

ALLAMA IQBAL OPEN UNIVERSITY, ISLAMABAD

(Department of Commerce)

SOLVED ASSIGNMENT NO. 2

Course Title:	Financial Accounting	Course Code:	1413
Level:	AD / B. Com	Semester:	Autumn 2026
Total Marks:	100	Pass Marks:	AD: 50 / BA: 40

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Question 1 (20 Marks)

Barton Corporation began operations on January 1, 2024:

- 2024:**
- Jan 1: Authorized 2,000,000 common shares (Rs. 5 par) & 100,000 preferred shares (Rs. 100 par, 10% cumulative).
- Jan 2: Issued 200,000 common shares for Rs. 12 cash per share.
- Jan 3: Issued 100,000 common shares for building (Rs. 820,000) & merchandise inventory (Rs. 380,000).
- Jan 4: Paid Rs. 10,000 cash for organization activities.
- Jan 5: Issued 12,000 preferred shares for Rs. 110 cash per share.

2025:

June 4: Issued 100,000 common shares for Rs. 15 cash per share.

Required:

- Journal entries for all transactions.
- Stockholders' Equity section of Balance Sheet as of Dec 31, 2024 and Dec 31, 2025.
- Dividend allocation table for 2024 (Rs. 50,000 declared) and 2025 (Rs. 300,000 declared).

Answer

Requirement 1: General Journal Entries

Date	Account Titles and Explanation	Debit (Rs.)	Credit (Rs.)
01-Jan-24	Authorized 2,000,000 common shares (Rs. 5 par) and 100k 10% cumulative preferred shares (Rs. 100 par). No accounting entry.	-	-
02-Jan-24	Issued 200,000 common shares for Rs. 12 cash per share. (200,000 x 12)	2,400,000	- 1,000,000 1,400,000
03-Jan-24	Issued 100,000 common shares for building (Rs. 820,000) & merchandise inventory (Rs. 380,000). (100,000 x 8.20)	820,000 380,000	- - 500,000 700,000
04-Jan-24	Paid Rs. 10,000 cash for organization activities. Organization Expense To Cash (Paid founders for organization activities)	10,000	- 10,000
05-Jan-24	Issued 12,000 preferred shares for Rs. 110 cash per share. (12,000 x 110)	1,320,000	- 1,200,000 120,000
04-Jun-25	Issued 100,000 common shares for Rs. 15 cash per share. (100,000 x 15)	1,500,000	- 500,000 1,000,000

Requirement 2: Stockholders' Equity Sections of Balance Sheet

As of December 31, 2024:

Stockholders' Equity Component	Details	Amount (Rs.)
Preferred Stock, 10% Cumulative	100,000 authorized, 12,000 issued & outstanding (Rs. 100 par)	1,200,000

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Common Stock	2,000,000 authorized, 300,000 issued & outstanding (Rs. 5 par)	1,500,000
Paid-in Capital in Excess of Par - Preferred	12,000 shares x Rs. 10 premium	120,000
Paid-in Capital in Excess of Par - Common	(200k x 7) + (100k x 7)	2,100,000
Total Contributed Capital	Sum of Paid-in Capital components	4,920,000
Retained Earnings	Assuming zero net income / dividend adjustments	0
TOTAL STOCKHOLDERS' EQUITY (2024)	As of December 31, 2024	4,920,000

As of December 31, 2025:

Stockholders' Equity Component	Details	Amount (Rs.)
Preferred Stock, 10% Cumulative	12,000 shares issued & outstanding (Rs. 100 par)	1,200,000
Common Stock	400,000 shares issued & outstanding (Rs. 5 par)	2,000,000
Paid-in Capital in Excess of Par - Preferred	12,000 shares x Rs. 10 premium	120,000
Paid-in Capital in Excess of Par - Common	Rs. 2,100,000 + (100k x Rs. 10)	3,100,000
Total Contributed Capital	Sum of Paid-in Capital components	6,420,000
Retained Earnings	Cumulative balance	0
TOTAL STOCKHOLDERS' EQUITY (2025)	As of December 31, 2025	6,420,000

Requirement 3: Dividend Allocation & Per Share Analysis

Annual Preferred Dividend Requirement = 12,000 shares x Rs. 100 par x 10% = Rs. 120,000 per year.

Year	Total Declared	Preferred Dividend	Common Dividend	Preferred Per Share	Common Per Share
2024	Rs. 50,000	Rs. 50,000 (Partial)	Rs. 0	Rs. 4.17	Rs. 0.00
2025	Rs. 300,000	Rs. 190,000*	Rs. 110,000	Rs. 15.83	Rs. 0.28

*Note for 2025: Preferred dividend includes Rs. 70,000 in arrears from 2024 (Rs. 120,000 - Rs. 50,000) plus current 2025 requirement of Rs. 120,000 = Rs. 190,000 total. Remaining Rs. 110,000 (Rs. 300,000 - Rs. 190,000) goes to 400,000 common shares (Rs. 0.275 per share).

Question 2 (20 Marks)

a. Explain financial statement analysis and vertical analysis of income statement and balance sheet with presumptive data.

b. Using 2008 as base year, prepare a trend analysis (round to 1 decimal place) and evaluate if situation is favorable/unfavorable:

Net Sales: 2012=\$25,520 | 2011=\$23,980 | 2010=\$24,200 | 2009=\$22,880 | 2008=\$22,000

COGS: 2012=\$17,220 | 2011=\$15,400 | 2010=\$15,540 | 2009=\$14,700 | 2008=\$14,000

G&A Exp: 2012=\$5,280 | 2011=\$5,184 | 2010=\$5,088 | 2009=\$4,896 | 2008=\$4,800

Op Income: 2012=\$3,020 | 2011=\$3,396 | 2010=\$3,572 | 2009=\$3,284 | 2008=\$3,200

Answer

Part (a): Financial Statement Analysis & Vertical Analysis

Financial Statement Analysis evaluates a company's financial performance, operational efficiency, and solvency. Vertical Analysis (Common-Size analysis) expresses each item on a financial statement as a percentage of a base figure (Total Sales for Income Statement; Total Assets for Balance Sheet).

Income Statement Line Item	Presumptive Amount (\$)	Vertical % (of Sales)
Net Sales Revenue	500,000	100.0%
Cost of Goods Sold (COGS)	(300,000)	60.0%
Gross Profit	200,000	40.0%

Operating Expenses (Selling & Admin)	(120,000)	24.0%
Operating Income (EBIT)	80,000	16.0%
Income Taxes (25%)	(20,000)	4.0%
NET INCOME	60,000	12.0%

Part (b): Trend Analysis (Base Year 2008 = 100.0%)

Trend Percentage = (Current Year Amount / Base Year Amount) x 100:

Financial Item	2008 (Base)	2009	2010	2011	2012
Net Sales (\$)	22,000	22,880	24,200	23,980	25,520
Net Sales Trend %	100.0%	104.0%	110.0%	109.0%	116.0%
Cost of Goods Sold (\$)	14,000	14,700	15,540	15,400	17,220
COGS Trend %	100.0%	105.0%	111.0%	110.0%	123.0%
G&A Expenses (\$)	4,800	4,896	5,088	5,184	5,280
G&A Expenses Trend %	100.0%	102.0%	106.0%	108.0%	110.0%
Operating Income (\$)	3,200	3,284	3,572	3,396	3,020
Operating Income Trend %	100.0%	102.6%	111.6%	106.1%	94.4%

- Evaluation & Interpretation: UNFAVORABLE TREND. Although Net Sales grew by 16.0% over 5 years (reaching 116.0% in 2012), Cost of Goods Sold increased at a much faster rate of 23.0% (reaching 123.0% in 2012). Furthermore, G&A Expenses grew by 10.0%. Consequently, Operating Income declined to 94.4% of its base level by 2012 (\$3,020 vs \$3,200 in 2008), indicating severe gross margin compression and cost control deterioration.

Question 3 (20 Marks)

a. Describe the three major activities reported in a Cash Flow Statement.

b. For year ended June 30, 2025, Silk Corporation Net Income = Rs. 7,400, Depreciation = Rs. 2,000.

Changes: A/R +Rs. 4,400 | Inventories +Rs. 7,000 | Prepaid Rent -Rs. 1,400 | A/P +Rs. 14,000 | Salaries Payable +Rs. 1,000 | Tax Payable -Rs. 600.

Prepare schedule of Cash Flows from Operating Activities using the Indirect Method.

Answer

Part (a): Three Major Activities in Cash Flow Statement

- 1. Operating Activities:** Cash flows from primary revenue-generating activities (cash received from customers, cash paid to suppliers and employees).
- 2. Investing Activities:** Cash flows from acquisition and disposal of long-term assets and investments (property, plant, equipment, loans granted).
- 3. Financing Activities:** Cash flows related to long-term liabilities and equity capital (issuing stock, paying dividends, borrowing/repaying bonds).

Part (b): Silk Corporation Cash Flow from Operating Activities

Cash Flow Line Item	Calculation / Detail	Amount (Rs.)
Net Income	As reported for year ended June 30, 2025	7,400
Adjustments for Non-Cash Expenses:		
+ Depreciation Expense	Add back non-cash expense	2,000
Changes in Operating Assets & Liabilities:		
- Increase in Accounts Receivable	Uses cash (cash tied up in receivables)	(4,400)
- Increase in Inventories	Uses cash (purchased additional inventory)	(7,000)
+ Decrease in Prepaid Rent	Provides cash (rent expense recorded without cash outflow)	1,400

+ Increase in Accounts Payable	Provides cash (delayed payment to suppliers)	14,000
+ Increase in Salaries Payable	Provides cash (accrued unpaid employee expenses)	1,000
- Decrease in Income Taxes Payable	Uses cash (paid past taxes owed)	(600)
NET CASH PROVIDED BY OPERATING ACTIVITIES	Total Cash Flow from Operations	13,800

Question 4 (20 Marks)

The Smart Company sold Rs. 500,000 of 8%, 20-year bonds on April 1, 2024 at 105. Semiannual interest dates: March 31 & Sept 30. Market rate = 7.5%. Fiscal year ends Sept 30. Use effective interest method.

- On April 1, 2024 issue: a. Cash received | b. Bonds Payable | c. Difference & name.
- On Sept 30, 2024 interest payment: a. Cash paid | b. Amortization | c. Interest expense.
- On March 31, 2025 interest payment: a. Cash paid | b. Amortization | c. Interest expense.

Answer**Requirements Breakdown & Calculations**

1. Bond Issue on April 1, 2024:

- a. Cash Received:** $105\% \times \text{Rs. } 500,000 = \text{Rs. } 525,000$.
- b. Bonds Payable:** Par Value = Rs. 500,000.
- c. Difference & Name:** Difference = Rs. 525,000 - Rs. 500,000 = Rs. 25,000. It is called Premium on Bonds Payable.

2. Bond Interest Payment on September 30, 2024 (First 6 Months):

- a. Cash Paid in Interest:** Par Value $\times$ (Stated Rate / 2) = Rs. 500,000 $\times$ (8% / 2) = Rs. 20,000.
- c. Interest Expense:** Carrying Value $\times$ (Market Rate / 2) = Rs. 525,000 $\times$ (7.5% / 2) = Rs. 525,000 $\times$ 3.75% = Rs. 19,687.50.
- b. Premium Amortization:** Cash Paid - Interest Expense = Rs. 20,000 - Rs. 19,687.50 = Rs. 312.50.

Unamortized Premium after Sept 30, 2024 = Rs. 25,000 - Rs. 312.50 = Rs. 24,687.50. Carrying Value = Rs. 524,687.50.

3. Bond Interest Payment on March 31, 2025 (Second 6 Months):

- a. Cash Paid in Interest:** Rs. 500,000 $\times$ 4% = Rs. 20,000.
- c. Interest Expense:** New Carrying Value $\times$ 3.75% = Rs. 524,687.50 $\times$ 3.75% = Rs. 19,675.78.
- b. Premium Amortization:** Cash Paid - Interest Expense = Rs. 20,000 - Rs. 19,675.78 = Rs. 324.22.

Question 5 (20 Marks)

Asif Trading Ltd established in 2017 (200,000 common stock @ Rs. 50 par authorized). Issued 150,000 shares @ Rs. 60 each in Aug 2017. Retained Earnings balance at June 30, 2020 = Rs. 750,000.

Purchased 20,000 own common stock in Aug 2020 @ Rs. 52 each.

Sold these shares in Jan 2021: 50% @ Rs. 48 each and 50% @ Rs. 55 each.

Required:

- Record purchase of own stock in Aug 2020 and present Equity section at Aug 31, 2020.
- Record sale of treasury stock in Jan 2021 and present Equity section at Jan 31, 2021.

Answer**Part (a): Purchase of Treasury Stock & Equity Section (Aug 31, 2020)**

Journal Entry (August 2020):

Date	Account Titles and Explanation	Debit (Rs.)	Credit (Rs.)
Treasury Stock	Treasury Stock (20,000 shares $\times$ Rs. 52) To Cash (Purchased 20,000 shares of own stock at cost)	1,040,000 -	- 1,040,000

Stockholders' Equity Section (as at August 31, 2020):

Equity Component	Details	Amount (Rs.)
Common Stock	200,000 authorized, 150,000 issued (Rs. 50 par)	7,500,000
Paid-in Capital in Excess of Par - Common	150,000 shares x Rs. 10 premium	1,500,000
Retained Earnings	Balance at June 30, 2020	750,000
Total Contributed Capital & Retained Earnings	Subtotal	9,750,000
Less: Treasury Stock (at cost)	20,000 shares purchased @ Rs. 52	(1,040,000)
TOTAL STOCKHOLDERS' EQUITY (Aug 31, 2020)	Net Stockholders' Equity	8,710,000

Part (b): Sale of Treasury Stock & Equity Section (Jan 31, 2021)

Journal Entries (January 2021):

Date	Account Titles and Explanation	Debit (Rs.)	Credit (Rs.)
January 1, 2021	To Treasury Stock (10,000 x 52 cost) (Sold 10,000 treasury shares @ Rs. 48)	480,000	40,000 -
January 1, 2021	To Paid-in Capital from Treasury Stock (Sold 10,000 treasury shares @ Rs. 55)	550,000	- -
January 1, 2021			- 520,000 30,000

Stockholders' Equity Section (as at January 31, 2021):

Equity Component	Details	Amount (Rs.)
Common Stock	150,000 shares issued & outstanding (Rs. 50 par)	7,500,000
Paid-in Capital in Excess of Par - Common	150,000 shares x Rs. 10 premium	1,500,000
Paid-in Capital from Treasury Stock	Gain on sale of 10,000 treasury shares @ Rs. 55	30,000
Retained Earnings	Rs. 750,000 - Rs. 40,000 loss on treasury sale	710,000
TOTAL STOCKHOLDERS' EQUITY (Jan 31, 2021)	Net Stockholders' Equity	9,740,000