

# **Financial Accounting Project**

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## Case Scenario Description

Three partners decide to start a video game company whose goal is to develop games for the Apple iPhone and iPod Touch. In its first year of existence, the company plans develop and release one game, along with a number of add-ons to that game.

Due to the relative simplicity of iPhone games, this project will be completed with a small staff of 6 people. The staff will include the 3 founders doing administrative jobs and each being paid a monthly salary of \$3000. There will also be a programmer, artist, and game designer, each being paid a monthly salary of \$6000 (only in March through October when the game is in active development).

Like most video game development, the largest expense of the business will be labor. There will also be miscellaneous monthly costs such as renting an office, utilities, and insurance. In the first several months, there will be startup costs such as purchasing computers and software, paying legal fees, buying supplies, and installing network equipment. In addition, the game will use licensed songs, so there will be music licensing fees. And near the game's release, there will be advertising costs.

The company will have several sources of revenue. The largest source of revenue will be sales of the game from Apple's App Store. Each unit of the game will sell for \$2 and Apple takes 30% of that in exchange for handling distribution (which is digital download only). Another source of revenue will be sales of game add-ons through the App Store. Each add-on will sell for \$1 and Apple again takes 30%. Finally, the game will feature in-game advertisements, which will be sold prior to release for a flat fee.

To help cover startup costs, the three founders decide to get a small business loan for \$350,000 at 5% annual interest. The principal of the loan does not need to be paid back until the end of year 3. Also, the founders decide to start the company as an LLC with no stock or dividends.

## Journal Entries (excerpt)

7/01/2010	Prepaid Rent (6 mo)		15000	
		Cash		15000
7/01/2010	Prepaid Insurance (6 mo)		1200	
		Cash		1200
7/03/2010	Music licensing expense		5000	
		A/P (music) – 2/10, n/30		5000
7/13/2010	Accounts payable (music)		5000	
		Purchase discount (music)		100
		Cash		4900
7/15/2010	FICA payable (Jun)		4131	
	Federal W/H payable (Jun)		4500	
		Cash		8631
7/15/2010	Salaries payable (Jun)		20434.5	
		Cash		20434.5
7/15/2010	Utilities payable (Jun)		300	
		Cash		300
7/20/2010	Cash		15000	
		Ad sales receivable (Jun)		15000
7/21/2010	Ad sales receivable (July)		15000	
		Ad sales revenue		15000
7/31/2010	Salaries Expense		27000	
		FICA Employee payable (July)		2065.5
		Federal W/H payable (July)		4500
		Salaries payable (July)		20434.5
7/31/2010	Payroll Tax Expense		2065.5	
		FICA Employer payable (July)		2065.5
7/31/2010	Utilities expense		300	
		Utilities payable (July)		300
7/31/2010	Rent expense		2500	
		Prepaid rent		2500
7/31/2010	Insurance expense		200	
		Prepaid insurance		200
7/31/2010	Office supplies expense		50	
		Office supplies		50
7/31/2010	Web Hosting expense		30	
		Prepaid Web Hosting		30

## Trial Balance

	Debits	Credits
Cash	274774.10	
Notes Payable		350000.00
Legal fees expense	1000.00	
Equipment	30500.00	
Accounts Payable (equip)		0.00
Office supplies expense	600.00	
Office supplies	400.00	
Salaries expense	252000.00	
FICA payable		1377.00
Federal W/H payable		1500.00
Salaries payable		6811.50
Payroll tax expense	19754.40	
FUTA payable		0.00
SUTA payable		0.00
Utilities expense	3600.00	
Utilities payable		300.00
Rent expense	30000.00	
Prepaid rent	0.00	
Insurance expense	2400.00	
Prepaid insurance	0.00	
Prepaid web hosting	30.00	
Web hosting expense	330.00	
Web designer fees	4500.00	
Music licensing expense	20000.00	
Accounts payable (music)	0.00	
Purchase discount (music)		300.00
Ad sales receivables	0.00	
Ad sales revenue		45000.00
Advertising expense	28000.00	
Advertising payable		0.00
Game sales receivable	200000.00	
Game sales revenue		575000.00
Game sales allowance	112500.00	
Interest expense	17500.00	
Interest payable		17500.00
	997888.50	997788.50

## Income Statement

	<b>2010</b>
<b>Revenues</b>	
Ad Sales	45000.00
Game Sales	575000.00
Game Sales allowances	172500.00
Production Wages	144000.00
Production Salary tax	11254.20
Licensing Fees	20000.00
Total Cost of Sales	347754.20
Gross Margin	272245.80
Gross Margin %	47.35%
<b>Operating Expenses</b>	
Advertising expense	28000.00
Admin Wages expense	108000.00
Admin payroll tax expense	8500.20
Interest expense	17500.00
Depreciation expense	5100.00
Utilities expense	3600.00
Web Hosting expense	330.00
Insurance expense	2400.00
Rent expense	30000.00
Supplies expense	600.00
Legal Fees	1000.00
Web Designer fees	4500.00
Total Operating Expenses	209530.20
Profit Before Interest & Taxes	62715.60
Interest Expense	17500.00
Income Taxes	15373.30
Net Profit	47342.296
Net Profit/Sales	8.23%

## Balance Sheet

	2010
<b>Assets</b>	
Short-term Assets	
Cash	274774.10
Game Sales Receivable	200000.00
Sales Allowances	-60000.00
Office Supplies	400.00
Prepaid Web Hosting	30.00
Total Short-term Assets	415204.10
Long-term Assets	
Network Hardware	5500.00
Office Computers	8000.00
Office Furniture	9000.00
Software	8000.00
Accumulated Depreciation	-5100.00
Total Long-term Assets	25400.00
<b>Total Assets</b>	<b>440604.10</b>
<b>Liabilities and Capital</b>	
Salaries payable	6811.50
Federal W/H payable	1500.00
FICA payable	1377.00
Utilities payable	300.00
Income Tax payable	15373.30
Note payable	350000.00
Interest payable	17500.00
Total Liabilities	392861.80
<b>Owner's Equity</b>	
Retained Earnings	0.00
Net Profit	47342.30
Total Capital	47342.30
<b>Total Liabilities and Owner's Equity</b>	<b>440204.10</b>

## Closing Entries

	Debit	Credit
Game sales revenue	575000.00	
Ad sales revenue	45000.00	
Purchase discount (music)	300.00	
Legal fees expense		1000.00
Office supplies expense		600.00
Salaries expense		252000.00
Payroll tax expense		19754.40
Utilities expense		3600.00
Rent expense		30000.00
Insurance expense		2400.00
Web hosting expense		330.00
Web designer fees		4500.00
Music licensing expense		20000.00
Advertising expense		28000.00
Game sales allowance		172500.00
Interest expense		17500.00
Retained Earnings	68115.60	

## Summary / Evaluation

My project turned out to be moderately profitable. Due to high labor and startup costs, the net income was fairly low. However, it is fairly normal for video game companies to not be profitable for several years. Theoretically, the company could release more games in future years (without adding much more staff) and make a larger profit as a result. I am definitely going to keep mobile game development in mind as a future career path, especially since it has a lower barrier to entry than other types of game development.