ACCT2111 Introductory Financial Accounting

2017-2018 2nd Term

Suggested Solution

Exam Booklet 1 – Section B

Problem 1

Part A

	Assets	**Liabilities**	**Stock. Equity**	**Revenue/ Gains**	**Expenses/ Losses**	**Cash from Operating**	**Cash from Investing**	**Cash from Financing**
a.	+	NE	+	+	NE	+	NE	NE
b.	NE	-	+	+	NE	NE	NE	NE
c.	NE	NE	NE	NE	NE	NE	NE	NE
d.	-	-	NE	NE	NE	-	NE	NE
e.	+	NE	+	+	NE	NE	+	NE

Part B

	2015 Net Income	**2015 Ret. Earnings**	**2015 Assets**	**2015 Liabilities**	**2016 Net Income**	**2016 Ret. Earnings**	**2016 Assets**	**2016 Liabilities**
a.	NE	NE	NE	NE	-	-	-	NE
b.	-	-	-	NE	NE	-	-	NE

Problem 2

(a) Dr	Warranty expense ($500,000 x 6%)	$30,000	
Cr	Provision for warranty repairs		$30,000
Dr	Provision for warranty repairs	$26,000	
Cr	Cash		$26,000

(b) Amount that Chong Man expects to owe its customers in terms of warranty liability at the end of 2017

= $7,000 + $4,000

= $11,000

(c) Amount paid = $4,185 + $3,002 - $4,343

= $2,844

(d) 2017

Mar 1	Dr	Cash	$10,000,000	
	Cr	Notes payable		$10,000,000
Dec 31	Dr	Interest expense ($10,000,000 x 14% x $\frac{10}{12}$)	$1,166,667	
	Cr	Interest payable		$1,166,667

2018

Mar 1	Dr	Interest expense ($10,000,000 x 14% x $\frac{2}{12}$)	$233,333	
	Dr	Interest payable	$1,166,667	
	Dr	Notes payable	$10,000,000	
	Cr	Cash		$11,400,000

(e) Total equity at the end of 2016 = $15 million - $6 million = $9 million

Total equity at the end of 2017 = $24 million - $14 million = $10 million

Since it is given that Kong You Specialty Cars did not issue any dividend or raise any equity capital during 2017, the increase in its total equity was probably due to the increase in its retained profit. As the retained profit in 2016 was not provided, it might be assumed that the retained profit in 2017 = $1 million ($10 million - $9 million).

Therefore, the net margin of Kong You Specialty Cars in 2017 might be :

$1,000,000 / $9,000,000 x 100%

= 11.1%

Problem 3

(a) 2016

Mar 31	Dr	Retained earnings	$7,000,000	
	Cr	Dividends payable		$7,000,000
May 15	Dr	Dividends payable	$7,000,000	
	Cr	Cash		$7,000,000

(b) 2016

May 1	Dr	Treasury shares	$2,000,000	
	Cr	Cash		$2,000,000

This transaction reduces the total shareholder's equity of 689 Grocery Store.

(c) 2016

Aug 1	Dr	Cash ($3 x 500,000)	$1,500,000	
	Cr	Treasury shares ($2 x 500,000)		$1,000,000
	Cr	Paid-in capital from treasury shares		$500,000

This transaction has no effect on the net income, and it increases the total shareholder's equity of 689 Grocery Store.

(d) 2016

Dec 1	Dr	Share option compensation	$500,000	
	Cr	Treasury shares		$500,000

(e) 2017

Mar 31	Dr	Retained earnings	$50,000,000	
	Cr	Share capital		$50,000,000

Exam Booklet 2

Problem 4

(a) Number of units sold during April 2018 = 100 + 120 + 70 + 40

= 330

(b) Cost of goods sold using the FIFO assumption = \$45 x 150 + \$50 x 80 + \$55 x 100

= \$16,250

(c) Cost of goods sold using the LIFO assumption = \$55 x 200 + \$50 x 80 + \$45 x 50

= \$17,250

Problem 5

(a)

	2018	2019	2020	2021
Straight-line	(\$35,000 - \$2,500) / 4 = \$8,125	(\$35,000 - \$2,500) / 4 = \$8,125	(\$35,000 - \$2,500) / 4 = \$8,125	(\$35,000 - \$2,500) / 4 = \$8,125
Units-of-productions	(\$35,000 - \$2,500) x 20,000 / 65,000 = \$10,000	(\$35,000 - \$2,500) x 25,000 / 65,000 = \$12,500	(\$35,000 - \$2,500) x 15,000 / 65,000 = \$7,500	(\$35,000 - \$2,500) x 5,000 / 65,000 = 2,500
Double-declining-balance *	\$35,000 x 50% = \$17,500	\$35,000 x 50% x 50% = \$8,750	\$35,000 x 50% x 50% x 50% = \$4,375	\$35,000 - \$17,500 - \$8,750 - \$4,375 - \$2,500 = \$1,875

* Depreciation rate using double-declining-balance method = 1 / 4 x 2 = 50%

(b) The units-of-productions method best tracks the wear and tear on the small truck.
Wear and tear increase with the usage of the small truck, while a larger depreciation expense is resulted from a higher usage of the truck when the units-of-productions method is used.

Exam Booklet 3

Problem 6

(a) Collections from customers = \$61,000,000 + \$2,395,000,000 - \$60,000,000
= \$2,396,000,000

(b) Opening inventory + Purchases – Closing inventory = Cost of goods sold
\$287,000,000 + Purchases - \$314,000,000 = \$1,806,000,000
Purchases = \$1,833,000,000
Payments for inventories = \$137,000,000 + \$1,833,000,000 - \$155,000,000
= \$1,815,000,000

(c) Payments for operating expenses = \$386,000,000 – (\$94,000,000 - \$63,000,000)
= \$355,000,000

(d) Payment for income taxes = \$29,000,000 – (\$20,000,000 - \$19,000,000)
= \$28,000,000

(e) Proceeds from issuance of shares = \$52,000,000 - \$45,000,000
= \$7,000,000

(f) Payments of cash dividends = \$396,000,000 + \$149,000,000 - \$456,000,000
= \$89,000,000

Problem 7

(1) Days' inventory outstanding = [($339,500,000 + $340,000,000) / 2] / $1,993,100,000 x 365

= 62.219 days

Days' sales outstanding = [($637,100,000 + $700,400,000) / 2] / ($2,941,500,000 x 90%) x 365

= 92.203 days

Days' payable outstanding = [($375,400,000 + $341,700,000) / 2] / $1,993,100,000 x 365

= 65.662 days

Therefore, Four Seas' cash conversion cycle in year 2016

= 62.219 + 92.203 – 65.662

= 88.8 days

This number means the speed at which the company is able to convert cash from its inventory and receivables, less the time it takes to settle accounts payable.

(2) ROA for 2016 = $45,200,000 / [($2,835,300,000 + $2,879,800,000) / 2]

= 1.6%

(3) Average equity = [($38,400,000 + $1,386,900,000) + ($38,400,000 + $1,358,000,000)] / 2

= $1,410,850,000

Therefore, ROE for 2016 = $45,200,000 / $1,410,850,000

= 3.2%

(4) Since the average total assets of Four Seas was larger than its average equity, its ROA was smaller than its ROE for 2016.

From the perspective of an investor in the company, the ROE might be more important. ROE shows the relationship between net income and shareholders' investment in the company, while ROA measures the company's success in using assets to earn a profit. As ROE directly shows the amount an investor can earn from his or her investment, the investor is more likely to concern about ROE rather than ROA.

(5) Suggestions for improving ROE :

- Reduce operating expenses by adopting strict control measures, so as to increase the net income
- Reduce share capital by repurchasing shares, so as to decrease the average equity

By adopting these measures, the company's ROE can be improved, which in turns increases shareholder value. However, as the company may not have the experience of reducing operating expenses or share capital before, the business operation may be adversely affected when they carry out expenses and capital reduction practices.

(6) Estimated dividends declared or paid for 2016
= \$1,386,900,000 + \$45,200,000 - \$1,358,000,000
= \$74,100,000

(7) In my opinion, Four Sea's dividend policy is not sensible. Net profit of the company decreased significantly to \$45,200,000 in 2016. As the estimated dividends declared or paid (\$74,100,000) was larger than the net profit, this means the company paid out a portion of its beginning retained earnings as dividends. This may lower the company's reserve for business operation.

In formulating a dividend policy, the type of industry and the age of corporation should also be considered. Regarding the type of industry, a consistent dividend policy may be adopted if the earnings of that particular industry are stable. Regarding the latter, new formed companies may retain major part of their earnings for further growth and expansion, thus they may pay lower dividends.