

CASE STUDY Missing Data; Income Statement; Schedule of Cost of Goods Manufactured

“I know I’m a pretty good scientist, but I guess I still have some things to learn about running a business,” said Staci Morales, founder and president of Medical Technology, Inc. “Demand has been so strong for our heart monitor that I was sure we’d be profitable immediately, but just look at the gusher of red ink for the first quarter. At this rate we’ll be out of business in a year.” The data to which Staci was referring are shown below:

Medical Technology, Inc. Income Statement For the Quarter Ended June 30		
Sales (16,000 monitors)		\$ 975,000
Less operating expenses:		
Selling and administrative salaries	\$ 90,000	
Advertising	200,000	
Cleaning supplies, factory	6,000	
Indirect labor cost	135,000	
Depreciation, office equipment	18,000	
Direct labor cost	80,000	
Raw materials purchased	310,000	
Maintenance, factory	47,000	
Rental cost, facilities	65,000	
Insurance, factory	9,000	
Utilities	40,000	
Depreciation, production equipment	75,000	
Travel, salespersons	60,000	1,135,000
Net operating loss		<u>\$ (160,000)</u>

Medical Technology was organized on April 1 of the current year to produce and market a revolutionary new heart monitor. The company’s accounting system was set up by Staci’s brother-in-law who had taken an accounting course about 10 years ago.

“We may not last a year if the insurance company doesn’t pay the \$227,000 it owes us for the 4,000 monitors lost in the truck accident last week,” said Staci. “The agent says our claim is inflated, but that’s a lot of baloney.”

Just after the end of the quarter, a truck carrying 4,000 monitors wrecked and burned, destroying the entire load. The monitors were part of the 20,000 units completed during the quarter ended June 30. They were in a warehouse awaiting sale at quarter-end and were sold and shipped on July 3 (this sale is *not* included on the income statement above). The trucking company’s insurer is liable for the cost of the goods lost. Staci’s brother-in-law has determined this cost as follows:

$$\frac{\text{Total costs for the quarter}}{\text{Monitors produced during the quarter}} = \$1,135,000 / 20,000 \text{ units} = \$56.75 \text{ per unit}$$

$$4,000 \text{ units} \times \$56.75 \text{ per unit} = \$227,000$$

The following additional information is available on the company’s activities during the quarter ended June 30:

- Inventories at the beginning and end of the quarter were as follows:

	Beginning of the Quarter	End of the Quarter
Raw materials	\$0	\$40,000
Work in process	\$0	\$30,000
Finished goods	\$0	?

- b. Eighty percent of the rental cost for facilities and 90% of the utilities cost relate to manufacturing operations. The remaining amounts relate to selling and administrative activities.

Required:

1. What conceptual errors, if any, were made in preparing the income statement above?
2. Prepare a schedule of cost of goods manufactured for the quarter.
3. Prepare a corrected income statement for the quarter. Your statement should show in detail how the cost of goods sold is computed.
4. Do you agree that the insurance company owes Medical Technology, Inc., \$227,000? Explain your answer.