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PROBLEM 2Mini problem 1

Balance sheet

Intangible assets

Amortization since inception	-89000	
Copyright	120000	
Patents	60000	
Goodwill	140000	
Total intangible assets	231000	

Income statement

Revenues

Sale of IT service	170000	
Total revenues		17000

Expenses

Amortization expense	-32000	
Loss on sale of copyright	-12000	
Research and development costs	-160000	
Total expenses	-204000	
Net income	-187000	

Mini problem 2

a)	Statement of cash flows		
	Cash flows from operating activities		
	Net income	60000	
	add back: depreciation	20000	
	Total cash flows from operating activities		80000
	Cash flows from investing activities		
	Purchase of truck	-15000	
	Total cash flows from investing activities		-15000
	Cash flows from financing activities		
	Dividends	-30000	
	Note payable	40000	
	Total cash flows from financing activities		10000
	Increase in cash flow	75000	
	Cash balance beginning of year	50000	
	Cash balance end of year	125000	

b) The difference between net income and cash flows from operations comes from depreciation. Depreciation allocates the cost of decreasing values of a company's assets over time. Because the decrease in value does not affect cash, depreciation, which is recorded in the income statement and decreases net income, is added back to net income in the statement of cash flows.

As in 2014 the total of \$80000 of cash is generated from operations and net income is 60000, depreciation must amount to $80000 - 60000 = 20000$.

Mini problem 3

Current ratio = current assets / current liabilities

$$\text{Current assets} = 11000 + 35000 + 33000 + 4000 + 2000 = 85000$$

$$\text{Current liabilities} = 61000$$

$$\text{Current ratio} = 85000 / 61000 = \underline{1.39}$$

Quick ratio = (Cash + marketable securities + current receivables) / current liabilities

$$\text{Cash} + \text{marketable securities} + \text{current receivables} = 11000 + 0 + 35000 = 46000$$

$$\text{Current liabilities} = 61000$$

$$\text{Quick ratio} = 46000 / 61000 = \underline{0.75}$$

As the current ratio is above one, current assets > current liabilities. This indicates that the company is liquid enough to pay for current debt. Because the quick ratio is much lower than (almost half of) the current ratio, it becomes evident that Cargo Corporation's current assets are to a large part composed of inventory, which is part of the numerator of the current ratio but not of the quick ratio, while the denominator is the same.

Mini problem 4

Trial balance	debit	credit
Retained earnings		49000
Accounts receivable	8000	
Accounts payable		24000
Capital stock		185000
Land	153000	
Cash	14000	
Equipment	20000	
Notes payable		17000

Buildings	80000	
Total	275000	275000

The total credit balance of Revlon equals 275000, by adding up retained earnings, accounts payable, capital stock and notes payable.

PROBLEM 3

1. Journal entries

May 1	Cash	12000	
	Stock		12000
	To record capital contribution by both owners of \$6000.		
May 1	Equipment	300	
	Accounts payable		300
	To record purchase of lighting equipment.		
May 5	Vendor fee expense	25	
	Cash		25
	To record payment of monthly fee.		
May 9	Tent	2400	
	Cash		2400
	To record purchase of event tent.		
May 10	Supplies	100	
	Accounts payable		100
	To record purchase of miscellaneous supplies.		
May 15	Advertisement expense	75	
	Cash		75
	To record payment of advertising bill.		
May 17	Cash	1500	
	Service revenue		1500
	To record receiving payment for service.		
May 24	Accounts receivable	800	
	Summer camp revenue		800
	To record bill to local park.		

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May 29	Cash	400	
	Accounts receivable		400
	To record payment of 50% of bill to local park.		
May 30	Cash	2000	
	Service revenue		2000
	To record receiving cash payment for parties		
May 30	Wage expense	300	
	Cash		300
	To record wage payment to friend for help.		
May 31	Accounts payable	100	
	Cash		100
	To record payment of supplies purchased on May 10.		

2. Income statement

Revenues	4300
Expenses	<u>-400</u>
Net income	<u>3900</u>

3. Balance sheet

Assets		Liabilities & Stockholder's equity	
Cash	13000	Accounts payable	300
Supplies	100	Total liabilities	<u>300</u>
Accounts receivable	400	Stock	12000
Total current assets	<u>13500</u>	Retained earnings	3900
Tent	2400	Total stockholder's equ.	<u>15900</u>
Equipment	300		
Total non-current assets	<u>2700</u>		
Total	16200		16200

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PROBLEM 4**DONG ENERGY**

The financial analysis of DONG shows that the company has not been very profitable during its last 5 accounting periods. The company has incurred increasing losses from 2010-2014:

Profit margin	net income/net sales				
	2014	2013	2012	2011	2010
	-3%	-2%	-8%	7%	8%

As profits were negative, returns on assets, as well as return on equity also show to negative.

ROA	Net income/Average total assets				
	2014	2013	2012	2011	2010
	-2%	-1%	-3%	3%	3%

ROE	Net income/average equity				
	2014	2013	2012	2011	2010
	-4%	-3%	-10%	8%	9%

However return on assets does not fall as drastically relative to the profit margin over the years. The reason for this can be found in the asset turnover ratio, which multiplied with the profit margin results in the ROA. This ratio in fact showed a steady increase, which implies that ROA is mainly driven by the company's asset turnover.

Asset turnover ratio	Net sales/Average total assets				
	2014	2013	2012	2011	2010
	0,49	0,48	0,42	0,40	0,40

A company which incurs losses seems to be a risky investment. As ROA and ROE almost have the same value, it seems like the company has a relatively high debt to equity ratio, to keep returns to stockholders on this level through leverage. (This would have to be further explored when analyzing the solvency of the company.)

What are the reasons for the company's losses? Is there an explanation, which makes an investment in DONG seem less risky and speculative?

A big part of DONG's business is to source and distribute oil and gas. This requires high levels of investments in the production assets, which is one reason for outflows of cash. Furthermore, the

company's income is dependent on international oil prices, which have been very low in recent years. In the note "Critical accounting estimates and judgements" DONG states to depreciate the production assets using the unit of production method. However changed expectations concerning future annual production and assumptions for future market conditions such as market prices also have to be accounted for. Therefore DONG faced extremely high impairment costs.

Impairment for property, plant and equipment in 2014 was twice as high (-16106) as only one year before (-8260) and explains, why the losses of the company increased.

A more useful measurement than the profit margin for the company's profitability would therefore be the EBITDA (Earnings before interest, taxes, depreciation and amortization) to net sales ratio, as it does not take impairment into the account in net income.

EBITDA/net sales

2014	2013	2012	2011	2010
28%	20%	11%	27%	26%

Of course these percentages are too high to compare them to the profit margin. However they show positive growth in last three years and relatively high numbers, which imply a healthy business.

Moreover cash flow increased and the company sold equity, so it might not be as risky to invest as it seems.

No time left