Practice Final 202
Covers Chapters 13 - 15

Problem - I — Multiple Choice (20 points)

Circle the one best answer.

1. Companies purchase investments in debt or stock securities for all of the following reasons except:
   a. earn investment income.
   b. strategic reasons.
   c. excess cash on hand.
   d. increase cash on hand.

2. The best way to study the relationship of the components of financial statements is to prepare
   a. common size statements.
   b. a trend analysis.
   c. profitabiltiy analysis.
   d. ratio analysis.

3. In performing a vertical analysis, the base for prepaid expenses is
   a. total current assets.
   b. total assets.
   c. total liabilities.
   d. prepaid expenses in a previous year.

4. Quine Company had credit sales of $600,000. The beginning accounts receivable balance was $80,000 and the ending accounts receivable balance was $60,000. Cash collections from customers were
   a. $680,000.
   b. $620,000.
   c. $600,000.
   d. $580,000.

5. Harbor Company reported net income of $30,000 for the year ended December 31, 2006. During the year, inventories decreased by $7,000, accounts payable decreased by $8,000, depreciation expense was $10,000 and a gain on disposal of equipment of $4,500 was recorded. Net cash provided by operations in 2006 using the *indirect method* was
   a. $59,500.
   b. $20,500.
   c. $48,500.
   d. $34,500.

6. On January 1, 2006, Franklinton Company sold bonds with a cost of $55,000 for $60,000. The annual interest payment on the bond had been received on December 31, 2005. The entry to record the sale of the bonds will include:
   a. a credit to Cash.
   b. a credit to Interest Receivable.
   c. a credit to Debt Investments.
   d. a debit to Loss on the Sale of Debt Investments.

7. Keifert Company had a balance in the Merchandise Inventory account of $260,000 at the beginning of the year and a balance of $340,000 at the end of the year. The inventory turnover ratio for 2006 was 4 times. If gross profit as a percentage of sales was 40%, the amount of sales for 2006 was
   a. $2,000,000.
   b. $1,200,000.
   c. $3,000,000.
   d. $750,000.

8. Foxter Company reported net income of $140,000 for 2006. The income statement also indicates that interest expense for 2006 was $40,000. Assuming an income tax rate of 30%, the number of times interest earned ratio for 2006 was
   a. 5 times.
   b. 6 times.
   c. 4.5 times.
   d. 3.5 times.

9. Simms Company has a 70% interest in the stock of Werton Company. What level of investment does Simms hold?
   a. Controlling
   b. Significant
   c. Insignificant
   d. Passive

10. Bechtel Enterprises has a 10% interest in Walton Company. During 2006, Walton earned net income of $45,000 and paid dividends of $20,000. The entry on the books of Bechtel to record income from the investment will include
   a. a debit to Stock Investments of $4,500.
   b. a credit to Investment Income of $2,500.
   c. a credit to Dividend Income of $2,000.
   d. a credit to Gain on the Sale of Stock Investments for $2,500.

Problem- II — Comparative Analysis (20 points)

Using the following selected items from the comparative balance sheet of Solver Company, illustrate horizontal and vertical analysis.

	December 31, 2006	December 31, 2005
Accounts Receivable	$ 870,000	$ 600,000
Inventory	950,000	750,000
Total Assets	4,100,000	3,000,000

Problem - III — Statement of Cash Flows (24 points)

The comparative balance sheet for Douder Company appears below:

DOUDER COMPANY
Comparative Balance Sheet

	Dec. 31, 2006	Dec. 31, 2005
Assets		
Cash	$53,000	$12,000
Accounts receivable	6,000	8,000
Inventory	11,000	7,000
Prepaid expenses	2,000	3,000
Equipment	20,000	20,000
Accumulated depreciation—equipment	(3,000)	(2,000)
Total assets	$89,000	$48,000
Liabilities and Stockholders' Equity		
Accounts payable	$ 1,000	$ 4,000
Long-term note payable	13,000	14,000
Common stock	38,000	18,000
Retained earnings	37,000	12,000
Total liabilities and stockholders' equity	$89,000	$48,000

The income statement for the year is as follows:

DOUDER COMPANY
Income Statement
For the Year Ended December 31, 2006

Sales (all on credit)		$280,000
Expenses and losses		
Cost of goods sold	$192,000	
Operating expenses, exclusive of depreciation	42,300	
Depreciation expense	1,000	
Interest expense	1,200	
Loss on sale of land	2,500	
Income taxes	9,000	
Total expenses and loss		248,000
Net income		$ 32,000

Cash dividends of $7,000 were paid during the year. Land costing $20,000 was acquired by the issuance of common stock. The property was subsequently sold for $17,500 cash.

Instructions
Prepare a statement of cash flows for the year ended December 31, 2006, using the indirect method.

OR

Prepare a statement of cash flows for the year ended December 31, 2006, using the direct method.

Problem - IV — Calculation of Ratios (26 points)

The financial information below was taken from the annual financial statements of Harris Company.

	2006	2005
Current assets	$240,000	$212,000
Current liabilities	80,000	90,000
Total liabilities	182,000	160,000
Total assets	520,000	480,000
Sales	400,000	370,000
Cost of goods sold	240,000	220,000
Inventory	100,000	125,000
Receivables	100,000	60,000
Net income	50,000	48,000
Net cash provided by operating activities	30,000	25,000

Instructions

Calculate the following ratios for Harris Company for 2006.

1. Current ratio.
2. Average collection period.
3. Current cash debt coverage ratio.
4. Debt to total assets ratio.
5. Cash debt coverage ratio.
6. Return on assets.
7. Profit margin ratio.
8. Asset turnover ratio.

Solutions — Practice Final 201

Problem - I — Solution

1.	**c**	**6.**	**c**
2.	**d**	**7.**	**a**
3.	**b**	**8.**	**b**
4.	**b**	**9.**	**a**
5.	**d**	**10.**	**c**

Problem - II — Solution

HORIZONTAL ANALYSIS

	December 31, 2006	December 31, 2005
Accounts Receivable	145%	100%
Inventory	127%	100%
Total Assets	137%	100%

VERTICAL ANALYSIS

	December 31, 2006	December 31, 2005
Accounts Receivable	21%	20%
Inventory	23%	25%
Total Assets	100%	100%

Problem - III — Solution

DOUDER COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2006
(Indirect Method)

Cash flows from operating activities		
Net income	$32,000	
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	$1,000	
Decrease in accounts receivable	2,000	
Increase in inventory	(4,000)	
Decrease in prepaid expenses	1,000	
Decrease in accounts payable	(3,000)	
Loss on sale of land	2,500	(500)
Net cash provided by operating activities		31,500
Cash flows from investing activities		
Proceeds from sale of land		17,500
Cash flows from financing activities		
Payment of cash dividends	(7,000)	
Payment of long-term note	(1,000)	
Net cash used by financing activities		(8,000)
Net increase in cash		41,000
Cash at beginning of period		12,000
Cash at end of period		$53,000
Noncash financing and investing activities		
Acquired land through issuance of common stock		$20,000

DOUDER COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2006
(Direct Method)

Cash flows from operating activities				
Cash receipts from customers			$282,000	(1)
Cash payments				
To suppliers	$199,000	(2)		
For operating expenses	41,300	(3)		
For interest expense	1,200			
For income taxes	9,000		250,500	
Net cash provided by operating activities			31,500	
Cash flows from investing activities				
Proceeds from sale of land			17,500	
Cash flows from financing activities				
Payment of cash dividends	(7,000)			
Payment of long-term note	(1,000)			
Net cash used by financing activities			(8,000)	
Net increase in cash			41,000	
Cash at beginning of period			12,000	
Cash at end of period			$ 53,000	
Noncash financing and investing activities				
Acquired land through issuance of common stock			$20,000	

(1)	**Sales**	**$280,000**
	Add: Decrease in accounts receivable	**2,000**
	Cash receipts from customers	**$282,000**
(2)	**Cost of goods sold**	**$192,000**
	Add: Increase in inventory	**4,000**
	Purchases	**196,000**
	Add: Decrease in accounts payable	**3,000**
	Cash payments to suppliers	**$199,000**
(3)	**Operating expenses, exclusive of depreciation**	**$42,300**
	Deduct: Decrease in prepaid expenses	**1,000**
	Cash payments for operating expenses	**$41,300**

Problem I V — Solution

1. **Current ratio: $240,000 ÷ $80,000 = 3:1.**

2. **Average collection period:** $\frac{\$400{,}000}{(\$100{,}000 + \$60{,}000) \div 2}$ **= 5**

   365 ÷ 5 = 73 days.

3. **Current cash debt coverage ratio:** $\frac{\$30{,}000}{(\$90{,}000 + \$80{,}000) \div 2}$ **= .35.**

4. **Debt to total assets ratio: $182,000 ÷ $520,000 = .35.**

5. **Cash debt coverage ratio:** $\frac{\$30{,}000}{(\$160{,}000 + \$182{,}000) \div 2}$ **= .18.**

6. **Return on assets:** $\frac{\$50{,}000}{(\$520{,}000 + \$480{,}000) \div 2}$ **= 10%.**

7. **Profit margin ratio: $50,000 ÷ $400,000 = 12.5%.**

8. **Asset turnover ratio:** $\frac{\$400{,}000}{(\$520{,}000 + \$480{,}000) \div 2}$ **= .8.**