

QUESTION3 (15 marks)

Part 1 (4 marks)

| Year | Depreciation expense (for the year) | Book Value (and the end of the year) |
|------|---|---|
| | | \$85,000 |
| 1 | $\$85,000 \times 1/5 \times 200\% = \$34,000$ | 51,000 |
| 2 | $\$51,000 \times 1/5 \times 200\% = \$20,400$ | 30,600 |
| 3 | $\$30,600 \times 1/5 \times 200\% = \$12,240$ | 18,360 |
| 4 | $\$18,360 \times 1/5 \times 200\% = \$7,344$ | 11,016 |
| 5 | $\$80,000 - \$73,984 \text{ accum. amort.} = \$6,016^*$ | 5,000 |

Cash \$35,000
 Accumulated depreciation \$66,640*
 Machine (or Equipment) \$85,000
 Gain \$16,640
 * $\$34,000 + 20,400 + 12,240 = \$66,640$ (see the table above)

Part 2 (3 marks)

Depreciation rate per unit = $(\$55,000 - 5,000) / 200,000 = \0.25
 Depreciation expense in 2012 = $\$0.25 \times (200,000 - 180,000) = \$5,000$

Part 3 (4 marks)

Cost of land = $\$315,000 \times [170,000 / (170,000 + 230,000)] + 5,000 = \$138,875$
 Cost of building = $\$315,000 \times [230,000 / (170,000 + 230,000)] + 0 = \$181,125$

Part 4 (4 marks)

New depreciable amount after repair = $\$100,000 - (100,000 / 5 * 4) + 30,000 = \$50,000$
 Depreciation expense in 2012 = $(\$50,000 - 2,000) / 3 = \$16,000$

Depreciation expense \$16,000
 Accumulated depreciation \$16,000

QUESTION 4 (16 marks)

Req. 1 (4 marks)

PV of principal = $\$1,000,000 \times 0.5537^* = \$ 553,700$
 PV of interest payments = $\$1,000,000 \times 8.0\% \times 1/2 \times 14.8775^{**} = \$ 595,100$
 Bond issue price: \$1,148,800

* PV factor, n = 20, i=3%
 ** PV annuity factor, n = 20, i=3%

| | | |
|--------------------------|-------------|-------------|
| Cash | \$1,148,800 | |
| Premium on bonds payable | | \$148,800 |
| Bonds payable | | \$1,000,000 |

Req. 2 (4 marks)

Big Burst Inc.
Statement of Financial Position (Partial)
on March 31, 2013

Current liabilities:

| | |
|------------------|----------|
| Interest Payable | \$6,667* |
|------------------|----------|

Long-term liabilities:

| | |
|----------------------------------|------------------|
| Bonds payable, 8%, due 2023 | 1,000,000 |
| Premium on bonds payable | <u>147,877**</u> |
| Carrying amount of bonds payable | <u>1,147,877</u> |

* $[(\$1,000,000 \times 8\% \times \frac{1}{2}) \times \frac{1}{6}] = \$6,667$

** $\$148,800 - \{6,667 - [(\$1,148,800 \times 6\% \times \frac{1}{2}) \times \frac{1}{6}]\} = \$147,877$

Format of the statement

Req. 3 (3 marks)

September 1, 2013

| | | |
|--|----------|--|
| Interest expense | \$28,720 | [$(\$1,148,800 \times 6\% \times \frac{1}{2}) \times \frac{5}{6}$] |
| Premium on bonds payable | \$4,613 | |
| Interest payable | \$6,667 | |
| Cash [$(\$1,000,000 \times 8\% \times \frac{1}{2})$] | | \$40,000 |

Req. 4 (3 marks)

September 1, 2013

| | |
|---|---------|
| Bonds payable ($\$1,000,000 \times .10$) | 100,000 |
| Premium on bonds payable | 14,326* |
| Cash ($\$1,000,000 \times .10 \times 1.02$) | 102,000 |
| Gain | 12,326 |

* $[147,877 \text{ (from req. 2)} - \$4,613 \text{ (from req. 3)}] \times .10 = \$14,326$

Req. 5 (2 marks)

(Sept. 1, 2013 - Mar. 1, 2023 => 9.5 years)

| | |
|---|---------------------------------|
| Total cash payments | \$684,000 * |
| * $\$40,000 \text{ (from req. 3)} \times .90 \times 9.5 \times 2$ | |
| Total premium to be amortized | <u>(\$128,938)**</u> |
| ** $147,877 \text{ (from req. 2)} - \$4,613 \text{ (from req. 3)} - \$14,326 \text{ (from req. 4)}$ | |
| = $\$128,938$ | |
| Cumulative interest expense | <u>\$555,062</u> |

QUESTION 5 (19 marks)

Req. 1 (15 marks)

Each ✓ = 1/3 mark.

Ponder Ltd.
Statement of Cash Flows
For the Year Ended December 31, 2012

Cash flows from (used in) operating activities:

| | |
|--|----------------|
| Net income..... | \$ 101,800 |
| Adjustments to reconcile net income to net cash provided by operating activities: | |
| Depreciation | \$14,300 |
| Loss on sale of land | 2,900 |
| Increase in trade receivables | (17,100) |
| Increase in inventories | (7,400) |
| Decrease in prepaid expenses..... | 3,500 |
| Increase in trade payables | 22,100 |
| Decrease in salaries payable..... | (13,300) |
| Increase in income taxes payable..... | 500 |
| Decrease in deposits from customers..... | <u>(6,100)</u> |
| Cash provided by operating activities..... | <u>101,200</u> |

Cash flows from (used in) investing activities:

| | |
|--|-----------------|
| Proceeds from sale of land (\$23,000 - \$16,100 - \$2,900)..... | \$4,000 |
| Purchase of equipment | (27,000) |
| Proceeds from sale of equipment (\$94,200 + \$27,000 - \$14,300 - \$104,900)..... | <u>2,000</u> |
| Cash used for investing activities | <u>(21,000)</u> |

Cash flows from (used in) financing activities:

| | |
|---|-----------------|
| Principal repayments on note payable | (8,000) |
| Issuance of common shares | 6,000 |
| Dividend payments (\$11,900 + \$101,800 - \$74,600) | <u>(39,100)</u> |
| Cash used for financing activities | <u>(41,100)</u> |

| | |
|---|------------------|
| Increase in cash and cash equivalents..... | \$39,100 |
| Cash and cash equivalents, December 31, 2011..... | <u>16,600</u> |
| Cash and cash equivalents, December 31, 2012..... | <u>\$ 55,700</u> |

Supplemental Disclosures

| | |
|------------------------------|----------|
| Amount of interest paid | \$2,600 |
| Amount of dividend paid | \$39,100 |
| Amount of income tax paid | \$8,500* |
| *900 + 9,000 - 1,400 = 8,500 | |

Req. 2 (4 marks)

Cash Coverage Ratio = (Cash flow from operating activities + Interest paid + Income tax paid) / Interest paid = $(\$101,200 + 2,600 + 8,500) / \$2,600 = 43.19$

The cash coverage ratio evaluates a company's ability to generate cash flows from operating activities to make required interest payment. Ponder has a high cash coverage ratio, which indicates high solvency.

Free Cash Flow = Cash flow from operating activities – Dividends – Capital expenditures = $(\$101,200 - 39,100 - 27,000) = \$35,100$

Free cash flow is a measure of a firm's ability to pursue long-term investment opportunities without the need for external financing. Ponder has a positive free cash flow, which indicates strong financial flexibility.

QUESTION 6 (14 marks)**Req. 1 (10 marks)**

- a) Return on Equity = Profit / Average Shareholders' Equity
= $12,600 / [(90,000 + 33,500 + 90,000 + 27,500) / 2] = 10.46\%$
Profitability Test
- b) Inventory Turnover = Cost of Sales / Average Inventory
= $952,000 / [(25,000 + 38,000) / 2] = 30.22$
Liquidity Test
- c) Quick Ratio = (Cash and Cash Equivalent + Short-term Investment + Net Trade Receivables) / Current Liabilities
= $(49,500 + 37,000) / (42,000 + 1,000) = 2.01$
Liquidity Test
- d) Times Interest Earned Ratio = (Profit + Interest Expense + Income Tax Expense) / Interest Expense
= $(12,600 + 4,000 + 5,400) / 4,000 = 5.5$
Solvency Test
- e) Dividend Yield = Dividend per Share / Market Price per Share
= $[(27,500 + 12,600 - 33,500) / 9,000] / 23 = 3.19\%$
Market Test

Req. 2 (4 marks)

a. Quick Ratio compares quick assets to current liabilities. Quick assets include cash, short-term investments, and net trade receivables. Compared to current assets, quick assets exclude inventories and prepayment. Inventories are omitted because of the uncertainty of the timing of

cash flows from their sales. Prepayment is also excluded because it is difficult to be converted to cash. Since quick assets only take into account cash and near-cash assets, the quick ratio is a more severe test of liquidity than the current ratio.

b. The times of interest earned ratio uses income statement measures (profit before interest and tax) to assess a company's ability to meet its accrued-based debt obligation (interest expense), and the cash coverage ratio uses cash flow measures (cash flows from operating activities before interest and taxes) to assess a company's ability to meet its cash-based debt obligation (interest paid). Profit includes cash and non-cash components, and the amount of interest expense is not necessarily the same as the amount of interest payment.