

Final (Regular) – Solutions

MCQ

1. e
2. c
3. b
4. b
5. a
6. a
7. d
8. b
9. c
10. c
11. d
12. b

QUESTION 2 *Financial Statements:*

Req. 1.

- a. *Earnings Quality*
Cash from Operating Activities / Net income
 $11,498 / 20,087 = 0.57$
- b. *Times Interest Earned*
Net income + Interest Expense + Income Taxes / Interest Expense
 $(20,087 + 13,983 + 7,424) / 13,983 = 2.967$
- c. *Return on Assets*
Net Income + Interest Expense (net of taxes) / Avg. Total Assets
 $20,087 + 13,983 [1 - (7,424 / 27,511)] / [(819,821 + 407,437) / 2] = 0.049$
- d. *Fixed Asset Turnover*
Net Sales / Avg. PPE
 $446,179 / [(12,482 + 10,509) / 2] = 446,179 / 11,495.5 = 38.81$
- e. *Cash Coverage*
(EBIT + Depreciation expense) / Interest Expense
 $(20,087 + 7,424 + 13,983 + 10,439) / 13,983 = 81,946 / 13,983 = 3.714$
- f. *Debt-to-Equity*
Total Liability / Total Shareholders' Equity = $621,994 / 197,827 = 3.14$

Req. 2

D/E 2013 = 230,997 / 176,440 = 1.31

Using debt to equity ratios from 2014 and 2013, the capital structure of Bauer has changed significantly. Compared to 2013, Bauer is much more heavily financed by debt (increased leverage). For every dollar of shareholder’s investment, there is \$3.14 borrowed from the debt holders in 2014, as opposed to \$1.31 borrowed per dollar invested by the shareholders.

Req. 3

Students’ answer to this question could differ substantially from the suggested solution. Please accommodate reasonable answers.

Although the company is highly leveraged, it has the ability to generate enough earnings and cash for the interest payment, according to the cash coverage and times interest earned ratios. Earnings quality indicates that 57% of the net income is from the main operation. The company seems to use the fixed asset efficiently, but return on assets seems low.

PART B

Req. 1

a. Raw materials inventory consists of items acquired by purchase, growth (such as food products), or extraction (natural resources) for processing into finished goods. Work-in-process inventory comprises goods in the process of being manufactured but not yet complete. Finished goods inventory refers to manufactured goods that are complete and available for sale. Finally, Finished goods in transit includes good that have been purchased and owned by Bauer, but have not arrived to the Company’s warehouse or stores.

b. Cost of sales	543	
Raw materials inventory		543

Req. 2

Trade receivables	70,916	
Inventory	37,610	
Intangible	206,837	
PPE	2,814	
Other asset	786	
Goodwill	58,228	
Current Liabilities		24,802
Cash		352,389

Net asset = (70,916+37,610+206,837+2814+786)-24,802=294,161

Goodwill= 352,389-294,161=58,228

QUESTION 3: Liabilities

PART A

Req. 1

$PV_{\text{face}} = \$800,000 * 0.5820 = 465,600$
 $PV_{\text{annuity}} = (\$800,000 * 6\%) * 5.9713 = 286,622$
 $PV_{\text{bond}} = \$752,222$

Req. 2

November 30, 2014

Interest Expense.....	17,552	
Accrued Interest Payable.....		16,000
Discount on bond payable		1,552

$\text{Interest Expense} = [(752,222) * 7\%] = 52,656 \text{ for 1 year}$
 $\text{Interest Expense for the period} = 52,656 * 4/12 = 17,552$
 $\text{Accrued Interest Payable} = \$800,000 * 6\% * 4/12 = 16,000$
 $\text{Discount on bond payable} = 17,552 - 16,000$

August 1, 2015

Interest Expense.....	35,104	
Accrued Interest Payable.....	16,000	
Discount on bond payable		3,104
Cash.....		48,000

$\text{Interest Expense for the period} = 52,656 * 8/12 = 35,104$
 $\text{Cash} = (\$800,000 * 6\% * 8/12) + 16,000 = 48,000$
 $\text{Discount on bond payable} = 35,104 - 32,000 = 3,104$

Req. 3

After Redemption on August 1, 2015

Statement of Financial Position

Bond Payable.....	480,000
Discount on Bond Payable.....	(25,873)
Bond, carrying amount.....	454,127

$\text{Bond Payable} = (800,000 - 40\% * 800,000) = 480,000$
 $\text{Discount on bond payable} = 47,778 - 4,656 - [(47,778 - 1,552 - 3,104) * 40\%] = 25,873$

Income Statement

Loss on redemption..... 39,649

*CA of bond redeemed = (800,000*40%)-(47,778-1,552 - 3,104)*40% (see above calculation)*

CA of bond redeemed=302,751

*Cash paid to redeem the bond= 107%*320,000= 342,400*

Loss= (342,400- 302,751) = 39,649

Cash Flow Statement

Cash from financing activities

Cash used to redeem the bond..... (342,400)

PART B

Req. 1

Deferred revenue, June 25, 2013	\$ 1,489
Collections in advance during 2014	17,365
Revenue earned during 2014	(X)
Deferred revenue, June 30, 2014	\$1,463

$\$1,489 - X + \$17,365 = \$17,391$

Req. 2

Sales returns.....	1,799	
Provision for sales returns		1,799
Recording a provision for sales returns.		
Provision for sales returns	1,722	
Cash		1,722
Refund of cash for merchandise returned by customers.		

QUESTION 4: Long-Term Asset

Req. 1

<i>July 1</i>			
Research Expense	210,000		
Cash		210,000	
Development Costs/Software	50,000		
Cash		50,000	
<i>July. 5</i>			
Trademark	7,000		
Cash		7,000	
<i>Sept. 1</i>			
Advertising Expense	60,000		
Cash		60,000	
<i>Oct. 1</i>			
Copyright (#2)	180,000		
Cash		180,000	
<i>Dec. 31</i>			
Impairment Loss (\$90,000 – \$125,000)	35,000		
Goodwill		35,000	

No entry for the trademark as the recoverable amount is greater than the carrying amount.

Req. 2

GHANI CORPORATION
Statement of Financial Position (Partial)
December 31, 2014

Intangible Assets

Definite useful life intangibles

Software	\$ 50,000
Accumulated amortization	<u>2,500¹</u>
New product, net	\$ 47,500
Copyright (#1)	\$48,000
Accumulated amortization	<u>36,000</u>
Copyright (#1), net	12,000 ²
Copyright (#2)	\$180,000
Accumulated amortization	<u>15,000</u>
Copyright (#2), net	165,000 ³

Indefinite life intangibles

Trademark	61,000 ⁴
Goodwill	<u>90,000⁵</u>
Total intangible assets	<u>\$375,500</u>

- 1 Depreciation New product ($\$50,000 \div 20 \times 2 \times 6/12 = \$2,500$)
- 2 Depreciation Copyright (#1): $48,000 \div 4 = 12,000$
Accumulated Depreciation (#1): $24,000 + 12,000 = 36,000$
- 3 Depreciation Copyright (#2): ($\$180,000 \div 3 \times 3/12 = \$15,000$)
- 4 Trademark: $\$54,000 + \$7,000 = \$61,000$
- 5 Goodwill: $\$125,000 - \$35,000 = \$90,000$

QUESTION 5 - Shareholders' Equity

Req. 1

Apr 9	Retained Earnings.....	54,000	
	Dividends Payable (preferred share)		54,000
	<i>To record declaration of dividends in arrears and the current year's preferred dividend (9,000 shares \times \$3 \times 2)</i>		
Apr 9	Retained Earnings.....	96,400	
	Dividends Payable (common share)		96,400
	<i>Dividend on common share max = $150,400 - 54,000 = 96,400$</i>		
Apr 12	No entry required.		
May 3	Dividends Payable (preferred shares)	54,000	
	Cash		54,000
May 3	Dividends Payable (common shares)	96,400	
	Cash		96,400

Req. 2

ESP= Income-(dividend on preferred shares)/average shares

EPS= $(150,400 - 54,000) / 400,000$

EPS= 0.24

Req. 3

April 9	Dividend Declared	60,000	
	Stock dividend distributable		60,000

*Calculations: $(400,000 * 1\%) * 15\$$*

May 3		
Stock dividend distributable.....	60,000	
Common share.....		60,000

Question 6 – Cash Flow Statement

Req. 1

Cash flow from operating activities

Net income	.....	\$278,800
Adjust for non-cash items		
Depreciation expense	.....	60,000
Loss on sale of equipment	.....	8,000
Decrease in accounts receivable	.....	10,000
Increase in inventory.....	.....	(20,000)
Increase in accounts payable.....	.....	43,000
Decrease in interest payable.....	.....	(1,000)
Net cash flow from operations.....		378,800

Cash flow from investing activities

Purchase of equipment.....	.....	(214,000) ^a
Proceeds from sale of equipment	.....	6,000 ^b
Net cash flow from investing activities (208,000)		

Note: The company purchased land in exchange of common shares worth \$120,000

*a. New Equipment: $540,000 + X - 134,000 = 620,000$
Cash to buy new equipment = 214,000*

b. Cash received upon selling old equipment: $14,000 - 8,000 = 6,000$

Req. 2

Cash received from issuing shares: $150,000 - 120,000 = 30,000$

Req. 3

Dividend declared = $98,000 + 278,800 - X = 240,000$

Dividend declared = 136,800

Cash dividend = $36,000 + 136,800 - X = 30,000$

Req. 4

Purchase: $160,000 + X - 520,000 = 180,000$

Purchase: 540,000

Cash paid to suppliers of merchandise: $38,000 + 540,000 - X = 81,000$

Cash paid=497,000

Req. 3

The reasons that cause cash to be different from income are: (1) non-cash expenses (i.e, depreciation expense, losses, gains, bond amortization), and (2) changes in non-cash working capital items. Depreciation expense, along with decreased working capital requirements (current assets – current liabilities), turned the net loss into positive operating cash flow.

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