

Handout Problem No. F-83_R2

(Revised to reflect SFAS No. 154-Change in Inventory Method)

The following trial balance of Garr Corporation at December 31, 1985, has been adjusted except for income tax expense.

Garr Corporation
TRIAL BALANCE
December 31, 1985

	<u>Dr.</u>	<u>Cr.</u>
Cash	\$ 1,175,000	
Accounts receivable (net)	1,695,000	
Inventory	2,185,000	
Property, plant and equipment (net)	8,660,000	
Accounts payable and accrued liabilities		\$ 1,895,000
Income tax payable		360,000
Deferred income tax		285,000
Common stock		2,300,000
Additional paid-in capital		3,675,000
Retained earnings, 1/1/85		3,350,000
Dividends	200,000	
Net sales — Regular		10,750,000
— Plastics Division		2,200,000
Cost of sales — Regular	5,920,000	
— Plastics Division	1,650,000	
Selling and administrative expenses — Regular	2,600,000	
— Plastics Division	660,000	
Interest income — Regular		65,000
Gain on litigation settlement — Regular		550,000
Gain on disposal of Plastics Division		150,000
Income tax expense	835,000	
	<u>\$ 25,580,000</u>	<u>\$ 25,580,000</u>

Income tax expense

Estimated tax payment	\$ 475,000
Accrued	360,000
Total charged to income tax expense (estimated)	<u>\$ 835,000</u>
Tax rate on all types of income	<u>40%</u>

Gain from litigation settlement is a taxable gain and is not considered infrequent

The \$835,000 does not properly reflect current or deferred income tax expense or intraperiod income tax allocation for financial statement purposes

Temporary difference (not related to plastics division)

Depreciation per tax return	\$ 750,000
Depreciation per financial statements	\$ 575,000

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Discontinued operations

On October 31, 1985, Garr sold its Plastics Division for \$2,950,000 when the carrying amount was \$2,800,000. For financial statement reporting, this sale was considered a disposal of a segment of a business. Since there was no phase-out period, the measurement date was October 31, 1985.

Change in inventory method

On January 1, 1985, Garr changed to the FIFO method from the weighted average method of valuation of its inventories. The following information concerning inventories is as follows:

	<u>FIFO</u>	<u>Average Cost</u>
January 1, 1985 inventory	\$1,350,000	\$1,000,000
December 31, 1985 inventory	2,185,000	\$1,950,000

Cost of goods sold for 1985 reflects the proper amount after adjusting for the inventory change.

Capital structure

Common stock, \$10 par, traded on a national exchange:

	<u>Shares</u>
Outstanding at 1/1/85	200,000
Issued on 7/1/85 as a 15% stock dividend	<u>30,000</u>
	<u>230,000</u>

Required:

Using the multiple-step format, prepare a **formal income statement** and a **formal retained earnings statement for Garr** for the year ended December 31, 1985. All components of income tax expense should be appropriately shown.