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Paper : Financial Accounting

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Exam : Final Term

Question # 4 :-

(a) Straight line Method

Cost = $145,000

Salvage value = $ 25,000

Useful life = 5 years

$$\text{Depreciation Expense} = \frac{\text{Cost - salvage Value}}{\text{Useful life}}$$

$$= \frac{\$145,000 - \$25,000}{5}$$

Depreciation Expense = $ 24,000/year

2017 Depreciation = $24,000 x 3/12 (Oct-Dec)

2017 Depreciation = $ 6,000

(b) Unit of activity Method:

$$\text{Depreciation per unit} = \frac{\text{Cost - salvage value}}{\text{Total estimated Production Unit}}$$

$$= \frac{\$145,000 - \$25,000}{20,000}$$

Depreciation per unit = $ 6 per hour.

For 2017 :-

Total hours used = 3400

= Depreciation Expense per hour X Total hours

= 6 x 3400

2017 Depreciation = $20,400.

(c) Declining Blance Method :-

Straight line Depreciation rate = $\frac{1}{\text{useful life}}$

$= \frac{1}{5} = 0.2 = 20\%$

Double Depreciation rate = 20% x 2

= 40%

2017 Depreciation = $\$145,000 \times \frac{3}{12} \times 40\%$

2017 Depreciation = $14,500

2018 Depreciation = Cost - Acc Dep

= $145,000 - $14,500

= $130,500

= $130,500 x 40%.

2018 Depreciation = $52,200

Question # 3

Date	A/c Title	Debit $	Credit $
2, Jan, 17	Patent	$840,000	
	Cash		$840,000
	To record Purchase of Patent		
1, Apr, 17	Good will	$450,000	
	Cash		$450,000
	To record the purchase of Goodwill		
1, July, 17	Prepaid Franchise	$330,000	
	Cash		$330,000
	To record the Purchase of franchise		
1, Sep, 17	Research & Development	$210,000	
	Cash		$210,000
	To record the Expenditure of Research & Development		

Adjusting entries as of Dec 31, 2017

31, Dec, 17	Patent amortization expense 840,000 × 1/7 = 120,000	$ 120,000	
	patent		$ 120,000
	To record amortization expense on patent		
31, Dec, 17	No entry Good will is not amortized. It is tested for impairment every year		
31, Dec, 17	Franchise fees $\left(30,000 \times \frac{1}{10} \times \frac{6}{12}\right)$	$ 16,500	
	Prepaid franchise		$ 16,500
	To record franchise fees for 6 months (July to Dec 2017)		
31, Dec, 17	No entry Cost of Research & Development is not amortized. The cost is expensed immediately.		

Question # 2 Explain the concept of partnership in detail with its different properties

Answer

The combination of entrepreneurial talents, experience, and capital make the formation of partnerships attractive small businesses and professional services typically enter into partnership agreements. When a partnership is formed the articles of partnership stipulate in particular how profits and losses are to be divided, the responsibilities of partners, the initial contributions, the name and the nature of the business.

Characteristics

1. Partnerships have a limited life.
2. Partners have unlimited personal liability.
3. All full partners have the right to use partnership property
4. All full partners are bound by contracts entered by other partners
5. All partners share in profits and losses
6. A partnership is a non-taxable entity.

Advantages

1. Capital, entrepreneurial skills and experience are combined.
2. Easy and inexpensive formation.
3. little government regulation

4 Non-taxable entity

Disadvantages

1 Mutual agency

2 Unlimited liability

3 limited life

4 limited capital raising abilities.

PROPERTIES:

Accounting For Partnerships

Accounting for partnerships is similar to other forms of business organization. The same accounts are used, with the exception of capital accounts. Partnerships have separate drawing and captial accounts for each partner. Income is distributed differently from other forms of business organizations. Since a partnership has limited life, special transaction need to be performed upon death or withdrawl of a partner, dissolution and liquidation.

Investing in Partnerships.

Separate entries are required for each member that joins a partnership. A monetary value is assigned to all non cash assets contributed by each partner. Only receivables which are collectible should be recorded in the

Partnership books. Any liability owed in to by members of the partnership becomes a liability of the newly formed business

Dividing Net Profits or losses

All members of partnership are entitled to share profits. If no provision are set forth in the articles of partnership has to how profits or losses are to be divided, they must be shared equally. Partners commonly receive a salary and an interest allowance. If net income remains after all allowance have been satisfied, the remaining income is split according to agreed proportions A loss is shared in the same proportions.

Financial statements for partnership

Partnership must provide information on how net income was distributed among partners. This information can be combined with the balance sheet or the income statement. If desired, it can also be reported separately.

Admitting new Partners

Partners can be admitted into a

Partnership by either.

1. Purchasing an interest of the firm from a current partner
2. contributing assets to the business

When a partner purchase an interest in a business, only the capital accounts change. When a new partner contributes assets to a business both assets and owner equity increase.

New partners and Goodwill

When a new partner is admitted the profitability of partnership often increases. Either the new partner or the former partners may be entitled to a bonus or goodwill. The bonus or goodwill is determined by bargaining between members of a partnership. Good will is recorded as an asset, and is credited to the proper capital accounts.

Liquidation of a partnership

When a partnership liquidated. the following occurs:

1. Assets are sold.
2. Creditors are paid
3. Cash is distributed to partners

4 Partner with deficiency pays partnership.

5 Partners with credit capital balances absorb deficiency in income sharing proportion.

With drawl of a Partner

A partner may withdraw from a partnership voluntarily by selling his or her equity in the firm or involuntarily by reaching a mandatory retirement age or by dying.

- The withdrawl of a partner may be accomplished by.

1. Payment from remaining partners personal assets or
2 Payment from partnership assets.

Types of Partnership

By duration

1. Partnership at will
2. Particular Partnership (when partnership is created to carry certain project for a specific time.

By liability:

1. General partnership (Joint venture + bound by the acts of one another)
2. limited Partnership (except the all other partners have limited liabilities).

Question#1 What do we mean by financial statement analysis. Different tools? liquidity analysis and Activity analysis?

Answer Financial statement analysis is the process of analyzing a company's financial statement for decision-making purposes. External stakeholders use it to understand the over all health of an organization as well as to evaluate financial performance and business value. The financial statements of a company record important financial data on every aspect of a business activities. As such they can be evaluated on the basis of past, current and projected performance.

Analysing financial statement involve

evaluating three characteristics of a company.

1. Its liquidity
2. Its profitability
3. Its solvency.

In a comparitive analysis, there are three types of comparisons.

1- Intra company basis.
2- Inter company basis
3- Industry averages

Tools:

Several techniques are commonly used as part of financial statement analysis. Three of the most important techniques include

1. Horizental analysis
2. Vertical analysis
3. Ratio analysis.

Horizental analysis:

Horizental analysis compares data horizentally, by analyzing values of line items across two or more years.

$$\text{change since base period} = \frac{\text{current year amount} - \text{Base year amount}}{\text{Base year amount}}$$

Vertical analysis:

Vertical analysis looks at the vertical effects of line item

have on other parts of the business as well as the business proportions. It expresses each item in a financial statement as a percentage of a base amount (total asset or net sales)

$$\text{Vertical analysis} = \left(\frac{\text{Statement line item}}{\text{Total base figure}}\right) \times 100$$

Ratio analysis:

Ratio analysis uses important ratio metrics to calculate statistical relationships.

- Liquidity ratios measure short-term ability of the enterprise to pay its maturing obligations and to meet unexpected needs for cash.
- Profitability ratios measure the income or operating success of an enterprise for a given period of time.
- Solvency ratios measure the ability to survive over a long period of time.

Revenue − Expense = Net income

Liquidity Analysis:

The liquidity of the firm measured by the ability to satisfy short term obligations as they become due. Liquidity refers to solvency of firm's overall financial position. the ease with which it can pay bills. A common precursor to financial distress and bankruptcy is low or declining liquidity. These ratios are viewed as good leading indicators of cash flow problems..

Current Ratio

This ratio measure the financial strength of the company - Generally 2:1 is treated as the ideal ratio

$$\text{Current Ratio} = \frac{\text{current Asset}}{\text{current liability}}$$

Acid test Ratio:

Measures immediate short-term debt paying ability.

$$\text{Acid Test Ratio} = \frac{\text{cash + temporary investments + net receivables}}{\text{current liabilities}}$$

Cash current Debt coverage Ratio

Measures short-term debt-paying ability (cash basis).

$$\text{cash current debt coverage ratio} = \frac{\text{cash provided by operating activities}}{\text{Average current liabilities}}$$

Receivable Turnover:

Measures liquidity of receivables

$$\text{Receivable turnover} = \frac{\text{Net credit sales}}{\text{Average net receivables}}$$

Collection Period.

Measures number of days receivables are outstanding:

$$\text{Collection period} = \frac{365 \text{ days}}{\text{Receivable turnover}}$$

Inventory Turnover.

Measures liquidity of inventory

$$\text{inventory turnover} = \frac{\text{Cost of good sold}}{\text{Average inventory}}$$

Days sales inventory.

Measures number of days inventory is on hand.

$$\text{Days inventory} = \frac{365 \text{ days}}{\text{inventory turnover}}$$

Activity Ratio :

Activity ratio measure the speed which various accounts are converted into sales or cash- inflows or out flows. Measure of liquidity are generally inadequate because differences in composition of a firm's current assets and current liabilities can affect its true liquidity

Inventory Turn over :

$$\text{Inventory turnover} = \frac{\text{cost of good solds}}{\text{inventory}}$$

Average collection period.

Average collection Period = $\frac{\text{Accounts Receivable}}{\text{Annual sales per day}}$

$\left[\text{Annual sales} = \frac{\text{Annual sales}}{365}\right]$

Average Payment Period

Average Payment Period = $\frac{\text{Accounts payable}}{\text{Annual purchase}/365}$

Total Asset Turnover:

Total Asset turnover = $\frac{\text{sales}}{\text{Total Asset}}$