

Handout Problem No. F-10

Russell Waters established a retail business in 1989. Early, in 1999, he entered into negotiations with John Jones with a view to forming a partnership. You have been asked by the two men to check Waters' books for the past three years, and to **compute correct net income** for each year.

The profits per client's statements were as follows:

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Net income. . . . .	<u>\$9,000</u>	<u>\$10,109</u>	<u>\$8,840</u>

During the audit, you found the following:

	<u>Year ending 12/31</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
Omissions from the books:			
Item			
A. Accrued expenses at end of year. .	\$2,160	\$2,094	\$4,624
B. Accrued income at end of year. . .	200	--	--
C. Prepaid expenses at end of year. .	902	1,210	1,406
D. Deferred income at end of year. . .	--	610	--
Goods in transit at end of year omitted from inventory:			
E. For which purchase entry had been made	--	2,610	--
F. For which purchase entry had not been made	--	--	1,710

Other points requiring consideration:

G. Depreciation of equipment had been recorded monthly by a charge to expense and a credit to an allowance for depreciation account at a blanket rate of 1% of end-of-month balances of equipment accounts. However, the sale during December 1997 of certain equipment was entered as a debit to Cash and a credit to the asset account for the sale price of

--	5,000	--
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(this equipment was purchased in July 1996 at a cost of \$6,000)

H. No allowance had been set up for uncollectible accounts. It is decided to set up one for the estimated probable losses as of December 31, 1998, for:

1997 accounts	--	--	700
1998 accounts	--	--	1,500

and to correct the charge against each year so that it will show the losses (actual and estimated) relating to that year's sales. Accounts had been written off to expense as follows:

1996 accounts. . . . .	1,000	1,200	--
1997 accounts. . . . .	--	400	2,000
1998 accounts. . . . .	--	--	1,600