Great Adventures, Inc.

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ABSTRACT

This case provides an overview of the accounting cycle from recording journal entries, posting to ledger accounting, recording adjusting entries, and preparing trial balance, income statement, balance sheet, and statement of cash flows. This case can be used as a term project in an introductory financial accounting course at the undergraduate or graduate levels. This case can also be used to collect data on student learning assessment for accreditation or program assessment purposes. A unique feature of this case is the direct method for operating cash flows in the statement of cash flows. Typical textbook cases on the accounting cycle use the indirect method for the operating cash flows. While the indirect method is more commonly used than the direct method in reporting operating cash flows, the direct method provides more information to external users. Since the introductory financial accounting course is intended for all business students, this case highlights the steps in estimating direct operating cash flows, which are critical skills for all business professionals. The steps for the indirect method are also provided so the instructor can choose one or both methods for students. Excel spreadsheet can also be required as an aid to complete the above tasks. Teaching notes for the solutions, including journal entries, T-accounts, and financial statements in Excel files, are available from the authors.

Keywords: statement of cash flows, direct method, indirect method, journal entries, accounting cycle

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INTRODUCTION

Great Adventures Company, Inc. specializes in supplies, gears, and equipment for sports and outdoor adventures. Its products range from tennis balls, gloves, skiing gear, and off-road motorcycles. The company purchases its products from manufacturers worldwide and sells them to an extensive network of independent retail shops and dealers in North America. Business is booming as the population becomes more health-conscious and more people participate in sports and outdoor adventures. In addition to its primary business, the company plans to diversify into running ski resorts and outdoor parks.

The company's stock is actively traded on the New York Stock Exchange. At the end of the first quarter of the year 2022, the company's CFO is in the process of preparing financial statements for filing with the SEC and reporting to shareholders at the coming stockholder's conference in late April. The CFO has obtained summarized information on the company's business activities from the controller's office. The CFO asks for your assistance in analyzing the information and developing a draft of the quarterly financial statement with a brief analysis.

Summary of Business Activities in the First Quarter 2022
All dollar amounts are in thousands (000) except the per-share values.

1. The company signed an agreement with a national bank in December 2021 to finance business expansion by obtaining a $30,000 three-year loan. The interest on the loan is due semiannually and carries a 12% annual interest rate. The amount was deposited into the company's bank account on January 1, 2022.

2. On January 20, Great Adventures agreed to purchase a large plot of land in a mountainous area in Vermont as the site for the future ski resort. In this share-based transaction, the company agreed to issue 500,000 shares of its common stock as a way of payment. The common stock has a $1 par value per share. The transaction was closed on March 1 when stocks traded at $23 per share.

3. On February 1, the company issued five million shares of its common stock through an investment banker on Wall Street and received $95,760 in cash proceeds.

4. On January 31, the company received $45,000 in cash from customers who bought merchandise last year. The remaining $30,000 was received on February 28.

5. On January 28, the company paid its suppliers $29,630 in cash through its bank for last year's purchases.

6. On February 1, the company signed an agreement with a national TV station to run the company's infomercial between 11:00 am – 12:00 pm each day for three months and paid a total cost of $1,660.

7. On February 15, the company closed a deal to purchase a new warehouse building in a suburban area outside Boston for $8,800 in cash. The warehouse was placed in use immediately.

8. On February 28, the company closed a deal to sell an office building for $4,580 in cash at a significant gain of $2,115. The building was temporarily rented to another company before it was sold. The building was purchased in 1980 for a total cost of $5,675.

9. On February 28, the company paid its suppliers for last year's unpaid purchases.

10. On March 1, the company paid the employer's portion of the health insurance premium to the insurance provider. The total amount paid was $12,435, which would cover a period of 12 months. The employees paid the remainder of the premium through salary withholding, according to the employment contract.

11. On March 15, the company purchased 300,000 shares of its own common stock at $24 per share. These shares were needed to issue to top executives for their employee stock option plan.

12. On March 30, the company declared and paid a quarterly cash dividend of $0.20 for shares outstanding on March 28. The stock closed at $25 per share on this last trading day of the quarter.

13. The company's total sales for the quarter are listed below. All sales were credit sales.

	Total Net Sales Revenue
January	$ 148,000
February	168,000
March	199,000
Total	$ 515,000

The amount was net of sales return and sales discount.

14. The collection for sales was as follows: January sales were received in full by the end of March. The total amount received for February and March sales was $138,000 and $106,000, respectively.

15. The company's total salary and other operating expenses each month were as follows:

	Salary & Payroll Tax Expenses	Other Operating Expenses
January	$ 26,410	$ 5,630
February	28,230	6,430
March (First 3 weeks)	21,620	4,460
Total	$ 76,260	$ 16,520

Salaries were paid in the form of direct deposits to employees' bank accounts biweekly. The employees' portion of health insurance premiums was withheld from salaries and paid to the insurance provider simultaneously when salaries were paid. The estimated personal income taxes were withheld and paid to the government agencies before the end of each month. Employer's payroll taxes, including unemployment and social security taxes, were immediately remitted to government agencies as they were recorded. Other operating expenses, including utility, property taxes, freight-out, and other miscellaneous expenses, were all paid in cash via online banking.

16. The company's merchandise purchases were as follows:

	Total Merchandise Purchase Costs
January	$ 106,000
February	108,000
March	121,000
Total	$ 335,000

The company's purchase agreement specifies that the suppliers ship merchandizes and send invoices. The company inspects merchandise after receiving them and pays the invoices after inspection. The listed purchase amount included price, tax, tariff, shipping, insurance, net of purchase returns, and discounts.

17. Payment for purchases was as follows: January purchases were fully paid by the end of March. The amount paid for February and March purchases was $99,000 and $87,000, respectively. The remaining unpaid purchases would be paid in the coming months in April and May.

18. The company paid in cash for the interest on the 2-year commercial note for the current quarter and the amount owed from last year. The note is not due until June 30, 2023.

19. The CFO also identified the following areas that need to be adjusted:

    A. Employee salary for the 4^{th} week in March totaled $6,500 and would be paid on April 5 through direct deposit.
    B. Goods ordered by customers in the past year but not delivered were all delivered on time in January. However, deliveries to some customers in the northeast region of the U.S. for sales made in March were delayed because of an unexpected snowstorm. As a result, sales totaling $57,000 were not delivered, and the merchandise remained in the company's warehouse.

    C. The depreciation for equipment and buildings totaled $6,800 for the quarter.

    D. The cost for the three-month infomercial paid on February 1 requires a proper adjustment.

    E. Health insurance premium for January and February totaled $2,300 and was prepaid last year. The health insurance premium paid on March 1 covers a period of 12 months. Proper adjustments are required.

    F. Interest expense on the new 3-year 12% loan borrowed in January must be recognized although not yet paid.

G. The company's inventory system shows the total costs of inventory on hand at the end of the quarter, based on LIFO, totaling $145,000. The number has been confirmed by a companywide inventory count completed at the end of March.

H. The company's income tax rate is 28%.

Balance Sheet for Great Adventures at 12/31/2021

Great Adventures, Inc.
Balance Sheet
(In USD 1,000)
December 31, 2021

Assets		Liabilities	
Current assets:		Current liabilities:	
Cash	$138,800	Accounts payable	$39,630
Accounts Receivable – Net	$75,000	Interest payable	$1,750
Merchandise Inventory	$111,836	Unearned Revenues	$38,846
Prepayments	$2,300	Income tax payable	$48,680
Total current assets	$327,936	Total current liabilities	$128,906
		Notes payable (2-year, 9%)	$25,000
Long-term assets:		Total Long-term Liabilities	$25,000
Land	$34,290	Stockholders' Equity	
Buildings	$85,000	Common stock ($1 Par)	$20,000
Equipment	$56,650	Additional Paid-in Capital	$157,965
Accumulated Depreciation	($25,225)	Retained earnings	$146,780
Total Long-term asset	$150,715	Total stockholders' equity	$324,745
Total assets	$478,651	Liabilities & stockholders' equity	$478,651

REQUIRED

With the CFO's help, you developed the following work plan for the project:

1. Set up T-accounts with proper account titles and beginning balances.
2. Analyze each of the transitions 1 – 18, determine the proper journal entries, and record the journal entries in the general journal.
3. Post journal entries to T-accounts.
4. Prepare an unadjusted trial balance. Correct mistakes before continuing to the next step if your accounts are out of balance.
5. Analyze adjustments in item 19 and determine proper adjusting entries. Record the adjusting entries in the general journal.
6. Post adjusting entries to T-accounts and prepare an adjusted trial balance. Correct mistakes before continuing to the next step if your accounts are out of balance.
7. Prepare classified Income Statement and then classified Balance Sheet. Prepare the Statement of Stockholder's Equity. Pay attention to proper titles, dates, and formats.
8. Prepare Statement of Cash Flows using direct and indirect methods. Significant non-cash transactions must be disclosed in the footnote.
9. Prepare and post the closing entries to T-accounts.
10. Compute EPS, ROA, ROE, Average Collection Period, Inventory Turnover, PE ratio, and Free-Cash Flow. Give comments on these ratios.
11. Submit a report with your name and UID. Please include the following in your reports:
    a. Balance Sheet, Income Statement, Statement of Owner's Equity, and Statement of Cash Flows.
    b. Financial ratios you computed in requirement 10 with your analysis.
    c. General Journal with all journal entries, including the adjusting entries.
    d. Adjusted and unadjusted trial balances.

Hints:

1. Do not keep decimals. Round all numbers to the thousand.
2. Record salary, payroll taxes, insurance, infomercial, and other expense as Operating Expenses. Keep Depreciation Expenses and Interest Expenses in separate accounts. This helps to reduce the number of T-accounts.
3. Assume the tax rate is also 28% for the gains on the sale of long-term assets.

Great Adventures, Inc.
<u>General Journal</u>
March 31, 2022

#	Date	Description	Debit	Credit
1		*Description - Example*		
		Cash	30,000	
		Note Payable		30,000

Great Adventures, Inc. Unadjusted / Adjusted Trial Balance March 31, 2022		
Accounts	**Debit**	**Credit**
Total		

Cash

Accounts Receivable

Inventories

Prepayments

Land

Buildings

Equipment

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Accumulated Depreciation	

Accounts Payable	

Interests Payable	

Unearned Revenue	

Income Tax Payable	

Notes Payable	

Common Stock	

Additional Paid-in Capital	

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Retained Earnings

Teaching notes

Great Adventures, Inc.

General Journal

(In thousands of dollars)

#	Date	Accounts	Dr.	Cr.
1	*1/1/2022*	***Borrow money from bank***		
		Cash	$30,000	
		Note Payable		$30,000
2	*3/1/2022*	***Purchase land with 500,000 shares common stock***		
		Land	$11,500	
		Common Stock		$500
		Paid In Capital		$11,000
3	*2/1/2022*	***Issue 5million shares of common stock for cash***		
		Cash	$95,760	
		Common Stock		$5,000
		Paid In Capital		$90,760
4A	*1/31/2022*	***Receive cash from sales made last year***		
		Cash	$45,000	
		Accounts Receivable		$45,000
4B	*2/28/2022*	***Receive cash from sales made last year***		
		Cash	$30,000	
		Accounts Receivable		$30,000
5	*1/28/2022*	***Pay suppliers for purchases made last year***		
		Account Payable	$29,630	
		Cash		$29,630
6	*2/1/2022*	***Purchase informercial from TV station***		
		Operating Expense	$1,660	
		Cash		$1,660
7	*2/15/2022*	***Purchase a warehouse building with cash***		
		Building	$8,800	
		Cash		$8,800
8	*2/28/2022*	***Sold a vacant office building for cash***		
		Cash	$4,580	
		Accumulate Depreciation	$3,210	
		Building		$5,675
		Gain		$2,115
9	*2/28/2022*	***Paid suppliers for purchases made last year***		
		Account Payable	$10,000	
		Cash		$10,000
10	*3/1/2022*	***Paid 1-year insurance premium***		
		Prepayment	$12,435	

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		Cash		$12,435
11	*3/15/2022*	***Purchased 300,000 of company's own stocks at $24 per share***		
		Treasury Stocks	$7,200	
		Cash		$7,200
12	*3/30/2022*	***Pay cash dividend on 25.2 mil. shares outstanding (See Note 1)***		
		Dividend	$5,040	
		Cash		$5,040
13	*3/30/2022*	***Record sales made in January - March***		
		Account Receivable	$515,000	
		Sales Revenue		$515,000
14	*3/30/2022*	***Receive cash from sales made in January - March***		
		Cash	$392,000	
		Accounts Receivable		$392,000
15	*3/30/2022*	***Pay salary and other operating expenses in January - March***		
		Operating Expense	$92,780	
		Cash		$92,780
16	*3/30/2022*	***Purchased merchandizes in January - March***		
		Purchase	$335,000	
		Account Payable		$335,000
17	*3/30/2022*	***Paid merchandize purchased in January - March***		
		Account Payable	$292,000	
		Cash		$292,000
18	*3/30/2022*	***Paid cash for interests on the 2-year notes***		
		Interest Expense	$562	
		Interest Payable	$1,750	
		Cash		$2,312
19A	*3/30/2022*	***Accrue salary expenses for the 4th week of March***		
		Operating Expense	$6,500	
		Salary Payable		$6,500
19B1	*1/31/2022*	***Delivered goods for cash advanced received last year***		
		Unearned Revenue	$38,846	
		Sales Revenue		$38,846
19B2	*3/20/2022*	***Adjust for delayed delivery due to storm***		
		Sales Revenue	$57,000	
		Unearned Revenue		$57,000
19C	*3/30/2022*	***Record depreciation on equipment and buildings***		
		Depreciation Expense	$6,800	
		Accumulate Depreciation		$6,800
19D	*3/30/2022*	***Adjust prepaid TV informercial paid on 2/1/2022***		
		Prepayment	$553	
		Operating Expense		$553
19E1	*1/31/2022*	***Adjust insurance premium paid last year***		

		Operating Expense	$2,300	
		Prepayment		$2,300
19E2	***3/30/2022***	***Adjust for expired insurance premium paid on 3/1/2022***		
		Operating Expense	$1,036	
		Prepayment		$1,036
19F	***3/30/2022***	***Accrue interest expenses on 3-year notes***		
		Interest Expense	$900	
		Interest Payable		$900
19G1	***3/30/2022***	***Close purchase and update inventory***		
		Inventory	$335,000	
		Purchase		$335,000
19G2	***3/30/2022***	***Record Cost of Goods Sold and update inventory***		
		Cost of Goods Sold	$301,836	
		Inventory		$301,836
19H	***3/30/2022***	***Record Income tax expense (See Note 2)***		
		Income Tax Expense	$23,839	
		Income Tax Payable		$23,839
		Check balances	**$2,698,517**	**$2,698,517**

Note 1:

Shares outstanding at the end of quarter (in 000)		***Outstanding***	***W. Average***
12/31/2021	Beginning of the quarter (3 / 3 Months)	20,000	$20,000
3/1/2022	Issued shares for land (1 / 3)	500	$167
2/1/2022	Issued shares for cash (2 / 3)	5,000	$3,333
3/1/2022	Purchase treasury stock (1 / 3)	-300	-$100
3/30/2022	Shares outstanding	25,200	$23,400

Note 2:

Income tax computation

Sales Revenue	$496,846
- Cost of Goods Sold	-$301,836
Gross Margin	$195,010
- Other Operating Expenses	-$103,723
- Depreciation Expenses	-$6,800
Operating Income	$84,487
+ Gain on Sales of L/T Assets	$2,115
- Interest Expenses	-$1,462
Net Income Before Tax	$85,140
- Income Tax Expenses (28%)	-$23,839
Net Income	$61,301

Great Advantures, Inc.

Income Statement

For First Quarter 2022

(In USA 000)

Net Sales Revenue	$496,846
- Cost of Goods Sold	$301,836
Gross Profits	$195,010
- Operation Expenses (other than depr. & amortization)	$103,723
Net Opt. Income Bef. Interest, Tax, Depr. & Amort. (EBITDA)	$91,287
- Depreciation & Amortization Expenses	$6,800
Net Operating Income Bef. Interest and Tax (EBIT)	$84,487
+/- Gain / Loss on Disposal of Long-term Assets	$2,115
- Interest Expenses	$1,462
Net Income Before Tax (NIBT)	$85,140
- Income Tax (28%)	$23,839
Net Income	$61,301
+ Beginning Balance of Retained Earnings	$146,780
- Dividends	$5,040
Ending Balance of Retained Earnings	$203,041

Great Adventures, Inc.
Balance Sheet
(In USD 1,000)

	3/30/2022	*12/31/2021*	*Change*
Assets			
Current Assets:			
Cash	$274,283	$138,800	$135,483
Accounts Receivable – Net	$123,000	$75,000	$48,000
Merchandise Inventory	$145,000	$111,836	$33,164
Prepayments	$11,952	$2,300	$9,652
Total Current Assets	$554,235	$327,936	$226,299
Long-term Assets:			
Land	$45,790	$34,290	$11,500
Buildings	$88,125	$85,000	$3,125
Equipment	$56,650	$56,650	$0
Accumulated Depreciation	($28,815)	($25,225)	($3,590)
Total Long-term Asset	$161,750	$150,715	$11,035
Total Assets	$715,985	$478,651	$237,334
Liabilities			
Current Liabilities:			
Accounts Payable	$43,000	$39,630	$3,370
Interest Payable	$900	$1,750	($850)
Unearned Revenues	$57,000	$38,846	$18,154
Income Tax Payable	$72,519	$48,680	$23,839
Salary Payable	$6,500	$0	$6,500
Total Current Liabilities	$179,919	$128,906	$51,013
Long-term Liabilities			
Notes Payable	$55,000	$25,000	$30,000
Total Long-term Liabilities	$55,000	$25,000	$30,000
Total Liabilities	$234,919	$153,906	$81,013
Stockholders' Equity			
Common Stock ($1 Par)	$25,500	$20,000	$5,500
Additional Paid-in Capital	$259,725	$157,965	$101,760
Retained Earnings	$203,041	$146,780	$56,261
- Treasuary Stock	($7,200)	$0	($7,200)
Total Stockholders' Equity	$481,066	$324,745	$156,321
Liabilities & Stockholders' Equity	$715,985	$478,651	$237,334

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Great Advantures, Inc.
Statement of Cash Flows
For First Quarter 2022
(In USA 000)

Operating Cash Flows	
+ Cash Recv'd from Customers(= Rev. - ΔAR + ΔUnearnedRev)	$467,000
- Cash Paid to Suppliers (= CGS + ΔInventory - ΔAP)	($331,630)
- Cash Paid Opt. Exp (= OptExp + ΔPrep - ΔRelated Payable)	($106,875)
- Cash Paid for Interest (= InterestExpense - ΔInterestPayable)	($2,312)
- Cash Paid Income Tax (= IncTaxExp - ΔIncTaxPayable)	($0)
Net Operating Cash Flow	$26,183
Investing Cash Flow	
+ Proceed from Selling Unused Building (JE #8)	$4,580
- Purchase Warehouse (JE #7)	($8,800)
Net Investing Cash Flow	($4,220)
Financing Cash Flow	
+ Issuing Common Stock (JE #3)	$95,760
+ Borrow Money from Bank (JE #4B)	$30,000
- Purchase of Treasury Stock (JE #11)	($7,200)
- Pay Dividend (JE #12)	($5,040)
Net Finance Cash Flow	$113,520
Net Cash Flow	$135,483
+ Beginning Balance of Cash	$138,800
Ending Balance of Cash	$274,283
Operating Cash Flow - Indirect Method	
Net Income	$61,301
+ None Cash Expenses (Depreciation)	$6,800
- / + Gain / Loss on Disposal of Long-term Assets	($2,115)
- Δ Current Assets Other Than Cash	($90,816)
+ Δ Current Liabilities	$51,013
Net Operating Cash Flow	$26,183