FOTAMAT

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1

Why do companies do analysis?

- Liquidity.
- Profitability.
- Solvency.

Who analysis?

- Short term creditors.
- Long term creditors.
- Shareholders. Profitability and solvency.

Comparison:

- Intracompany basis.

- Industry average.

- Intercompany basis.

Tools of analysis:

- Horizontal analysis. Intracompany comparison.
- Vertical analysis. Intra + inter-company comparison.
- ratio analysis. Intra + inter-company + average comparison.

Which one of the following is primarily interested in the liquidity of a company?

a. Government agencies
b. Shareholders
c. Long-term creditors
d. Short-term creditors

Which one of the following is **not** a characteristic generally evaluated in analyzing financial statements?

a. Liquidity
b. Profitability
c. Marketability
d. Solvency

In analyzing the financial statements of a company, a single item on the financial statements

a. should be reported in bold-face type.
b. is more meaningful if compared to other financial information.
c. is significant only if it is large.
d. should be accompanied by a footnote.

Short-term creditors are usually most interested in evaluating

a. solvency.
b. liquidity.
c. marketability.
d. profitability.

Long-term creditors are usually most interested in evaluating

a. liquidity and solvency.
b. solvency and marketability.
c. liquidity and profitability.
d. profitability and solvency.

Comparisons of data within a company are an example of which one of the following comparative bases?

a. Industry averages
b. Intercompany
c. Intracompany
d. Interregional

A technique for evaluating financial statements that expresses the relationship among selected items of financial statement data is

a. common size analysis.
b. horizontal analysis.
c. ratio analysis.
d. vertical analysis.

A shareholder is interested in the ability of a firm to

a. pay consistent dividends.
b. appreciate in share price.
c. survive over a long period.
d. All of these answer choices are correct.

Comparisons of financial data made within a company are called

a. intracompany comparisons.
b. interior comparisons.
c. intercompany comparisons.
d. intramural comparisons.

Comparisons can be made on each of the following bases **except**

a. industry averages.
b. intercompany basis.
c. intracompany basis.
d. All of these answer choices are basis for comparison.

In analyzing financial statements, horizontal analysis is a

a. requirement.
b. tool.
c. principle.
d. theory.

Horizontal analysis is also called

a. linear analysis.
b. vertical analysis.
c. trend analysis.
d. common size analysis.

Vertical analysis is also known as

a. perpendicular analysis.
b. common size analysis.
c. trend analysis.
d. straight-line analysis.

In ratio analysis, the ratios are never expressed as a

a. rate.
b. negative figure.
c. percentage.
d. simple proportion.

Shareholders are most interested in evaluating

a. liquidity and solvency.
b. profitability and solvency.
c. liquidity and profitability.
d. marketability and solvency.

2

Liquidity ratios	
Measure the short-term ability of the company to pay its maturing obligations or unexpected needs of cash.	
Current ratio.	Measures short term debt paying ability.
Acid test (quick ratio).	Measures immediate short-term liquidity.
Receivables turnover.	Measures liquidity of receivables.
Inventory turnover.	Measures liquidity of inventories.

Profitability ratios	
Measures the income or operating success of a company for a period of time.	
Profit margin.	Measures net income generated by each currency unit of sale.
Asset turnover.	Measures how efficiently assets are used to generate sales.
Return on asset (ROA).	Measures overall profitability of assets.
Return on Equity (ROE).	Measures profitability or owner's investment.
Earnings per share (EPS).	Measured net income earned on each ordinary share.
Price earnings ratio (PE).	Measures the ratio of the market price per share to earnings per share.
Payout ratio.	Measures percentage of earnings distributed in the form of cash dividends.

Solvency ratios	
Measures the ability of a company to survive over a long period of time.	
Debt to total asset ratio.	Measures the percentage of total assets provided by creditors.
Times interest earned.	Measures ability to meet interest payment as they come due.

ratio	formula
Current ratio	Current asset / current liability
Acid-test (quick) ratio	(Current assets - inventory) / current liability
Receivables turnover	Net credit sales / average net receivables
Inventory turnover	COGS / Average inventory
Profit margin	Net income / net sales
Asset turnover	Net sales / average assets
Return on assets	Net income / average assets
Return on ordinary shareholder's equity	(net income - preference div) / average ordinary shareholder's equity
Earnings per share	(Net income - preference div) / weighted average ordinary shares outstanding
Price earnings (PE)	Market price per share / earnings per share
Payout ratio	Cash dividends / net income
Debt to total assets ratio	Total debt / total assets
Times interest earned	Income before income taxes and interest expense / interest expense

1-Each of the following is a liquidity ratio **except** the

a. acid-test ratio.
b. current ratio.
c. debt to total assets ratio.
d. inventory turnover.

2-A ratio calculated in the analysis of financial statements

a. expresses a mathematical relationship between two numbers.
b. shows the percentage increase from one year to another.
c. restates all items on a financial statement in terms of dollars of the same purchasing power.
d. is meaningful only if the numerator is greater than the denominator.

3-A liquidity ratio measures the

a. income or operating success of an enterprise over a period of time.
b. ability of the enterprise to survive over a long period of time.
c. short-term ability of the enterprise to pay its maturing obligations and to meet unexpected needs for cash.
d. number of times interest is earned.

4-The current ratio is

a. calculated by dividing current liabilities by current assets.
b. used to evaluate a company's liquidity and short-term debt paying ability.
c. used to evaluate a company's solvency and long-term debt paying ability.
d. calculated by subtracting current liabilities from current assets.

5-The acid-test (quick) ratio

a. is used to quickly determine a company's solvency and long-term debt paying ability.
b. relates cash, short-term investments, and net receivables to current liabilities.
c. is calculated by taking one item from the income statement and one item from the statement of financial position.
d. is the same as the current ratio except it is rounded to the nearest whole percent.

6-The current ratio may also be referred to as the

a. short run ratio.
b. acid-test ratio.
c. working capital ratio.
d. contemporary ratio.

7-A weakness of the current ratio is

a. the difficulty of the calculation.
b. that it doesn't take into account the composition of the current assets.
c. that it is rarely used by sophisticated analysts.
d. that it can be expressed as a percentage, as a rate, or as a proportion.

3

E15-9 The income statement for Christiansen, A/S, appears below.

CHRISTIANSEN, A/S Income statement For the year ended December 31,2017	
Net sales	400,000
Cost of goods sold	235,000
Gross profit	165,000
Expenses (including 14,000 interest and 17,000 income taxes)	105,000
Net income	60,000

Additional information:

1. The weighted-average ordinary shares outstanding in 2017 were 32,000 shares.
2. The market price of Christiansen, A/S was €10.80 per share in 2017.
3. Cash dividends of €20,000 were paid, €5,000 of which were to preference shareholders.

Instructions

Compute the following ratios for 2017.

1. Earnings per share.
2. Price-earnings ratio.
3. Payout ratio.
4. Times interest earned.

8-A supplier to a company would be most interested in the company's

a. asset turnover.
b. profit margin.
c. current ratio.
d. earnings per share.

9-Which one of the following ratios would **not** likely be used by a short-term creditor in evaluating whether to sell on credit to a company?

a. Current ratio
b. Acid-test ratio
c. Asset turnover
d. Accounts receivable turnover

10-Ratios are used as tools in financial analysis

a. instead of horizontal and vertical analyses.
b. because they may provide information that is not apparent from inspection of the individual components of the ratio.
c. because even single ratios by themselves are quite meaningful.
d. because they are prescribed by IFRS.

11-Walker Clothing Store had a balance in the Accounts Receivable account of $390,000 at the beginning of the year and a balance of $410,000 at the end of the year. Net credit sales during the year amounted to $3,000,000. The average collection period of the receivables in terms of days was

a. 30 days.
b. 365 days.
c. 274 days.
d. 49 days.

12-Parr Hardware Store had net credit sales of $8,000,000 and cost of goods sold of $5,000,000 for the year. The Accounts Receivable balances at the beginning and end of the year were $600,000 and $700,000, respectively. The accounts receivable turnover was

a. 7.7 times.
b. 4.6 times.
c. 11.4 times.
d. 12.3 times.

13-Waters Department Store had net credit sales of €16,000,000 and cost of goods sold of €10,000,000 for the year. The average inventory for the year amounted to €2,000,000. Inventory turnover for the year is

a. 8 times.
b. 10 times.
c. 5 times.
d. 4 times.

14-Waters Department Store had net credit sales of €16,000,000 and cost of goods sold of €10,000,000 for the year. The average inventory for the year amounted to €2,000,000. The average number of days in inventory during the year was

a. 91 days.
b. 73 days.
c. 46 days.
d. 37 days.

15-Each of the following is included in computing the acid-test ratio **except**

a. cash.
b. inventory.
c. receivables.
d. short-term investments.

16-Which one of the following would **not** be considered a liquidity ratio?

a. Current ratio
b. Inventory turnover
c. Acid-test ratio
d. Return on assets

17-Asset turnover measures

a. how often a company replaces its assets.
b. how efficiently a company uses its assets to generate sales.
c. the portion of the assets that have been financed by creditors.
d. the overall rate of return on assets.

18-Silas Corporation had net income of $200,000 and paid dividends to ordinary shareholders of $40,000 in 2014. The weighted average number of shares outstanding in 2014 was 50,000 shares. Silas Corporation's ordinary shares are selling for $50 per share on the New York Stock Exchange.

Silas Corporation's price-earnings ratio is

a. 3.2 times.
b. 12.5 times.
c. 15.6 times.
d. 4 times.

Silas Corporation's payout ratio for 2014 is

a. $4 per share.
b 25%.
c. 20%.
d. 12.5%.

19-Farr Company reported the following on its income statement:

Income before income taxes	$600,000
Income tax expense	150,000
Net income	$450,000

An analysis of the income statement revealed that interest expense was $50,000.
Farr Company's times interest earned was

a. 13 times.
b. 12 times.
c. 6 times.
d. 7 times.

20-The debt to total assets ratio measures

a. the company's profitability.
b. whether interest can be paid on debt in the current year.
c. the proportion of interest paid relative to dividends paid.
d. the percentage of the total assets provided by creditors.

21-Trading on the equity (leverage) refers to the

a. amount of working capital.
b. amount of capital provided by owners.
c. use of borrowed money to increase the return to owners.
d. number of times interest is earned.

22-The current assets of Kile Company are $160,000. The current liabilities are $100,000.
The current ratio expressed as a proportion is

a. 160%.
b. 1.6 : 1
c. .63: 1
d. $160,000 ÷ $100,000.

23-The acid-test ratio

a. is a quick calculation of an approximation of the current ratio.
b. does not include all current liabilities in the calculation.
c. does not include inventory as part of the numerator.
d. does include prepaid expenses as part of the numerator.

24-A company has an accounts receivable turnover of 10 times. The average net accounts receivable during the period are ¥500,000,000. What is the amount of net credit sales for the period?

a. ¥50,000,000
b. ¥5,000,000,000
c. ¥500,000,000
d. Cannot be determined from the information given

4

P15-2 The comparative statements of Larker Tool SA are presented below.

Larker tool SA Income statement For the year ended December 31	**2017**	**2016**
Net sales	1,818,500	1,750,500
Cost of goods sold	1,011,500	996,000
Gross profit	807,000	754,500
Selling and administrative expense	516,000	479,000
Income from operations	291,000	275,500
Interest expense	15,000	14,000
Income before income taxes	276,000	261,500
Income tax expense	84,000	77,000
Net income	192,000	184,500

LARKER TOOL SA
Statement of financial position
December 31

Assets	**2017**		**2016**	
Plant assets (net)		600,300		520,300
Current assets				
inventory	110,950		115,500	
Account receivables	105,750		102,800	
Short term investments	69,000		50,000	
cash	60,100	345,800	64,200	332,500
Total assets		946,100		852,800
Equity and liabilities				
Equity				
Share capital ordinary (5$ par).	300,000		300,000	
Retained earnings.	242,600		165,400	
Total equity		542,600		465,400
Bonds payable	200,000		200,000	
Current liability				
Accounts payable	160,000		145,400	
Income tax payable	43,500		42,000	
Total current liabilities		203,500		187,400
Total liabilities		403,500		387,400
Total equity and liabilities		946,100		852,800

All sales were on account.

Instructions

Compute the following ratios for 2017. (Weighted-average ordinary shares in 2017 were 60,000.)

1. Earnings per share.
2. Return on ordinary shareholders' equity.
3. Return on assets.
4. Current ratio.
5. Acid-test ratio.
6. Accounts receivable turnover.
7. Inventory turnover.
8. Times interest earned.
9. Asset turnover.
10. Debt to assets ratio.

1-The ratios that are used to determine a company's short-term debt paying ability are

a. asset turnover, times interest earned, current ratio, and accounts receivable turnover.
b. times interest earned, inventory turnover, current ratio, and accounts receivable turnover.
c. times interest earned, acid-test ratio, current ratio, and inventory turnover.
d. current ratio, acid-test ratio, accounts receivable turnover, and inventory turnover.

2-A measure of the percentage of each dollar of sales that results in net income is

a. profit margin.
b. return on assets.
c. return on ordinary shareholders' equity.
d. earnings per share.

3-Baden Company had $375,000 of current assets and $150,000 of current liabilities before borrowing $75,000 from the bank with a 3-month note payable.

What effect did the borrowing transaction have on the amount of Baden Company's working capital?

a. No effect
b. $75,000 increase
c. $150,000 increase
d. $75,000 decrease

4-What effect did the borrowing transaction have on Baden Company's current ratio?

a. The ratio remained unchanged.
b. The change in the current ratio cannot be determined.
c. The ratio decreased.
d. The ratio increased.

5-If equal amounts are added to the numerator and the denominator of the current ratio, the ratio will always

a. increase.
b. decrease.
c. stay the same.
d. equal zero.

6-If a company has an acid-test ratio of 1.2:1, what respective effects will the borrowing of cash by short-term debt and collection of accounts receivable have on the ratio?

	Short-term Borrowing	Collection of Receivable
a.	Increase	No effect
b.	Increase	Increase
c.	**Decrease**	**No effect**
d.	Decrease	Decrease

7-If the average collection period is 40 days, what is the accounts receivable turnover?

a. 8.3 times
b. 9.1 times
c. 4.6 times
d. None of these answer choices are correct.

8-A general rule to use in assessing the average collection period is that

a. it should not exceed 30 days.
b. it can be any length as long as the customer continues to buy merchandise.
c. it should not greatly exceed the discount period.
d. it should not greatly exceed the credit term period.

9-Inventory turnover is calculated by dividing

a. cost of goods sold by the ending inventory.
b. cost of goods sold by the beginning inventory.
c. cost of goods sold by the average inventory.
d. average inventory by cost of goods sold.

10-A company has an average inventory on hand of ¥60,000,000 and the days in inventory is 73 days. What is the cost of goods sold?

a. ¥300,000,000
b. ¥4,380,000,000
c. ¥600,000,000
d. ¥2,190,000,000

11-A successful grocery store would probably have

a. a low inventory turnover.
b. a high inventory turnover.
c. zero profit margin.
d. low volume.

12-Gold Clothing Store had a balance in the Accounts Receivable account of £920,000 at the beginning of the year and a balance of £980,000 at the end of the year. Net credit sales during the year amounted to £7,600,000.

The accounts receivable turnover ratio was

a. 8.0 times.
b. 8.4 times.
c. 7.8 times.
d. 8.3 times.

13-The average collection period of the receivables in terms of days was

a. 91.3 days.
b. 45.6 days.
c. 30 days.
d. 46.7 days.

14-An aircraft company would most likely have

a. a high inventory turnover.
b. low profit margin.
c. high volume.
d. a low inventory turnover.

15-Earnings per share is calculated

a. only for ordinary shares.
b. only for preference shares.
c. for ordinary and preference shares.
d. only for treasury shares.

16-Which of the following is **not** a profitability ratio?

a. Payout ratio
b. Profit margin
c. Times interest earned
d. Return on ordinary shareholders' equity

17-Times interest earned is also called the

a. money multiplier.
b. interest coverage ratio.
c. coupon coverage ratio.
d. premium ratio.

18-Gomez Company reports the following amounts for 2014:

Net income	$ 150,000
Average shareholders' equity	2,600,000
Preference dividends	48,000
Par value preference shares	200,000

The 2014 rate of return on ordinary shareholders' equity is

a. 5.1%.
b. 5.7%.
c. 7.5%.
d. 8.3%.

19-Net sales are $6,000,000, beginning total assets are $2,800,000, and the asset turnover is 3.0 times. What is the ending total asset balance?

a. $2,000,000
b. $1,200,000
c. $2,800,000
d. $3,200,000

20-The acid-test ratio is also known as the

a. current ratio.
b. quick ratio.
c. fast ratio.
d. times interest earned ratio.

21-Ratios that measure the short-term ability of the company to pay its maturing obligations are

- **a. liquidity ratios.**
- b. profitability ratios.
- c. solvency ratios.
- d. trend ratios.

22-What type of ratios best measure the short-term ability of the company to pay its maturing obligations and to meet unexpected needs for cash?

- a. Leverage
- b. Solvency
- c. Profitability
- **d. Liquidity**

23-The debt to total assets ratio

- **a. is a solvency ratio.**
- b. is computed by dividing total assets by total debt.
- c. measures the total assets provided by shareholders.
- d. is a profitability ratio.

24-The ratio that uses weighted average ordinary shares outstanding in the denominator is the

- a. price-earnings ratio.
- b. return on ordinary shareholders' equity.
- **c. earnings per share.**
- d. payout ratio.

25-Net income does **not** appear in the numerator of the

- a. profit margin.
- b. return on assets.
- c. return on ordinary shareholders' equity.
- **d. payout ratio.**

26-Dooley Corporation had net income of $200,000 and paid dividends to ordinary shareholders of $40,000 in 2014. The weighted average number of shares outstanding in 2014 was 50,000 shares. Dooley Corporation's ordinary shares are selling for $35 per share

Dooley Corporation's price-earnings ratio is

- a. 5 times.
- **b. 8.8 times.**
- c. 4 times.
- d. 10.9 times.

Dooley Corporation's payout ratio for 2014 is

- a. $4 per share.
- **b. 20%.**
- c. 25%.
- d. 10%.

27-Tate Company reported the following on its income statement:

Income before income taxes	$500,000
Income tax expense	150,000
Net income	$350,000

An analysis of the income statement revealed that interest expense was $200,000.
Tate Company's times interest earned was

a. 2.8 times.
b. 3.5 times.
c. 1.8 times.
d. 2.5 times.

28-Miley Corporation had net income of €250,000 and paid dividends to ordinary shareholders of €50,000 in 2014. The weighted average number of shares outstanding in 2014 was 50,000 shares. Miley Corporation's ordinary shares are selling for €40 per share.

Miley Corporation's price-earnings ratio is

a. 2 times.
b. 8 times.
c. 10 times.
d. 5 times.

Miley Corporation's payout ratio for 2014 is

a. 25%.
b. 20%.
c. 12.5%.
d. $5 per share.

29-The following financial statement information is available for Houser Corporation:

	2014	2013
Inventory	$ 44,000	$ 43,000
Current assets	75,000	106,000
Total assets	432,000	358,000
Current liabilities	30,000	36,000
Total liabilities	102,000	88,000

The current ratio for 2014 is

a. .40:1.
b. 2.5:1.
c. .31:1.
d. 4.24:1.

30-The following information pertains to Soho Company. Assume that all statement of financial position amounts represent both average and ending balance figures. Assume that all sales were on credit.

Assets	
Property, plant and equipment	$ 210,000
Inventory	20,000
Accounts receivable (net)	25,000
Cash and short-term investments	40,000
Total Assets	$295,000
Equity and Liabilities	
Shareholders' equity—ordinary	$ 150,000
Non-current liabilities	85,000
Current liabilities	60,000
Total Equity and Liabilities	$295,000
Income Statement	
Sales revenue	$ 85,000
Cost of goods sold	45,000
Gross margin	40,000
Operating expenses	20,000
Net income	$ 20,000
Number of ordinary shares	6,000
Market price of ordinary shares	$20
Dividends per share	.90

Answer the questions in the next page

a-What is the current ratio for Soho?

- **a. 1.42**
- b. .80
- c. 1.16
- d. .60

b-What is the accounts receivable turnover for Soho?

- a. 2.8 times
- b. 2 times
- **c. 3.4 times**
- d. 3 times

c-What is the inventory turnover for Soho?

- a. 2 times
- **b. 2.3 times**
- c. 1 time
- d. .44 times

d-What is the return on assets for Soho?

- **a. 6.8%**
- b. 10.5%
- c. 11.7%
- d. 26.7%

e-What is the profit margin for Soho?

- a. 42.9%
- b. 18.8%
- **c. 23.5%**
- d. 15.0%

f-What is the return on ordinary shareholders' equity for Soho?

- **a. 13.3%**
- b. 5.0%
- c. 23.3%
- d. 53.3%

g-What is the price-earnings ratio for Soho?

- **a. 6.0 times**
- b. 2.5 times
- c. 8.0 times
- d. 4.0 times

31-The following information is available for Charles Company:

	2014	2013
Accounts receivable	$ 460,000	$ 500,000
Inventory	340,000	420,000
Net credit sales	2,470,000	1,400,000
Cost of goods sold	1,860,000	1,060,000
Net income	300,000	170,000

The accounts receivable turnover for 2014 is

a. 1.6 times.
b. 5.4 times.
c. 5.1 times.
d. 3.9 times.

The inventory turnover for 2014 is

a. 6.2 times.
b. 4.9 times.
c. 5.5 times.
d. 4.4 times.

32-The following financial statement information is available for Barrett Corporation:

	2014	2013
Net income	$115,000	$ 80,000
Tax expense	50,000	29,000
Interest expense	15,000	14,000
Dividends paid to preference shareholders	22,000	20,000
Dividends paid to ordinary shareholders	15,000	10,000

The times interest earned for 2014 is

a. 8.8 times.
b. 7.7 times.
c. 12.0 times.
d. 11.0 times.

33-The following amounts were taken from the financial statements of Palmer Company:

	2014	2013
Total assets	$800,000	$1,000,000
Net sales	720,000	650,000
Gross profit	352,000	320,000
Net income	144,000	117,000
Weighted average number of ordinary shares outstanding	120,000	120,000
Market price of ordinary shares	$36	$40

The profit margin for 2014 is

a. 10%.
b. 15%.
c. 20%.
d. 30%.

The price-earnings ratio for 2013 is

a. 30 times.
b. 20 times.
c. 10 times.
d. 5 times.

34-The following financial statement information is available for Howard Corporation:

	2014	2013
Shareholders' equity-ordinary	$330,000	$270,000
Net sales	784,000	697,000
Cost of goods sold	406,000	377,000
Net income	115,000	80,000
Tax expense	50,000	29,000
Interest expense	15,000	14,000
Dividends paid to preference share holders	22,000	20,000
Dividends paid to ordinary shareholders	15,000	10,000

The return on ordinary shareholders' equity for 2014 is

a. 26.0%.
b. 38.3%.
c. 33.3%.
d. 31.0%.

THE END

Good luck