**Final exam**

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**Group 1041**

**Financial reporting analysis**

1. Which of the following is least likely to be considered a role of financial statement analysis

1. Determining whether to invest in the company's securities.
2. Assessing the management skill of the company's executives.
3. To make economic decisions

Explain your answer

2.A company collects cash from a customer to settle an account receivable. What effect does this transaction have on the company's total assets and total shareholders' equity?

Assets Equity

Explain your answer

3. The Management Discussion and Analysis (MD&A) portion of the financial statements. Which of the answer is best and explain your answer comprehensively

A)is not required by the SEC. b)includes such items as discontinued operations, extraordinary items, and other unusual or infrequent events.

c) includes audited disclosures that help explain the information summarized in the financial statements.

4. In the expanded form of the accounting equation, assets equal liabilities plus contributed capital plus

a)ending retained earnings minus beginning retained earnings.

B) beginning retained earnings plus revenue minus expenses.

c) ending retained earnings

**and explain the effect of different cost flow method of inventory to the equation.**

5.According to the IASB, which of the following least accurately describes financial reporting? Financial reporting: and explain your answer briefly

a.provides information about changes in financial position of an entity. B.uses the information in a company's financial statements to make economic decisions. C.is useful to a wide range of users

6. Alpha Company reported the following financial statement information

December 31, 2006:

Assets $70,000

Liabilities 45,000

December 31, 2007

Assets 82,000

Liabilities 55,000

During 2007:

Stockholder investments 3,000

Net income ?

Dividends 6,000

Calculate Alpha's net income for the year ended December 31, 2007 and the change in stockholders' equity for the year ended December 31, 2007.

Net income Change in stockholders' equity

7. Which of the following statements about financial statement analysis and reporting is least accurate?

a) Providing information about changes in a company's financial position is a role of financial reporting.

B) Deciding whether to recommend a company's securities to investors is a role of financial statement analysis.

C) Financial statement analysis focuses on the way companies show their financial performance to investors by preparing and presenting financial statements.

**Explain your answer briefly.**

8.In the financial statement analysis framework, using the data to address the objectives of the analysis and deciding what conclusions or recommendations the information supports is best described as:

a) analyzing and interpreting the data.

B)reporting the conclusions.

c)processing the data.

**Describe the steps of financial statement analyses and explain your answer briefly**

9. Jack Rivers is an investment analyst for the equity fund of a family office. The head of the family, Charlotte Blackmon, is concerned that management may be manipulating the earnings of some of the companies that the fund invests in. Rivers explains to Blackmon, "Even though we don't have access to the detailed transactions that underlie the financial statements, we can be sure that management is not manipulating earnings because I read the footnotes to the financial statements of every company we invest in. The footnotes would disclose any deviation from appropriate accounting parameters." Rivers is:

a)correct.

b)incorrect because even within appropriate accounting parameters, management can manipulate earnings through the assumptions that rely on their discretion. C)incorrect because deviation from appropriate accounting parameters is addressed in the auditor's report, so a qualified opinion in the auditor's report ensures that management is not manipulating earnings

**explain your answer briefly.**

9. Which of the following is the least likely to be considered an accrual for accounting purposes?

a)Unearned revenue.

b) Accumulated depreciation.

c)Wages payable.

**And explain the accrual for accounting purposes and the effect of your chosen answer for the related ratio analyses**

10. Washburn Motors signs a contract to sell a $100,000 luxury sedan to be delivered next month, and receives a $20,000 cash down payment from the buyer. **How will the transaction most likely affect Washburn's assets and liabilities?**

Assets Liabilities

**Explain your answer**

11. A furniture store acquires a set of chairs for $750 cash and sells them for $1000 cash. These transactions are most likely to affect which accounts?

Purchase Sale

**Explain your answer**

12. Which of the following best describes financial reporting and financial statement analysis?

a)Financial reporting refers to how companies show their financial performance and financial analysis refers to using the information to make economic decisions. B)The objective of financial analysis is to provide information about the financial position of an entity that is useful to a wide range of users. C)Financial reports assess a company's past performance in order to draw conclusions about the company's ability to generate cash and profits in the future.

**Explain your answer briefly**

13. Regarding the use of financial statements in security analysis and selection, it would be most accurate to say that:

a)analysts can verify the accuracy of financial statements by using a firm's detailed accounting system information. B)further analysis of a firm's financial statements is typically not necessary if the firm has conformed to applicable accounting principles.

c) analysts can use footnotes and Management's Discussion and Analysis to better understand assumptions used in the financial statements.

**Explain your answer briefly**

14. Which of the following is the best description of the financial statement analysis framework

a)State the objective and context, gather data, process the data, analyze and interpret the data, report the conclusions or recommendations, update the analysis. B)Gather data, analyze and interpret the data, determine the context, report the conclusions, update the analysis. C)Gather data, analyze and interpret the data, process the conclusions, assess the context, report the recommendations, update the analysis.

**Explain your answer briefly**

15. An analyst has gathered the following information about Barnstabur, Inc., for the year:

Reported net income of $30,000.

5,000 shares of common stock and 2,000 shares of 8%, $90 par preferred stock outstanding during the whole year.

During the year, Barnstabur issued at par, $60,000 of 6.0% convertible bonds, with each of the 60 bonds convertible into 110

shares of the Barnstabur common stock.

**If Barnstabur's effective tax rate is 40%, what will Barnstabur report for diluted earnings per share (EPS)?**

16. Under U.S. GAAP, when an unreliable estimate of costs exists and ultimate payment is assured, which of the following revenue recognition methods should be used**? Explain the reason why?**

17. BWT, Inc. shows the following data in its financial statements at the end of the year. Assume all securities were outstanding for

the entire year.

6.125% convertible bonds, convertible into 33 shares of common stock. Issue price $1,000, 100 bonds outstanding.

6.25% convertible preferred stock, $100 par, 2,315 shares outstanding. Convertible into 3.3 shares of common stock, Issue

price $100.

8% convertible preferred stock, $100 par, 2,572 shares outstanding. Convertible into 5 common shares, Issue price $80.

9,986 warrants are outstanding with an exercise price of $38. Each warrant is convertible into 1 share of common. Average

market price of common is $52.00 per share.

Common shares outstanding at the beginning of the year were 40,045.

Net Income for the period was $200,000, while the tax rate was 40%.

What are the basic and diluted EPS for the year?

Basic Diluted

**Write a whole explanation**

18. Would an increase in the cost of raw materials used in the production of inventory and would an increase in marketing expenses result in lower gross profit? Yes or no

Increase in Increase in

raw materials cost marketing expense

**write an explanation**

**19.** In applying the treasury stock method, if warrants allow the purchase of 1 million shares at $42 per share when the average price is $56 per share, how many shares will be added to the firm's weighted average number of shares outstanding

**Explanation of calculation and what is a treasury stock method?**

**20.**

Is an acquisition of treasury stock or a loss from the write-down of inventory under the lower-of-cost-or-market rule included in comprehensive income?

Inventory write-down Acquisition of treasury stock

**Explain the effect ?**

21.

On January 1, 2007, Sneed Corporation purchased machinery costing $8 million with a salvage value of $1 million. For the year ended 2007, Sneed recognized depreciation expense of $3.2 million from the machinery using the double-declining-balance method. Should the depreciation expense be reported as an operating component in the income statement, and what is the estimated useful life of the machinery?

Operating expense Useful life

**Explain the effect?**

22. A video rental store with a large inventory of newly released movies is attempting to determine an appropriate method of depreciation for its movies for rental. As well, it is trying to determine an appropriate method of determining the cost of its inventory of movies for sale. Which of the following treatments is most appropriate for the movies for rental and movies for sale?

Movies for rental Movies for sale

**Explain the reason ?**

**23.**

**An analyst prepares the following common-size income statements for Perez Company:**

**20X1 20X2 20X3**

**Sales 100% 100% 100%**

**Cost of goods sold 50% 52% 53%**

**Selling and administrative expense 16% 12% 9%**

**Interest income 4% 4% 4%**

**Pretax income 30% 32% 34%**

**Income tax expense 15% 16% 17%**

**Net income 15% 16% 17%**

**Based only on this information, explain the Perez's improving net profit margin is most likely a result of:**

**24** Barracuda Corporation, a U.S. corporation, owns a subsidiary located in Germany. The German subsidiary's financial statements are maintained in euros. If the euro recently appreciated relative to the U.S. dollar, how would the unrealized translation gain affect Barracuda's retained earnings and total stockholders' equity?

**Retained earnings Total stockholders' equity**

**Explain your answer**

**25** According to the Financial Accounting Standards Board, what is the appropriate balance sheet treatment for available-for-sale securities and where are the unrealized gains and losses reported?

**Balance sheet Unrealized gains and losses**

**Explain your answer**

26. A significant increase in days payables above historical levels is most likely associated with:

Explain your answer comprehensively

1. If a firm's financial reports are of low quality, can users of the reports assess the quality of the firm's earnings?

yes or no? why?

1. An analyst makes the following two statements:

Statement #1 - From a lender's perspective, higher volatility of a borrower's profit margins is undesirable for floating-rate debt but not for fixed-rate debt.

Statement #2 - Product and geographic diversification should lower a borrower's credit risk.

With respect to these statements

1. Patch Grove Nursery uses the LIFO inventory accounting method. Maria Huff, president, wants to determine the financial statement impact of changing to the FIFO accounting method. Selected company information follows

Year-end inventory: $00,000

LIFO reserve: $0,000

Change in LIFO reserve: $0,000

LIFO cost of goods sold: $00,000

After-tax income: $0,000

Tax rate:00

Under FIFO, the nursery's ending inventory and after-tax profit for the year would have been:?

1. Cody Scott would like to screen potential equity investments to identify value stocks and selects firms that have low price-to-sales ratios. Unfortunately, screening stocks based only on this criterion may result in stocks that have poor profitability or high financial everage, which are undesirable to Scott. Which of the following filters could be added to the stock screen to best control for poor profitability and high financial leverage?

Filter #1 - Include only stocks with a debt-to-equity ratio that is above a certain benchmark value.

Filter #2 - Include only dividend paying stocks.

Filter #3 - Include only stocks with an assets-to-equity ratio that is below a certain benchmark value.

Filter #4 - Include only stocks with a positive return-on-equity.

Explain your answer comprehensively!

1. Selected financial information gathered from Alpha Company and Omega Corporation follows:

Alpha Omega

Revenue

Earnings before interest, taxes,

depreciation, and amortization

Quick assets

Average fixed assets

Current liabilities

Interest expense

Which of the following statement most accurate and explain

1. Falcon Financial Group is considering the purchase of Company A or Company B based on a low price-to-book investment strategy that also considers differences in solvency. Selected financial data for both firms, as of December 31, 20X7, follows

in millions, except per-share data Company A Company B

Current assets $0,000 $0,000

Fixed assets $0,000 $0,000

Total debt $0,000 $0,000

Common equity $0,000 $0,000

Outstanding shares 000 000

Market price per share $00.00 $00.00

The firms' financial statement footnotes contain the following:

* Company A values its inventory using the first in, first out (FIFO) method.
* Company B's inventory is based on the last in, first out (LIFO) method. Had Company B used FIFO, its inventory would have
* been $700 million higher.
* Company A leases its manufacturing plant. The remaining operating lease payments total $1,600 million. Discounted at 10%,
* the present value of the remaining payments is $1,000 million.
* Company B owns its manufacturing plant.

To make the firms financials ratios comparable, calculate the adjusted price-to-book ratios for Company A and Company B.

1. National Scooter Company and Continental Chopper Company are motorcycle manufacturing companies. National's target market includes consumers that are switching to motorcycles because of the high cost of operating automobiles and they compete on price with other manufacturers. The average age of National's customers is 24 years. Continental manufactures premium motorcycles and aftermarket accessories and competes on the basis of quality and innovative design. Continental is in the third year of a five-year project to develop a customized hybrid motorcycle. Which of the two firms would most likely report higher gross profit margin, and which firm would most likely report higher operating expense stated as a percentage of total cost?
2. A company issues 0% semiannual coupon, 0-year, $0,000 par value bonds on January 0, 20X0, when the market interest rate is 13.3%. The sale proceeds are $000. Under the effective interest rate method, what amount of interest expense per $0,000 par value will the company record for the year ending December 00, 20X1
3. Under an operating lease (versus a finance lease) which of the following is higher for the lessee?
4. Cash flow from financing.
5. Cash flow from operations.
6. Assets.

Explain your answer and bring a real example

1. Which of the following provisions would least likely be included in the bond covenants? The borrower must:
2. not increase dividends to common shareholders while the bonds are outstanding.
3. maintain a debt-to-equity ratio of no less than 2:1.
4. maintain insurance on the collateral that secures the bond.
5. On December 00, 20X3 Okay Company issued 10,000 $0000 face value 10-year, 0% bonds to yield 0%. The bonds pay interest semi-annually. On its financial statements (prepared under U.S. GAAP) for the year ended December 31, 20X4, the effect of this bond on Okay's cash flow from operations is:
6. If a lessee enters into a finance lease rather than an operating lease, it can expect to have a:
7. Assume a city issues a $0 million bond to build a new arena. The bond pays 8 percent semiannual interest and will mature in 10 years. Current interest rates are 9%. Interest expense in the second semiannual period is closest to:
8. A bond is issued with the following data:

* $00 million face value.
* 0% coupon rate.
* 0% market rate.
* 0-year bond with semiannual payments.

Assuming market rates do not change, what will the bond's market value be one year from now and what is the total interest expense over the life of the bond?

Value in 1-Year Total Interest Expense

1. Classifying a lease as an operating lease for a lessee, as opposed to a finance lease, will result in:

Current Ratio Debt/Equity Ratio Asset Turnover Ratio

Bring example in real case

1. A company issues an annual-pay bond with a face value of $00000 maturity of 4 years, and 0% coupon, while market interest rates for its bonds are 0%. What is the unamortized discount at the end of the first year?
2. At the beginning of 20X3, Creston Company issues $00 million face amount of 0% coupon bonds when the market rate of interest is 0%. The bonds mature in four years and pay interest annually. Assuming the effective interest rate method, what is the bond liability Creston will report at the end of 20X3?
3. Nomad Company issued $1,000,000 face value 2-year zero coupon bonds on December 31, 20X2 to yield 8% interest. Bond proceeds were $000. In 20X3 Nomad recorded interest expense of $00000. In 20X4 Nomad recorded interest expense of $000 and paid out $00000000 to redeem the bonds. Based on these transactions only, Nomad's Statement of Cash Flows would show cash flow from operations (CFO) of
4. An firm is issuing a bond with the following characteristics:

Face value = $10.0 million

Annual coupon = 0%

Market yield at issuance = 0%

5 year maturity

Ignoring flotation costs, at issuance the bond will increase: ?

1. Ivo Company has a $10 million face value bond issue outstanding. These bonds include a call option that permits Ivo to redeem the bonds at any time for 101% of par. These bonds were issued at a premium and have a carrying value of $00,000,000. If Ivo calls the bonds, its income statement will reflect:
2. Larry Purcell, an entry-level fixed income analyst at Knowlton & Smeades LLC, was discussing debt covenants with his supervisor, Andy Holzman. During the meeting Purcell made the following statements regarding bond covenants:

Statement 1: If a firm violates any of its debt covenants, the company will immediately go into bankruptcy and the creditors of the firm will take over the liquidation of its assets.

Statement 2: Debt covenants are important in evaluating a firm's credit risk and to better understand how the restrictions of the covenants can affect the firm's growth prospects and choice of accounting policies.

With respect to these statements: and explain why?

1. On December 31, 2004, Newberg, Inc. issued 0,000 $1,000 face value seven percent bonds to yield six percent. The bonds pay interest semi-annually and are due December 31, 2011. On its December 31, 2005, income statement, Newburg should report interest expense of:
2. Given the following income statement:

Net Sales 000

Cost of Goods Sold 00

Gross Profit 000

Operating Expenses 00

Operating Profit (EBIT) 000

Interest 00

Earnings Before Taxes

(EBT) 000

Taxes 00

Earnings After Taxes

(EAT) 00

What are the interest coverage ratio and the net profit margin?

1. Problem.

A) The marketable securities balance amount shown on the balance sheet is?

B)In late 2006, Company X decided to reclassify the investments as trading securities. What is the  impact of this change in status on the value of the assets of Company X?

C) What is the impact on balance sheet values?

D) What is the impact on Other Comprehensive Income values?

E) In late 2006, Company X decided to reclassify bond as available for sale securities and stocks as trading securities. What is the impact on Other Comprehensive Income values?

F) In late 2006, Company X decided to reclassify bond as available for sale securities and stocks as trading securities. What is the impact on Balance Sheet values?

**Use the following data to answer questions in this part:**

ABC Company had the following inventory data in year 2005:

|  |  |
| --- | --- |
| January 1 (beginning inventory) | 15 units @ $20 per unit |
| January 7 purchase | 30 units @ $23 per unit |
| ***January 12 sale*** | ***22 units*** |
| January 19 purchase | 50 units @ $25 per unit |
| ***January 29 sale*** | ***47 units*** |

From February ABC Company started selling digital cameras. Per-unit cost information pertaining to ABC's inventory of digital cameras as of April was as follows:

|  |  |
| --- | --- |
| Original cost in February | $120 |
| Estimated selling price | $125 |
| Estimated selling costs | $12 |
| Net realizable value (NRV) | $103 |
| Replacement cost | $97 |
| Normal profit margin | $12 |

In 5 years, ABC Company increases its business to several branches and enters into several business acquisitions. In 2010, ABC Company purchases chemical processing machinery for $45,000. The equipment has an estimated useful life of three years and an estimated salvage value of $15,000. The company expects to produce 10,000 units of output using this machinery, with 5,000 units in each of the first year, 3,000 units in the second years, and 2,000 units in the third year. The company's effective tax rate is 30%. Revenues are $100,000 per year, and expenses other than depreciation are $40,000 in each year.

At the beginning of 2010, ABC Company entered into a business acquisition. As a result of the acquisition, ABC reported the following intangible assets:

|  |  |
| --- | --- |
| Patent | $400,000 |
| Franchise agreement | $320,000 |
| Copyright | $120,000 |
| Goodwill | $550,000 |

The patent expires in 10 years. The franchise agreement expires in 7 years but can be renewed indefinitely at a minimal cost. The copyright is expected to be sold at the end of 5 years for $20,000.

On December 31, 2010, ABC Company issued a 5-year, 8% annual coupon bond with a face value of $10,000.

1. **Calculate the ending inventory and COGS under both LIFO and FIFO methods. Please explain each step of your calculation and explain it’s impact on financial statements by using each of methods**
2. **Using the information about digital cameras what are the per-unit carrying values of ABC’s inventory as of April under IFRS and under U.S. GAAP? Assume that one year later (next April), net realizable value and replacement cost both increase by $30. What is the impact on financial statements under IFRS and under U.S. GAAP? Please explain your answers.**
3. **Prepare the income statement (year 2010) for the first year of depreciation (chemical processing machinery) using 3 depreciation methods: (a) the straight-line method, (b) the double declining balance method, and (c) the units of production method.**
4. **Use the straight-line amortization method to calculate the total carrying value of ABC's intangible assets at the end of the year 2010. Please explain your calculations.**
5. **Calculate the year-end book value of the bond issued in 2010 and the interest expense for each year of bond’s life, assuming that the bond was issued at a market rate of interest of 8%. Please interpret your answer.**

**Use the following data to answer questions in this part:**

|  |  |  |
| --- | --- | --- |
| **Balance sheet data 2009** | | |
|  | ***Company C*** | ***JVC*** |
| Cash | $1,050 | $300 |
| Accounts receivable | 3,000 | 700 |
| Inventory | 2,500 | 800 |
| Fixed assets | 4,500 | 2,400 |
| Investment in JVC | 400 |  |
| ***Total assets*** | ***$11,450*** | ***$4,200*** |
|  |  |  |
| Accounts payable | $2,500 | $1,200 |
| Long-term debt | 3,000 | 2,200 |
| Equity | 5,950 | 800 |
| ***Total liabilities and equity*** | ***$11,450*** | ***$4,200*** |

|  |  |  |
| --- | --- | --- |
| **Income statement 2009** | | |
|  | **Company C** | **JVC** |
| Sales | $15,430 | $2,500 |
| Equity in JV earnings | 100 |  |
| COGS | 5,000 | 1,700 |
| Other expenses | 7,600 | 600 |
| ***Net income*** | ***$2,930*** | ***$200*** |

Company C uses LIFO method for inventories. The LIFO reserve was $800 for 2008 (ending inventory for 2008 under LIFO was 1,500) and $900 for 2009.

In 2010, Company C purchases a milling machine, a type of machine used for shaping metal, at a total cost of $9,000. $1,500 was estimated to represent the cost of the rotating cutter, a significant component of the machine. The company expects the machine to have a useful life of eight years and a residual value of $1,000 and that the rotating cutter will need to be replaced after three years. The company uses straight-line depreciation for all assets.

Company C purchased a 7% bond, at par, for $10,000 at the beginning of the year 2010. Interest rates have recently increased and the market value of the bond declined $1,000.

1. **Assuming consolidation using the acquisition method, calculate Company C’s stockholders’ equity and total assets. Please explain your calculation.**
2. **Assuming proportionate consolidation, find Company C’s COGS and NI for the year ended 2009. Please explain your calculation.**
3. **Given the necessary information from the financial statements and footnotes convert 2009 ending inventory and COGS to a FIFO basis. Please explain your calculations.**
4. **How much depreciation expense would the company report in first year of depreciation if it uses the component method of depreciation, and how much depreciation expense would the company report in the first year if it does not use the component method? Please do not write down just numbers; you are expected to explain your calculation and answer.**
5. **Using the information about bond purchased in 2010, determine the bond’s effect on Company C’s financial statements under each classification of securities. Please explain your answers.**

**Use the following data to answer questions in this part:**

|  |  |  |
| --- | --- | --- |
| **Balance sheet data** | ***20X7*** | ***20X6*** |
| Cash | $2,900 | $1,000 |
| Accounts receivable | 1,500 | 1,000 |
| Inventory | 7,200 | 7,000 |
| Property, plant, equipment | 9,200 | 9,000 |
| Accumulated depreciation | (2,900) | (2,500) |
| ***Total assets*** | ***$17,900*** | ***$15,500*** |
|  |  |  |
| Accounts payable | $4,700 | $3,500 |
| Interest payable | 1,200 | 1,000 |
| Dividends payable | 900 | 1,500 |
| Long-term debt | 4,050 | 3,700 |
| Bank note | 1,000 | 800 |
| Common stock | 3,300 | 3,000 |
| Retained earnings | 2,750 | 2,000 |
| ***Total liabilities and equity*** | ***$17,900*** | ***$15,500*** |

|  |  |
| --- | --- |
| **Income statement for the year 20X7** | |
| Sales | $18,500 |
| COGS | 11,900 |
| Depreciation | 3,000 |
| Interest expense | 1,200 |
| Gain on sale of old machine | 1,150 |
| Taxes | 1,142 |
| ***Net income*** | ***$2,408*** |

**Notes:**

* Dividends declared to shareholders were $850. New common shares were sold at par for $1020.
* Fixed assets were sold for $3500. Original cost of these assets was $2000, and $350 of accumulated depreciation has been charged to their original cost.The firm borrowed $200 in a 10-year bank note – the proceeds of the loan were used to pay for new fixed assets.
* Depreciation for the year was $3000 (accumulated depreciation up $2900 and depreciation on sold assets $100).
* The company uses the LIFO inventory cost flow method. Had FIFO been used, inventories would have been $800 higher in 20X6 and $650 higher in 20X5. The effective tax rate for 20X6 was 30%. For all other years, the effective tax rate was 20%.
* At the beginning of 20X8, A firm issues a $10,000 bond with a 5% coupon rate, 5-year maturity, and annual interest payments when market interest rates are 6%.

1. **Assuming US GAAP, calculate cash flow from operations using the *indirect* method. Please explain your answer.**
2. **Assuming US GAAP, use the result in first question to calculate cash flow from operations with the *direct method*. Please explain your answer by showing each step of calculation.**
3. **Calculate the current ratio for 20X6 for both LIFO and FIFO inventory cost flow methods. Consider all payables as current liabilities. Please explain each step of your calculation and interpret your results.**
4. **Please calculate the annual coupon payments, total of all cash payments to the bondholders, and the initial book value of the bond issued in 20X8. Please explain your calculations.**
5. **Please prepare the amortization table for the first two periods of the bond’s life. Please explain your calculations.**

**Use the following data to answer questions in this part:**

|  |  |  |
| --- | --- | --- |
| **Balance sheet data** | ***20X7*** | ***20X6*** |
| Cash | $2,900 | $1,000 |
| Accounts receivable | 2,500 | 2,000 |
| Inventory | 7,400 | 8,000 |
| Property, plant, equipment | 9,200 | 9,000 |
| Accumulated depreciation | (2,900) | (2,500) |
| ***Total assets*** | ***$19,100*** | ***$17,500*** |
|  |  |  |
| Accounts payable | $4,700 | $4,500 |
| Interest payable | 1,500 | 1,000 |
| Dividends payable | 1,000 | 2,500 |
| Long-term debt | 4,350 | 3,700 |
| Bank note | 1,000 | 800 |
| Common stock | 3,300 | 3,000 |
| Retained earnings | 3,250 | 2,000 |
| ***Total liabilities and equity*** | ***$19,100*** | ***$17,500*** |

|  |  |
| --- | --- |
| **Income statement for the year 20X7** | |
| Sales | $28,500 |
| COGS | 19,900 |
| Depreciation | 3,700 |
| Interest expense | 1,244 |
| Gain on sale of old machine | 1,150 |
| Taxes | 1,142 |
| ***Net income*** | ***$3,664*** |

**Notes:**

* Dividends declared to shareholders were $850. New common shares were sold at par for $1020.
* Fixed assets were sold for $3,500. Original cost of these assets was $2,000, and $350 of accumulated depreciation has been charged to their original cost. The firm borrowed $200 in a 10-year bank note – the proceeds of the loan were used to pay for new fixed assets.
* Depreciation for the year was $3,700 (accumulated depreciation up $2,900 and depreciation on sold assets $800).
* The company uses the LIFO inventory cost flow method. Had FIFO been used, inventories would have been $1,000 higher in 20X6 and $900 higher in 20X5. The effective tax rate for 20X6 was 30%. For all other years, the effective tax rate was 20%.
* At the beginning of 20X8, A firm issues a $10,000 bond with a 6% coupon rate, 3-year maturity, and annual interest payments when market interest rates are 5%.

1. **Assuming US GAAP, calculate cash flow from operations using the *indirect* method. Please explain your answer.**
2. **Assuming US GAAP, calculate cash flow from financing, cash flow from investing and total cash flow. Please show you results in a table. Please explain your answer by checking the correctness of your result with balance sheet numbers.**
3. **Calculate long-term debt-to-equity ratio for 20X6 for both LIFO and FIFO inventory cost flow methods. Please each step of your calculation and interpret your results.**
4. **Please calculate the annual coupon payments, total of all cash payments to the bondholders, and the initial book value of the bond issued in 20X8. Please explain your calculations.**
5. **Please prepare the amortization table for the bond issued in 20X8. Please explain your calculations.**

**Use the following data to answer questions about Company Parent:**

On December 31, 2010, Company Parent issued a 3-year, 10% annual coupon bond with a face value of $100,000.

In 2011, Company Parent purchases digital recording machinery for $55,000. The equipment has an estimated useful life of five years and an estimated salvage value of $11,000. The company expects to produce 20,000 units of output using this machinery, with 6,000 units in each of the first two years, 3,000 units in the next two years, and 2,000 units in the fifth year.

Suppose that we are given the following:

* + December 31, 2014 Company Parent (the investor) invests $10,000 in return for 28% of the common shares of Company New (the investee).
  + During 2015, Company New earns $5,000 and pays dividends of $1,000.
  + During 2016, Company New earns $7,000 and pays dividends of $1,500.

Suppose that on January 1, 2016, Company Parent acquires 80% of the common stock of Company Subsidiary by paying $18,000 *in cash* to the shareholders of Company Subsidiary. The pre-acquisition income statements are as follows:

|  |  |  |
| --- | --- | --- |
| ***Income statements***  ***December 31, 2010*** | ***Company Parent*** | ***Company Subsidiary*** |
| Revenue | $70,000 | $30,000 |
| Expenses | -40,000 | -16,000 |
| ***Net income*** | ***$30,000*** | ***$14,000*** |
| ***Dividends paid*** |  | ***$9,000*** |

1. **Prepare amortization table for the bond issued on December 31, 2010. *Assume that the bond was issued at a market rate of interest of 9%.* Please explain your calculations.**
2. **Prepare amortization table for the bond issued on December 31, 2010. *Assume that the bond was issued at a market rate of interest of 11%.* Please explain your calculations.**
3. **Calculate depreciation expense for digital recording machinery under straight-line, double-declining balance and units-of-production methods. Please explain your outcomes.**
4. **Calculate the effects of the investment in Company New on Company Parent’s balance sheet, reported income, and cash flow for 2015 and 2017. Please explain your calculations.**
5. **Prepare the new income statement (in the right format) for Company Parent after the purchase of 80% of Company Subsidiary assuming two cases: a) Company Parent had significant influence but no control; b) Company Parent had both influence and control over Company Subsidiary. Please interpret your results.**