

Session 2: Post class test solutions

1. **a. \$50 million.** Since it is a 3-year contract and the services will be spread over three years, I would record one third of the transaction revenues this year. The payment schedule is irrelevant (at least for income statements)
2. **a, b and e are cost of goods sold, and c & d are other operating expenses.** Factory maintenance, labor and material are all related directly to products that are sold. Selling and G&A expenses are not. (Factory maintenance may not be a variable cost, but it is still part of cost of goods sold).
3. **c. High gross profits, low operating profits, even lower net profits.** Low cost of goods sold should translate into high gross profits, but high selling and G&A expenses will make operating profit low, and high interest payments on debt will make net profit even lower.
4. **d. In the company's net profits.** When you own a 5% stake in another company, the profits from this holding will show up in the income statement below the operating income line and thus will be part of net income.
6. **d. The expense will show up infrequently and be irregular.** If an expense shows up every year or at regular intervals, it is part of the company's business operations and should not be considered extraordinary.