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Financial Accounting
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Q#3: Henning Company, organized in 2017

General Journal:

Date	A/C Title & Explanation	Debit $	Credit $
2 Jan 2017	Patent	840,000	
	Cash		840,000
	To record the purchase of goodwill		
1 April 2017	Goodwill	450,000	
	Cash		450,000
	To record the purchase of goodwill.		
1 July 2017	Prepaid Franchise	330,000	
	Cash		330,000
	To record the purchase of franchise		

1 Sep 2017	Research & Development	$210,000	
	Cash		$210,000
	To record R&D expenditure		

Adjusting Enteries as of Dec 31, 2017:-

Date	A/c Title & Explanation	Debit $	Credit $
Dec, 31 2017	Patent Amortization Expense	120,000	
	Patent		120,000
	To record amortization expense on patent		
	$840,000 \times 1/7 = 120,000$		
Dec 31, 2017	No Entry	–	–
	Goodwill is not amortized. Goodwill is tested for impairment each year.		
Dec 31, 2017	Franchise Fees	16,500	
	Prepaid Franchise		16,500
	$330,000 \times \frac{1}{10} \times \frac{6}{12} = 16,500$		
	To record franchise fees for six months July-Dec 2017		

Dec 31, 2017	No Entry Research & Development cost is not amortized. The cost is expensed immediately.	–	–

Q#4: Numo Company...

@ Straight line for 2017.

Straight Line Method:

Cost = \$145,000

Salvage Value = \$25,000

Useful Life = 5 yrs

$$\text{Depreciation Expense} = \frac{\text{Cost} - \text{Salvage value}}{\text{Useful Life}}$$

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

$$= \$24,000 \text{ per year}$$

$$\text{2017 depreciation} = \$24,000 \times \frac{3}{12} \quad \text{oct-dec}$$

$$= \underline{\underline{\$6000}}$$

(b) Units of activity for 2017:

data: machine usage 3,400 hrs

Unit of Activity Method:

$$\text{Depreciation per unit} = \frac{\text{Cost} - \text{Salvage Value}}{\text{Total Estimated production unit}}$$

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

$$= \$6 \text{ per hour}$$

2017 depreciation $= 3,400 \text{ hrs} \times \$6$

$= \underline{\underline{\$20,400}}$

(c) Declining balance using double of straight-line rate for 2017 & 2018.

Declining Balance Method:

$$\text{Straight-line depreciation rate} = \frac{1}{\text{Useful life}}$$

$= 1/5\text{yrs}$

$= 0.2 = 20\%$

Double depreciation rate $= 0.2 \times 2$

$= 0.4 = 40\%$

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

$= \underline{\underline{\$14{,}500}}$

Book Value January 1, 2018 = Cost − Acc. Depreciation

$= \$145{,}000 - \$14{,}500$

$= \underline{\underline{\$130{,}500}}$

2018 Depreciation $= \$130{,}500 \times 40\%$

$= \underline{\underline{\$52{,}200}}$

Q#1:

Financial Statement Analysis:

Financial Statement analysis is the process of analyzing financial statements for decision making purposes.

It is used to evaluate financial performance & business values. Internal constituents use it as a monitoring tool for managing the finances.

Tools for Financial Analysis:

Financial statements are prepared to have complete information regarding assets, liabilities, equity, reserves, expenses and profit and loss of an enterprise.

To analyze and interpret the financial statements, commonly used tools are:

1) Comparative statements
2) Common size statement
3) Trend analysis
4) Ratio analysis
5) Cash Flow analysis
6) Average Analysis
7) Statement of changes in working capital

8) Fund Flow analysis
9) Cost Volume Profit Analysis

Comparative Statements:

Also known as Horizontal Analysis. It shows financial position and profitability at different periods of time.

$$\text{Change since base period} = \frac{\text{Current yr amount} - \text{Base yr amount}}{\text{Base yr amount}}$$

It includes comparative balance sheet, which observes following aspects:
- → current financial position & liquidity position
- → Long-term financial position
- → profitability of the concern.

It includes comparative income statement which has following aspects:
- → Increase / decrease in gross profit.
- → Study of operational profit
- → Increase / decrease in net profit
- → Study of overall profitability of business.

Common Size Statement:

Common size statements are also known as 'Vertical Analysis'.

→ The total incomes in terms of percentage by taking the total incomes as 100.
→ To The total expenses in terms of percentage by taking total expenses as 100.

Ratio Analysis :
Quantitative analysis of information contained in a company's financial statements. It includes:

i) Liquidity Ratio : Measures short term ability of enterprise to pay maturing obligations & to meet unexpected needs for cash.

ii) Profitability Ratios : Measures income or operating success of enterprise for given time period.

iii) Solvency Ratio : Measures the ability of enterprise to survive over a long period of time.

Cash Flow Analysis :
The actual movement of cash into and out of a business is cash flow analysis.

Cash flow statement is prepared to project. the manner in which the cash has been received & has been utilized during an accounting year.

Average Analysis:

The trend ratio are calculated for a business concern, such ratios are compared with industry average.

Fund Flow Analysis:

Fund flow analysis deals with detailed sources & application of funds of the business concern for specific period.

Cost Volume Profit Analysis:

It discloses the prevailing relationship among sales, cost and profit.

Liquidity Analysis:

The liquidity of a firm measured by the ability to satisfy short-term obligation as they come 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.

Formulae:

1) Current Ratio:

This ratio measures the financial strength of the company. Generally '2:1' is treated as the ideal ratio.

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

where current asset = stock, debtor, cash & bank, receivables, loans etc

current liability = creditor, short-term loan, bank overdraft, outstanding expense etc.

⇒ The higher the current ratio, the more liquid the firm is considered to be.

2) Quick (Acid-Test) Ratio:

This ratio is the best measure of the liquidity in the company. This ratio is more conservative than the current ratio. The quick asset is computed by adjusting current assets to eliminate those assets which are not in cash. Generally, 1:1 is treated as an ideal ratio.

$$\text{Quick Ratio} = \frac{\text{Current Asset} - \text{Inventory}}{\text{Current liabilities}}$$

The quick ratio provides better measurement of overall liquidity only when firm's inventory cannot be easily converted into cash.

Activity Ratios:-

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

1) Inventory Turnover:

It commonly measure the activity or liquidity of firm's inventory.

$$\text{Inventory turnover} = \frac{\text{Cost of Goods Sold}}{\text{Inventory}}$$

A low inventory turnover ratio is a sign that inventory is moving slowly & tying up capital. A company with high inventory turnover can be moving inventory in rapid pace. However, if inventory turnover is too high, it can lead to shortages & lost sales.

2) Average Collection Period:

The average collection period, or average age of account receivable, is useful in evaluating credit and collection policies.

$$\text{Average collection period} = \frac{\text{Accounts Receivable}}{\text{Avg. sales per day}}$$

$$= \frac{\text{Account Receivable}}{\frac{\text{Annual sale}}{360}}$$

3) Average Payment Period:

The average payment period or average age of a/c payables is calculated as:

$$\text{Average payment period} = \frac{\text{Account Payable}}{\text{Average purchase per day}}$$

$$= \frac{\text{Accounts payable}}{\frac{\text{Annual purchase}}{360}}$$

The average payment period calculation can reveal insight about company's cash flow and creditworthiness, exposing potential concerns.

4) Total Asset Turnover:

It indicates the effeciency with which the firm uses its assets to generate sales. Total asset turnover is calculated as:

$$\text{Total asset turnover} = \frac{\text{Sales}}{\text{Total Asset}}$$

Higher the firm's total asset turnover, the more effeciently its assets have been used.

Q#2:

Partnership:

The concept of partnership is when two or more individuals come together for undertaking a lawful business and agreed to share the profits and losses arising from it according to the shares.

Form of business where two or more people share ownership as well as responsibility for managing the company. The income is paid to partners, who then claim it on their personal tax returns.

The members of partnership are jointly known as partnership firm or known as partners.

Following are different properties of partnership:

1) Membership: Atleast 2 members are required to begin a partnership with maximum limit upto 100. All members entering into partnership should be legally competent.

2) Unlimited liability: The members of partnership have unlimited liability that is they are collectively & individually liable

for firms debts & obligations. In case business assets are not adequate to repay liabilities, personal assets of all or any partner can be claimed by creditors to realize outstanding amount.

3) Sharing of profit & loss:
The main purpose of partnership is to share profit in the agreed ratio. In the absence of any agreement b/w partners, the business profits or losses are divided equally among partners.

4) Mutual Agency: The partnership business is undertaken by all partners any of the partner, who acts on behalf of all partners. Every partner is a principal as well as an agent. The acts of partners bind each other as well as the firm.

5) Continuity: There is lack of continuity in partnership like deaths, bankruptcy, retirement of any partner can lead the partnership

to end.

6) Voluntary Registration:
The registration of partnership is not mandatory, but recommended as it offers certain benefits e.g in case of any conflict then the firm can file case against that party.

7) Contractual Relationship:
The relation substituting between partners is due to contract, which can be oral, written, or implied.

8) Transfer of Interest: Mutual consent of all partners is a must for transferring the interest in the firm to any external party

9) Admitting new partners:
Partners can be admitted into partnership by either purchasing an interest at the firm from a current partner or contributing assets to the business.

10) Liquidating a partnership:

When a partnership liquidity, the following occurs:

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