	-	-
Ending cash		\$ -

d)

Smithson CORPORATION		
Balance Sheet		
December 31, 20X3		
Assets		
Cash		\$ -
Accounts receivable		-
Land		-
Building		-
Equipment		-
Total assets		<u>\$ -</u>
Liabilities		
Rent payable	\$ -	
Wages payable	-	
Interest payable	-	
Loan payable	-	
Total liabilities	<u>-</u>	\$ -
Stockholders' equity		
Capital stock	\$ -	
Retained earnings	-	
Total stockholders' equity	<u>-</u>	-
Total liabilities and equity		<u>\$ -</u>

Solution 7

- a) and
b)

SMITHSON CORPORATION			
Income Statement			
For the Year Ending December 31, 20X3			
Revenues			
Services to customers		\$	3,200,000
Expenses			
Rent	\$	300,000	
Wages		1,620,000	
Interest		162,000	
Taxes		30,000	2,512,000
Net income		\$	688,000

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SMITHSON CORPORATION Statement of Retained Earnings For the Year Ending December 31, 20X3		
Beginning retained earnings	\$	-
Plus: Net income		688,000
	\$	688,000
Less: Dividends		150,000
Ending retained earnings	\$	538,000

c)

Cash received:	\$	2,950,000	
From customers (\$3,200,000 – \$250,000)		2,000,000	
From stockholders		1,500,000	\$ 6,450,000
From lenders			
Cash payments:			
For rent	\$	280,000	
For Wages		1,560,000	
For interest		150,000	
For taxes		430,000	
For dividends		150,000	
For land, building, equipment		2,000,000	
For repayment of loans		100,000	4,670,000
Ending cash	\$		1,780,000

d)

Smithson CORPORATION		
Balance Sheet		
December 31, 20X3		
Assets		
Cash		\$ 1,780,000
Accounts receivable		250,000
Land		400,000
Building		1,000,000
Equipment		600,000
Total assets		<u>\$ 4,030,000</u>
Liabilities		
Rent payable	\$ 20,000	
Wages payable	60,000	
Interest payable	12,000	
Loan payable	<u>1,400,000</u>	
Total liabilities		\$ 1,492,000
Stockholders' equity		
Capital stock	\$ 2,000,000	
Retained earnings	<u>538,000</u>	
Total stockholders' equity		<u>2,538,000</u>
Total liabilities and equity		<u>\$ 4,030,000</u>