FIN621 MIDTERM SUBJECTIVE SOLVED

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Remember me and my family in your prayers

May ALLAH grant you goodness!

Which one of the cash flow and income statement is best tool for measuring the profitability of a sound business? Marks 3

The income statement, also called the profit and loss statement, is the financial statement that directly shows the profitability of a company. The income statement reports profits and losses from a company's various business activities. Cash Flow statement is prepared on cash basis of accounting but profit is calculated on accrual basis. So cash flow statement is not a judge of profitability.

If the company issues stocks or bonds to pay debts, would u include it in the cash flow statement? Marks 3

If a company issues stocks or bonds for cash and then pays off the debt, the transaction is reported in the financing section of the statement of cash flows.

If the transaction is a direct conversion of debt to equity (shares of stock) or debt to bonds and no cash receipts or cash payments occur, the transaction is to be disclosed as supplementary information

Explain how the adoptions of FIFO method rather than LIFO will tend to raise or lower the quality of a company's earnings? Assume the continuance of the inflation.

With FIFO, the income statement shows a higher income due to the COGS being valued at a lower amount. At the same time with FIFO the balance sheet shows a higher value for the inventory at hand. With LIFO, the income statement shows a lower income due to the COGS being valued at a higher amount. At the same time, LIFO lowers the value shown on the balance sheet for inventory at hand. Finally, the retained earnings statement will show a higher retained earnings value at the end of the accounting period if FIFO is used as the FIFO method gives a higher net income.

Can a company get a positive cash flow from operating activities even if the company has net loss during the period? Explain with the help of example

Net income takes everything into account, while cash flows only take cash into account. Look at the items that are added back into net income/loss to calculate cash flows.

Depreciation, Amortization or Depletion

Non-operating Losses

Any increases in Current Liabilities

Any decreases in Current Assets

You could have a net loss; but if these items are more than the net loss, you could end up with a positive cash flow.

An accountant of a large corporation said that the company uses several methods to calculate depreciation of the assets. Whereas, the notes to the accounts show that depreciation is calculated using straight line method. Explain.

The various methods are used to accelerate the write-off or to modify it. Straight line uses a linear relation so that an equal portion of the cost is charged off each period.

Affects of dividends on retained earnings? Explain in terms of dividend declared and dividend payment? 3 marks

When a corporation declares a cash dividend on its stock, its retained earnings are decreased and its current liabilities (Dividends Payable) are increased. When the cash dividend is paid, the Dividends Payable account is decreased and the corporation’s Cash account is decreased.

The net result of the declaration and payment of the dividend is that the corporation’s assets and stockholders’ equity have decreased. Specifically, the balance sheet accounts Cash and Retained Earnings were decreased.

Do it is necessary to record each expense and revenue as closing entries??

Yes. The reason for the closing entries is to ensure that each revenue and expense account will begin the next accounting year with a zero balance. The second reason closing entries are prepared is so the company's retained earnings account will show an increase from revenues from the prior year and a decrease from expenses, which aids in keeping the accounts reconciled.

Why a company prefers straight line method over accelerated depreciation method

Straight-line depreciation is straightforward, uncomplicated, easy to understand and simple to apply and looks better for a company's financial statements. This is because accelerated depreciation shows less profit in the early years of asset acquisition. Most companies use straight-line depreciation for financial statements

What are deferred expenses?

The term “deferred expense” is used to describe a payment that has been made, but it won’t be reported as an expense until a future accounting period.

For Example: Insurance paid in advance for coverage in future months

An asset that was purchased for Rs. 60,000 and was fully depreciated with no salvage value was disposed off for no cost? What effect will this have on the cash flow statement and why? Give Reasons?

When you dispose of a fully depreciated asset, there are no cash flows, so it will not appear in the statement of cash flows. Only Cash transactions are included in the Cash Flow Statement. A fully depreciated asset has a net book value of zero.