

Chapter 1--Overview of Financial Reporting, Financial Statement Analysis, and Valuation

Student: _____

1. The tools for studying industry economics do **not** include
 - A. Value chain analysis
 - B. Classification using Porter's five forces
 - C. Classification of cash flows
 - D. Economic attributes framework

2. Which of the following is a question an analyst would ask when assessing the quality of a firm's financial statements?
 - A. Are the company's products designed to meet a specific market segment?
 - B. Has the firm integrated forward into retailing to final consumers?
 - C. Is the firm diversified across several geographical markets?
 - D. Do earnings include nonrecurring gains or losses?

3. Which of the following economic characteristics is consistent with a grocery store chain?
 - A. minimal competition
 - B. extensive competition
 - C. high net income to sales
 - D. differentiated product

4. On a common size basis, which of the following assets is normally largest for a electric utility?
 - A. Accounts receivable
 - B. Inventory
 - C. Property, Plant and Equipment
 - D. Cash and Marketable Securities

5. On a common size basis, which of the following assets is normally largest for a commercial bank?
 - A. Accounts and Notes Receivable
 - B. Inventory
 - C. Property, Plant and Equipment
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6. Which of the following is **not** one of Porter's five forces?

- A. Buyer Power
- B. Supplier Power
- C. Threat of Regulation
- D. Threat of Substitutes

7. When assessing buyer power using Porter's five forces, which of the following is **not** consistent with low buyer power?

- A. Brand loyalty
- B. Control of distribution channel
- C. Large number of suppliers
- D. Low price

8. The second step in financial statement analysis is to identify the company strategy. Which of the following is a question an analyst should ask when performing a strategy analysis?

- A. Are industry sales growing rapidly or slowly?
- B. Do earnings include revenues that appear mismatched with the business model employed by the firm?
- C. Does the industry include a large number of firms selling similar products?
- D. What is the company's degree of geographical diversification?

9. The third step in financial statement analysis is to assess the quality of the firm's financial statements. Which of the following is a question an analyst should ask when performing this step?

- A. Are industry sales growing rapidly or slowly?
- B. Do earnings include revenues that appear mismatched with the business model employed by the firm?
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10. An example of an intangible asset is

- A. a patent
- B. land
- C. investment in another company
- D. raw material inventory

11. Which of the following would **not** appear as a liability on the balance sheet?

- A. a labor contract
- B. a note due to a bank
- C. salary due employees at year-end
- D. accounts payable

12. Which of the following assets would appear on the balance sheet at an amount greatly below its fair market value?
- A. inventory
 - B. marketable securities
 - C. equipment
 - D. brand name
13. The accrual basis of accounting recognizes
- A. revenue when cash is received from customers
 - B. expenses when paid
 - C. revenue when all or a substantial portion is performed
 - D. revenue when contracts are signed
14. Which of the following is **not** an activity reported in the cash flows financial statement?
- A. operating
 - B. investing
 - C. manufacturing
 - D. financing
15. The accrual basis method of accounting can be best described as:
- A. The recording of transactions and adjustments so that debits equal credits.
 - B. The method that equates assets with liabilities and owners' equity.
 - C. The method that recognizes revenue when money is received.
 - D. The method that matches incurred expenses with related revenues when they are earned.
16. A value chain for an industry sets forth
- A. the layers of management the needed to be successful
 - B. sequence of activities involved in the creation, manufacture and distribution of its products.
 - C. Sequence of activities involved in a firm's research and development activities.
 - D. Whether the industry is horizontally or vertically integrated.
17. Which of the following economic characteristics is consistent with a commercial bank?
- A. Low barriers to entry.
 - B. High levels of research and development.
 - C. Low profit margin on lending activities.
 - D. Low profit margin on fee-based financial services, such as merger consulting.

18. Which of the following economic characteristics is consistent with a pharmaceutical company?

- A. Low barriers to entry.
- B. High levels of research and development.
- C. Low profit margins.
- D. Low business risk.

19. Which of the following economic characteristics is consistent with a grocery store chain?

- A. Low barriers to entry.
- B. High levels of research and development.
- C. High profit margins.
- D. Low capital intensity.

20. When attempting to identify the economic characteristics of the industry in which a particular firm participates an analyst might ask which of the following questions?

- A. Does technological change play an important role in the firm maintaining a competitive advantage?
- B. Has the firm diversified across several geographic markets?
- C. Has the firm recognized revenues at the proper time?
- D. Has the firm structured transactions to make it look more profitable than economic conditions suggest?

21. Which of the following would **not** inhibit new entrants into a market?

- A. Existing technological expertise.
- B. Large required capital investment.
- C. Lack of rivalry among current participants.
- D. Existing patented technology.

22. Current assets are defined as

- A. cash and cash equivalents.
- B. all assets expected to be quickly used by the firm.
- C. cash and other assets that the firm expects to sell or consume during the normal operating cycle of a business, usually one year.
- D. cash and other assets that the firm expects maintain for a period including the normal operating cycle of a business, usually one year.

23. Which of the following is **not** an expense of a business?

- A. Depreciation
- B. Dividends
- C. Salaries
- D. Advertising

24. Which of the following is **not** a characteristic of an extraordinary item?

- A. Material in amount.
- B. Nonrecurring.
- C. Unusual given the nature of the firm's activities.
- D. Requires a cash outflow.

25. Which of the following activities reported in the Statement of Cash Flows is **not** a financing activity?

- A. Repayment of outstanding debt.
- B. Investing in equity securities of other companies.
- C. Payment of dividends.
- D. Issuing debt.

26. What is the principal activity of security analysts?

- A. to assign credit ratings.
- B. to apply IFRS adjustments.
- C. to value firms.
- D. to assess the need for audits.

27. All of the following are the building blocks for financial statement analysis **except**:

- A. Targeting growth opportunities that diversify exchange rates, risk exposure, and political uncertainty.
- B. Describing strategies that a firm pursues to differentiate itself from competitors in order to evaluate competitive advantages, sustainability of the firm's earnings, and its risks.
- C. Evaluating the financial statements, including the accounting concepts and methods that underlie them and the quality of the information they provide.
- D. Identification of the economic characteristics of the industries and the relation of those economic characteristics to the various financial statement ratios.

28. When a firm attempting to create unique products or services for particular market niches, in order to achieve relatively high profit margins, this is best known as

- A. a quality strategy
- B. a low-cost leadership strategy
- C. a vertical integration strategy
- D. a product differentiation strategy

29. The following steps make up the steps in financial statement analysis.
1. Identify the strategies the firm pursues to gain and sustain a competitive advantage.
 2. Analyze the current profitability and risk of the firm using information in the financial statements.
 3. Value the firm.
 4. Identify the economic characteristics and competitive dynamics of the industry in which a particular firm participates.
 5. Assess the quality of the firm's financial statements and, if necessary, adjust them for such desirable characteristics as sustainability or comparability.
 6. Prepare forecasted financial statements.

Which of the following is the proper order for these interrelated sequential steps?

- A. 4,1,5,2,6,3
- B. 1,2,3,4,5,6
- C. 1,4,2,5,6,3
- D. 1,4,2,5,3,6

30. All of the following are reasons that pharmaceutical companies have higher barriers for entry than grocery stores **except**:

- A. There is lengthy government testing and approval required.
- B. Research and development is a lengthy and uncertain process.
- C. Patent protection is needed for exclusive rights.
- D. The largest asset is typically capital intensive Property, Plant and Equipment.

31. Which forces typically represent vertical competition in a value chain?

- A. potential entry and substitutes.
- B. buyer power and rivalry among existing firms
- C. supplier power and potential entry.
- D. buyer power and supplier power

32. Which forces typically represent horizontal competition in a value chain?

- A. rivalry among existing firms and supplier power.
- B. potential entry and buyer power.
- C. substitutes and potential entry.
- D. buyer power and supplier power.

33. Which of the following is an independent entity comprising 15 members and a full-time professional staff that specifies acceptable accounting principles known as the IFRS?

- A. FASB
- B. IASB
- C. SEC
- D. GAAP

34. Which two organizations are working together to harmonize financial reporting worldwide?

- A. FASB and IASB
- B. GAAP and FASB
- C. SEC and FASB
- D. EU and SEC

35. Which of these is **not** an intangible asset?

- A. trademark
- B. patent
- C. equipment
- D. goodwill

36. Extraordinary gains and losses arise from events that have all the following characteristics **except**:

- A. they are unusual given the nature of the firm's activity.
- B. they are nonrecurring.
- C. they are material in amount.
- D. they result from terminated involvement in a line of business.

37. Opinions on the effectiveness of the internal control system and the fairness of the amounts reported in the financial statements are known as:

- A. Management Discussion and Analysis.
- B. Assurance Opinions.
- C. Notes to the Financial Statements
- D. Management Assessments.

38. Which SEC form may be the best place to start learning about the economics of an industry and the particular strategy a firm has selected for competing in the industry?

- A. Form 8-K
- B. Form 10-K
- C. Form MD&A
- D. Form FSAP

39. The primary purpose of the balance sheet is to:

- A. report the current value of the business.
- B. measure the net income of a business up to a particular point in time.
- C. report the difference between cash inflows and cash outflows for the period.
- D. report the financial position of the reporting entity at a particular point in time.

40. Which financial statement would you look at to determine whether a company will be able to pay for the goods when payment is due in 30 days?

- A. statement of cash flows.
- B. statement of stockholders' equity.
- C. income statement.
- D. balance sheet.

41. Which of the following is **not** considered to be a liability?

- A. wages payable.
- B. accounts payable.
- C. notes payable.
- D. cost of goods sold.

42. Assets for a particular business might include

- A. cash, retained earnings, and accounts payable.
- B. cash, common shareholders' equity, and accounts receivable.
- C. cash, property, plant, and equipment, and accumulated other comprehensive income.
- D. cash, inventories, and goodwill.

43. The two categories of shareholders' equity usually found on the balance sheet of a corporation are

- A. contributed capital and property, plant, and equipment.
- B. retained earnings and notes payable.
- C. common stock and retained earnings.
- D. contributed capital and equity securities.

44. Which financial statement for a business would you look at to determine the company's earnings performance during an accounting period?

- A. balance sheet.
- B. income statement.
- C. statement of cash flows.
- D. the Management Assessment.

45. Accounts receivable represent:

- A. amounts which are due to stockholders.
- B. amounts which have been borrowed to finance operations.
- C. amounts which are owed to the company by its customers resulting from credit sales.
- D. amounts which are owed by the company to its suppliers for past purchases.

46. On the statement of cash flows, an amount paid for utilities would be classified as

- A. a financing activity.
- B. an operating activity.
- C. an investing activity.
- D. a noncash activity.

47. Which form does the balance sheet equation take in the United Kingdom?

- A. $\text{Noncurrent Assets} + \text{Noncurrent Liabilities} = \text{Shareholders' Equity}$
- B. $\text{Revenues} - \text{Expenses} = \text{Shareholders' Equity}$
- C. $\text{Noncurrent Assets} + [\text{Current assets} - \text{Current Liabilities}] - \text{Noncurrent Liabilities} = \text{Shareholders' Equity}$
- D. $\text{Noncurrent Assets} - \text{Current assets} = \text{Noncurrent Liabilities} - \text{Current Liabilities} + \text{Shareholders' Equity}$

48. Net income is equal to:

- A. Assets minus Liabilities
- B. Revenues and Gains minus Expenses and Losses
- C. Shareholders' Equity minus Assets
- D. Revenues and Assets minus Expenses and Liabilities

49. All of the following are principal provisions of the Sarbanes-Oxley Act of 2002 **except**:

- A. At least one member of the audit committee of the board of directors must be a "financial expert."
- B. The lead audit or coordinating partner and the reviewing partner of the public accounting firm must rotate, or change, every five years.
- C. The firm's chief executive officer and the chief financial officer must issue a statement along with the audit report stating that the financial statements and notes fairly present the operations and financial position of the firm.
- D. The FASB has oversight and enforcement authority over the SEC.

50. Why is the operating activities section of the statement of cash flows often believed to be the most important part of the statement?

- A. Because it shows the dividends that have been paid to stockholders.
- B. Because it indicates a company's ability to generate cash from sales to meet current cash payments for goods or services.
- C. Because shows the net increase or decrease in cash during the period.
- D. Because it gives the most information about how operations have been financed.

51. The tools of effective financial statement analysis are also useful for assessing whether to extend _____ to a firm, either for a short-term or for a long-term.

52. The first step in financial statement analysis is to identify the _____ of the industry in which a firm participates.

53. Another important step in financial statement analysis is to assess the quality of a firm's _____ and if necessary adjust them for such characteristics as sustainability or comparability.

54. The fourth step in financial statement analysis is using the financial statements to analyze the current _____ and _____ of the firm.

55. When identifying the strategies that a particular firm pursues to gain a competitive advantage it is important to determine if its products are designed to meet the needs of a specific market segment or are they intended for a _____.

56. The _____ sets forth the sequence of activities involved in the creation, manufacture and distribution of its products and services.

57. The higher the value added from any activity, the higher should be the _____ from engaging in that activity.

58. Normally, intense rivalries have a tendency to reduce _____.

59. The threat of new entrants is measured by whether there are entry barriers, such as capital investment, _____, patents, or regulation that inhibit new entrants.

60. The five economic attributes that are normally studied are demand, supply, manufacturing, _____, and investing and financing.

61. Obtaining a competitive advantage by being the first company to introduce new concepts or ideas is referred to as _____.

62. Resources that have the potential for providing a firm with future economic benefits are called _____.

63. Assets that do **not** represent a claim to a fixed amount of cash are called _____ assets.

64. _____ assets include the rights established by law or contract to the future use of property.

65. Labor contracts and purchase order commitments are examples of _____ contracts.

66. The residual interest in a company is referred to as _____.

67. Under the _____ basis of accounting, a firm recognizes revenue when it performs all or a substantial portion, of the services it expects to perform and receives either cash or a receivable.

68. _____ equals net income for a period plus or minus the changes in shareholders' equity accounts other than from net income and transactions with owners.

69. Statements that express all items in a particular financial statement as a percentage of some common base are called _____ statements.

70. A firm obtains cash from short and long-term _____ and from issuing preferred and

_____.

71. The _____ defines more clearly the explicit responsibility of managers for financial statements, the relation between the independent auditor and the firm audited and the kinds of services permitted and not permitted.

72. Under the Sarbanes-Oxley Act _____ assumes responsibility for establishing and maintaining adequate internal control structure and procedures.

73. Most financial statement analysis aims to assess a firm's _____ and

_____.

74. _____ financial statements are helpful in highlighting the relative magnitude of changes in financial statement data from year to year.

75. Basic EPS is calculated as net income minus _____ divided by the weighted average number of shares outstanding.

76. Firms intending to issue new bonds or capital stock file a _____ with the SEC that describes the offering.

77. _____ relates to the relative number of buyers and sellers in a particular industry.

78. How easily can new firms enter a market is a question one might ask when assessing _____.

79. How easily can customers switch to substitute products is a question one might ask when assessing the _____.

80. Nonmonetary assets include assets that are _____, such as inventories, and assets that are _____ such as brand names.

81. What are the six interconnected activities related to financial statement analysis?

82. What is an industry's value chain?

83. When assessing the threat of new entrants what questions might an analyst ask about an industry?

84. What three financial statements are prepared by business firms and what information does each provide?

85. Many people view the balance sheet as being a representation of a firm's economic position. What are some issues that reduce the quality of this representation?

86. Under the Sarbanes-Oxley Act of 2002, financial statements must include both a Management Assessment and an Assurance Opinion. What information do the Management Assessment and an Assurance Opinion provide to financial statement users?

87. What are three activities reported in the statement of cash flows and what information does each activity provide?

88. What is comprehensive income?

89. What is the rationale for the statement of cash flows?

90. Many market participants argue that financial markets are efficient and that financial statement users cannot routinely analyze financial statements to find mispriced securities. This view would lead some to suggest that there is little value to financial statement analysis.

Required:

Provide a discussion of the role of financial statement analysis in an efficient capital market and reasons why financial statement analysis is still valuable.

91. Prepare an analysis of the automobile manufacturing industry using Porter's five forces framework. For **each** component force provide support for your conclusion. In addition, at the completion of your analysis provide a conclusion, along with support, of whether **you** expect the automobile industry to report high or low profitability in the near future.

92. Prepare an analysis of the grocery industry using Porter's Five Forces framework. For **each** component force provide support for your conclusion. In addition, at the completion of your analysis provide a conclusion, along with support, of whether **you** expect the grocery industry to report high or low profitability in the near future.

93. Tremble Company manufactures outdoors wear for women. During 2009, the company reported the following items that affected cash.

Required:

Indicate whether each of these items is a cash flow from operating activities (O), investing activities (I), or financing activities (F).

- ☐ A. Paid cash for supplies
- ☐ B. Purchased equipment by paying cash
- ☐ C. Collected cash on account from customers
- ☐ D. Paid dividends to stockholders
- ☐ E. Paid suppliers for fabric
- ☐ F. Borrowed money from a bank on a long-term note
- ☐ G. Paid interest to bank on the note
- ☐ H. Paid wages to employees
- ☐ I. Sold shares of common stock to new stockholders

94. During 2011, Waggoner Company performed services for which customers paid or promised to pay \$587,000. Of this amount, \$552,000 had been collected by year end. Waggoner paid \$340,000 in cash for employee wages and owed the employees \$15,000 at the end of the year for work that had been done but had not paid for. Waggoner paid interest expense of \$3,000 and \$195,000 for other service expenses. The income tax rate was 35%, and income taxes had not yet been paid at the end of the year. Waggoner declared and paid dividends of \$20,000. There were no other events that affected cash.

Required:

1. What was the amount of the increase or decrease in cash during the year?
2. Prepare an income statement for Waggoner for the year (December 31 year-end).

95. The following selected financial data pertain to four companies: a hotel, a travel agency, a meat packing company and a pharmaceutical company.

Required: Match each with the financial information and explain why you made your choice as you did.

Balance Sheet Data (component percentages)	Company 1	Company 2	Company 3	Company 4
Cash	7.2	22.0	6.0	11.2
Accounts Receivable	28.0	40.0	3.4	23.0
Inventory	21.4	0.5	0.9	27.4
Property, Plant & Equipment	32.0	19.0	75.1	25.0
Income Statement Data (component percentages)				
Gross Profit	15.2	Not Applicable	Not Applicable	44.0
Profit before Taxes	1.8	3.3	2.5	7.0
Ratios				
Current ratio (over the last five years)	1.6	1.3	0.5	1.8
Inventory turnover ratio	27.8	Not Applicable	Not Applicable	3.4
Debt-to-equity ratio	1.8	2.3	5.8	1.4

96. Nickel Industries reported the following amounts on its balance sheet on December 31, 2011:

Cash	\$180,000
Notes payable	100,000
Inventory	325,000
Contributed Capital	750,000
Net Property, Plant & Equipment	600,000
Accounts Receivable	30,000
Accounts Payable	75,000
Retained Earnings	?

Required:

1. What is the amount of Nickel's total assets at the end of 2011?
2. Identify the items listed above that are liabilities.
3. What is the amount of Nickel's retained earnings at the end of 2011?
4. Prepare a balance sheet for Nickel Industries using U.S. GAAP as of December 31, 2011.
5. Nickel Industries wishes to purchase merchandise from your company on account. The amount of the purchases would probably be about \$11,000 per month, and the terms would require Nickel to make payment in full within 30 days. Would you recommend that your company grant credit to Nickel under these terms? Explain the reasoning for your response.

97. Comparative financial statement data for Donovan Company and Maltese Company, two competitors in the same industry, appear below. All balance sheet data are as of December 31, 2012, and December 31, 2011.

	Donovan Company	Maltese Company	
	2012	2011	2011
Net sales	\$1,549,035		
Cost of goods sold	1,080,490		
Operating expenses	302,275		
Interest expense	8,980		
Income tax expense	54,500		
Current Assets	325,975	312,410	879,467
Common Stock, \$10 par	500,000	500,000	1120,000
Retained earnings	173,460	146,595	328,998
Non-current liabilities	108,500	90,000	225,000

Current liabilities	65,325	75,815	330,281
			5
			3
			4
			8

REQUIRED:

- (a) Prepare a common-size 2012 income statement using the data for Donovan Company and Maltese Company in columnar form.
- (b) Comment on the relative profitability of the companies by computing the return on assets (Net income/(Average total assets) and the return on total equity (Net income / (Average Shareholders' Equity) ratios for both companies.

98. Use the current asset section of the balance sheets of the El Paso Company as of January 31, 2012 and 2011 presented below to answer the questions that follow.

	2012	2011
Cash and cash equivalents	\$ 75,000	\$ 58,800
Trade accounts receivable, net	157,500	193,200
Inventory	208,200	253,400
Other current assets	18,400	15,500
Total current assets	\$ 459,100	\$ 520,900
Total assets	\$2,650,000	\$3,430,000

Required:

- (a) In the spaces provided below, complete a Percentage Change analysis of the current asset section of El Paso Company's balance sheet for 2012, using the following format to provide your answers for the amount of dollar change and the amount of percentage change, rounding "% Change" to one decimal place, e.g., 8.3%.

<u>Accounts</u>	<u>\$ Change</u>	<u>% Change</u>
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- (b) Provide a short evaluation of this analysis.

99. Comparative financial statements for Larson Company, prepared on December 31 are shown below:

Income Statement	2012	2011
Sales revenue	\$190,000	\$167,000
Cost of goods sold	<u>112,000</u>	<u>100,000</u>
Gross profit	78,000	67,000
Operating expenses and interest expense	<u>56,000</u>	<u>53,000</u>
Pretax income	22,000	14,000
Income tax	<u>8,000</u>	<u>4,000</u>
Net income	<u>14,000</u>	<u>10,000</u>
 Balance Sheet		
Cash	\$4,000	\$7,000
Accounts receivable (net)	14,000	18,000
Inventory	40,000	34,000
Operational assets (net)	<u>45,000</u>	<u>38,000</u>
	<u>103,000</u>	<u>97,000</u>
Current liabilities (no interest)	\$16,000	\$17,000
Long-term liabilities (10% interest)	45,000	45,000
Common stock (par \$5)	30,000	30,000
Retained earnings	<u>12,000</u>	<u>5,000</u>
	<u>103,000</u>	<u>97,000</u>

Required:

Assume that one-third of sales are on credit and that cash dividends of \$3,000 were declared and paid in 2012. Then, complete a percentage change income statement and a percentage change balance sheet for the company, using both amount and percentage changes from 2011 to 2012.

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- D. Low business risk.

19. Which of the following economic characteristics is consistent with a grocery store chain?

- A. Low barriers to entry.**
- B. High levels of research and development.
- C. High profit margins.
- D. Low capital intensity.

20. When attempting to identify the economic characteristics of the industry in which a particular firm participates an analyst might ask which of the following questions?

- A. Does technological change play an important role in the firm maintaining a competitive advantage?**
- B. Has the firm diversified across several geographic markets?
- C. Has the firm recognized revenues at the proper time?
- D. Has the firm structured transactions to make it look more profitable than economic conditions suggest?

21. Which of the following would **not** inhibit new entrants into a market?

- A. Existing technological expertise.
- B. Large required capital investment.
- C. Lack of rivalry among current participants.**
- D. Existing patented technology.

22. Current assets are defined as

- A. cash and cash equivalents.
- B. all assets expected to be quickly used by the firm.
- C. cash and other assets that the firm expects to sell or consume during the normal operating cycle of a business, usually one year.**
- D. cash and other assets that the firm expects maintain for a period including the normal operating cycle of a business, usually one year.

23. Which of the following is **not** an expense of a business?

- A. Depreciation
- B. Dividends**
- C. Salaries
- D. Advertising

24. Which of the following is **not** a characteristic of an extraordinary item?

- A. Material in amount.
- B. Nonrecurring.
- C. Unusual given the nature of the firm's activities.
- D.** Requires a cash outflow.

25. Which of the following activities reported in the Statement of Cash Flows is **not** a financing activity?

- A. Repayment of outstanding debt.
- B.** Investing in equity securities of other companies.
- C. Payment of dividends.
- D. Issuing debt.

26. What is the principal activity of security analysts?

- A. to assign credit ratings.
- B. to apply IFRS adjustments.
- C.** to value firms.
- D. to assess the need for audits.

27. All of the following are the building blocks for financial statement analysis **except**:

- A.** Targeting growth opportunities that diversify exchange rates, risk exposure, and political uncertainty.
- B. Describing strategies that a firm pursues to differentiate itself from competitors in order to evaluate competitive advantages, sustainability of the firm's earnings, and its risks.
- C. Evaluating the financial statements, including the accounting concepts and methods that underlie them and the quality of the information they provide.
- D. Identification of the economic characteristics of the industries and the relation of those economic characteristics to the various financial statement ratios.

28. When a firm attempting to create unique products or services for particular market niches, in order to achieve relatively high profit margins, this is best known as

- A. a quality strategy
- B. a low-cost leadership strategy
- C. a vertical integration strategy
- D.** a product differentiation strategy

29. The following steps make up the steps in financial statement analysis.
1. Identify the strategies the firm pursues to gain and sustain a competitive advantage.
 2. Analyze the current profitability and risk of the firm using information in the financial statements.
 3. Value the firm.
 4. Identify the economic characteristics and competitive dynamics of the industry in which a particular firm participates.
 5. Assess the quality of the firm's financial statements and, if necessary, adjust them for such desirable characteristics as sustainability or comparability.
 6. Prepare forecasted financial statements.

Which of the following is the proper order for these interrelated sequential steps?

- A. 4,1,5,2,6,3
- B. 1,2,3,4,5,6
- C. 1,4,2,5,6,3
- D. 1,4,2,5,3,6

30. All of the following are reasons that pharmaceutical companies have higher barriers for entry than grocery stores **except**:

- A. There is lengthy government testing and approval required.
- B. Research and development is a lengthy and uncertain process.
- C. Patent protection is needed for exclusive rights.
- D. The largest asset is typically capital intensive Property, Plant and Equipment.

31. Which forces typically represent vertical competition in a value chain?

- A. potential entry and substitutes.
- B. buyer power and rivalry among existing firms
- C. supplier power and potential entry.
- D. buyer power and supplier power

32. Which forces typically represent horizontal competition in a value chain?

- A. rivalry among existing firms and supplier power.
- B. potential entry and buyer power.
- C. substitutes and potential entry.
- D. buyer power and supplier power.

33. Which of the following is an independent entity comprising 15 members and a full-time professional staff that specifies acceptable accounting principles known as the IFRS?

- A. FASB
- B.** IASB
- C. SEC
- D. GAAP

34. Which two organizations are working together to harmonize financial reporting worldwide?

- A.** FASB and IASB
- B. GAAP and FASB
- C. SEC and FASB
- D. EU and SEC

35. Which of these is **not** an intangible asset?

- A. trademark
- B. patent
- C.** equipment
- D. goodwill

36. Extraordinary gains and losses arise from events that have all the following characteristics **except**:

- A. they are unusual given the nature of the firm's activity.
- B. they are nonrecurring.
- C. they are material in amount.
- D.** they result from terminated involvement in a line of business.

37. Opinions on the effectiveness of the internal control system and the fairness of the amounts reported in the financial statements are known as:

- A. Management Discussion and Analysis.
- B.** Assurance Opinions.
- C. Notes to the Financial Statements
- D. Management Assessments.

38. Which SEC form may be the best place to start learning about the economics of an industry and the particular strategy a firm has selected for competing in the industry?

- A. Form 8-K
- B.** Form 10-K
- C. Form MD&A
- D. Form FSAP

39. The primary purpose of the balance sheet is to:

- A. report the current value of the business.
- B. measure the net income of a business up to a particular point in time.
- C. report the difference between cash inflows and cash outflows for the period.
- D.** report the financial position of the reporting entity at a particular point in time.

40. Which financial statement would you look at to determine whether a company will be able to pay for the goods when payment is due in 30 days?

- A. statement of cash flows.
- B. statement of stockholders' equity.
- C. income statement.
- D.** balance sheet.

41. Which of the following is **not** considered to be a liability?

- A. wages payable.
- B. accounts payable.
- C. notes payable.
- D.** cost of goods sold.

42. Assets for a particular business might include

- A. cash, retained earnings, and accounts payable.
- B. cash, common shareholders' equity, and accounts receivable.
- C. cash, property, plant, and equipment, and accumulated other comprehensive income.
- D.** cash, inventories, and goodwill.

43. The two categories of shareholders' equity usually found on the balance sheet of a corporation are

- A. contributed capital and property, plant, and equipment.
- B. retained earnings and notes payable.
- C.** common stock and retained earnings.
- D. contributed capital and equity securities.

44. Which financial statement for a business would you look at to determine the company's earnings performance during an accounting period?

- A. balance sheet.
- B.** income statement.
- C. statement of cash flows.
- D. the Management Assessment.

45. Accounts receivable represent:

- A. amounts which are due to stockholders.
- B. amounts which have been borrowed to finance operations.
- C.** amounts which are owed to the company by its customers resulting from credit sales.
- D. amounts which are owed by the company to its suppliers for past purchases.

46. On the statement of cash flows, an amount paid for utilities would be classified as

- A. a financing activity.
- B.** an operating activity.
- C. an investing activity.
- D. a noncash activity.

47. Which form does the balance sheet equation take in the United Kingdom?

- A. $\text{Noncurrent Assets} + \text{Noncurrent Liabilities} = \text{Shareholders' Equity}$
- B. $\text{Revenues} - \text{Expenses} = \text{Shareholders' Equity}$
- C.** $\text{Noncurrent Assets} + [\text{Current assets} - \text{Current Liabilities}] - \text{Noncurrent Liabilities} = \text{Shareholders' Equity}$
- D. $\text{Noncurrent Assets} - \text{Current assets} = \text{Noncurrent Liabilities} - \text{Current Liabilities} + \text{Shareholders' Equity}$

48. Net income is equal to:

- A. Assets minus Liabilities
- B.** Revenues and Gains minus Expenses and Losses
- C. Shareholders' Equity minus Assets
- D. Revenues and Assets minus Expenses and Liabilities

49. All of the following are principal provisions of the Sarbanes-Oxley Act of 2002 **except**:

- A. At least one member of the audit committee of the board of directors must be a "financial expert."
- B. The lead audit or coordinating partner and the reviewing partner of the public accounting firm must rotate, or change, every five years.
- C. The firm's chief executive officer and the chief financial officer must issue a statement along with the audit report stating that the financial statements and notes fairly present the operations and financial position of the firm.
- D.** The FASB has oversight and enforcement authority over the SEC.

50. Why is the operating activities section of the statement of cash flows often believed to be the most important part of the statement?

- A. Because it shows the dividends that have been paid to stockholders.
- B. Because it indicates a company's ability to generate cash from sales to meet current cash payments for goods or services.**
- C. Because shows the net increase or decrease in cash during the period.
- D. Because it gives the most information about how operations have been financed.

51. The tools of effective financial statement analysis are also useful for assessing whether to extend _____ to a firm, either for a short-term or for a long-term.

credit

52. The first step in financial statement analysis is to identify the _____ of the industry in which a firm participates.

economic characteristics

53. Another important step in financial statement analysis is to assess the quality of a firm's _____ and if necessary adjust them for such characteristics as sustainability or comparability.

financial statements

54. The fourth step in financial statement analysis is using the financial statements to analyze the current _____ and _____ of the firm.

profitability, risk or risk, profitability

55. When identifying the strategies that a particular firm pursues to gain a competitive advantage it is important to determine if its products are designed to meet the needs of a specific market segment or are they intended for a _____.

broader consumer market

56. The _____ sets forth the sequence of activities involved in the creation, manufacture and distribution of its products and services.

value chain

57. The higher the value added from any activity, the higher should be the _____ from engaging in that activity.

profitability

58. Normally, intense rivalries have a tendency to reduce _____.

profitability

59. The threat of new entrants is measured by whether there are entry barriers, such as capital investment, _____, patents, or regulation that inhibit new entrants.

technological expertise

60. The five economic attributes that are normally studied are demand, supply, manufacturing, _____, and investing and financing.

marketing

61. Obtaining a competitive advantage by being the first company to introduce new concepts or ideas is referred to as _____.

first mover advantage

62. Resources that have the potential for providing a firm with future economic benefits are called _____.

assets

63. Assets that do **not** represent a claim to a fixed amount of cash are called _____ assets.

nonmonetary

64. _____ assets include the rights established by law or contract to the future use of property.

Intangible

65. Labor contracts and purchase order commitments are examples of _____ contracts.

executory

66. The residual interest in a company is referred to as _____.
shareholders' equity

67. Under the _____ basis of accounting, a firm recognizes revenue when it performs all or a substantial portion, of the services it expects to perform and receives either cash or a receivable.
accrual

68. _____ equals net income for a period plus or minus the changes in shareholders' equity accounts other than from net income and transactions with owners.
Comprehensive income

69. Statements that express all items in a particular financial statement as a percentage of some common base are called _____ statements.
common size

70. A firm obtains cash from short and long-term _____ and from issuing preferred and _____.
borrowing, common stock

71. The _____ defines more clearly the explicit responsibility of managers for financial statements, the relation between the independent auditor and the firm audited and the kinds of services permitted and not permitted.
Sarbanes-Oxley Act of 2002

72. Under the Sarbanes-Oxley Act _____ assumes responsibility for establishing and maintaining adequate internal control structure and procedures.
management

73. Most financial statement analysis aims to assess a firm's _____ and _____.
profitability, risk or risk, profitability

74. _____ financial statements are helpful in highlighting the relative magnitude of changes in financial statement data from year to year.

Percentage change

75. Basic EPS is calculated as net income minus _____ divided by the weighted average number of shares outstanding.

dividends on preferred stock

76. Firms intending to issue new bonds or capital stock file a _____ with the SEC that describes the offering.

prospectus

77. _____ relates to the relative number of buyers and sellers in a particular industry.

Buyer power

78. How easily can new firms enter a market is a question one might ask when assessing _____.

threats of new entrants

79. How easily can customers switch to substitute products is a question one might ask when assessing the _____.

threat of substitutes

80. Nonmonetary assets include assets that are _____, such as inventories, and assets that are _____ such as brand names.

tangible, intangible

81. What are the six interconnected activities related to financial statement analysis?

1. Identify the economic characteristics of the industry in which a firm participates.
2. Identify the strategies that a particular firm pursues to gain and sustain a competitive advantage.
3. Assess the quality of a firm's financial statements and, if necessary, adjust them for such desirable characteristics such as sustainability or comparability.
4. Analyze the current profitability and risk of the firm using information in the financial statements.
5. Prepare forecasted financial statements.
6. Value the particular firm.

82. What is an industry's value chain?

An industry's value chain is the sequence of activities involved in the creation, manufacture and distribution of its products and services.

83. When assessing the threat of new entrants what questions might an analyst ask about an industry?

1. How easily can new firms enter the market?
2. Do new firms require a large capital investment?
3. Do new firms require large amounts of technological expertise?
4. Does regulation inhibit new firms from entering the market?

84. What three financial statements are prepared by business firms and what information does each provide?

1. Balance sheet--Point in time reporting of assets, liabilities and stockholders' equity.
2. Income statement--Measurement of operating performance for a period of time.
3. Statement of cash flows--The net cash flows for a period of time from the three business activities: operating, investing and financing.

85. Many people view the balance sheet as being a representation of a firm's economic position. What are some issues that reduce the quality of this representation?

1. Many valuable resources of a firm that generate cash flows, such as a patent, will only appear as assets if acquired, not when they are internally developed.
2. Nonmonetary assets appear at acquisition cost, even though their current market values might exceed acquisition cost.
3. Certain rights to use resources and commitments to make future payments may not appear as assets and liabilities.
4. Noncurrent liabilities appear at the present value of expected cash flows discounted at an interest rate determined when the liability arose, not at the current rate.

86. Under the Sarbanes-Oxley Act of 2002, financial statements must include both a Management Assessment and an Assurance Opinion. What information do the Management Assessment and an Assurance Opinion provide to financial statement users?

The *Management Assessment* makes explicit management's responsibility for not only the financial statements but for the underlying accounting and control system that generates the financial statements.

The *Assurance Opinion* is provided by the independent auditor and is included with the opinion on the fairness of the amounts reported in the financial statements. The *Assurance Opinion* provides the auditor's opinion on the effectiveness of the internal control system.

87. What are three activities reported in the statement of cash flows and what information does each activity provide?

1. Operating activities - Provides information on cash generated and used by a firm in its normal activities of selling goods and providing services.
2. Investing activities - Provides information about the firm's use of cash in the acquisition of long-lived productive assets and cash provided by the disposal of long-lived productive assets. In addition, cash provided and used by investment in debt and equity securities are included in this category.
3. Financing activities - Provides information about cash provided and used by short- and long-term borrowing and from issuing or repurchasing capital stock. In addition, cash used for dividends is reported in this category.

88. What is comprehensive income?

Comprehensive income equals net income for a period plus or minus the changes in shareholders' equity accounts other than from net income and transactions with owners. Items affecting comprehensive income include foreign currency translation adjustments, cash flow hedge accounting, minimum pension liability adjustments and unrealized gains and losses from holding investment securities classified as available for sale.

89. What is the rationale for the statement of cash flows?

The statement of cash flows provides information on the sources and uses of cash. Even profitable firms sometimes find themselves in need of cash and unable to pay suppliers, employees, and other creditors. This may occur for two reasons:

1. The timing of cash receipts from customers does not necessarily coincide with the recognition of revenue, and the timing of cash expenditures does not necessarily coincide with the recognition of expenses under the accrual basis of accounting.

Normally cash expenditures precede the recognition of expenses and cash receipts occur after the recognition of revenue.

2. The firm may need to acquire new property, plant, and equipment; retire outstanding debt; or reacquire shares of its common stock when there is insufficient cash available.

90. Many market participants argue that financial markets are efficient and that financial statement users cannot routinely analyze financial statements to find mispriced securities. This view would lead some to suggest that there is little value to financial statement analysis.

Required:

Provide a discussion of the role of financial statement analysis in an efficient capital market and reasons why financial statement analysis is still valuable.

1. Even if markets are perfectly efficient, someone must do the analysis to bring about appropriate prices.
2. A finding that the market is efficient on average does not preclude temporary mispricing of securities. Financial analysis can identify specific mispriced securities.
3. Research has shown that equity markets are not perfectly efficient, financial analysis has uncovered anomalies.
4. Financial analysis can adjust financial statements for the biases related to managers' preference of job security and compensation.
5. Financial analysis is valuable outside to the equity capital markets.

91. Prepare an analysis of the automobile manufacturing industry using Porter's five forces framework. For **each** component force provide support for your conclusion. In addition, at the completion of your analysis provide a conclusion, along with support, of whether **you** expect the automobile industry to report high or low profitability in the near future.

Buyer Power--HIGH--It appears that consumers are sensitive to price as many manufacturers have similar offerings in each auto product class. In addition, cars are a large part of most consumers budget. Working against high buyer power is brand loyalty and control of the distribution channel.

Supplier Power--LOW--Given auto makers size it is likely that these companies exert significant influence over suppliers, leading to low supplier power.

Rivalry among existing firms--HIGH--There is intense rivalry among auto firms, which is evidenced by heavy advertising. In addition, the market is mature so additional market share must come from other competitors leading to intense competition.

Threat of new entrants--MEDIUM--While entirely new auto companies are rare, non-U.S. companies entering the U.S. market is more common. Kia and Hyundai are companies that have recently started competing in the U.S. market.

Threat of substitutes--MEDIUM/LOW--It is doubtful that many U.S. consumers are going to switch to mass transit or bicycles due to the logistics of the U.S., however one threat to auto manufacturers is used cars. As cars become more reliable and longer lasting many consumers may switch from purchasing new cars to used.

92. Prepare an analysis of the grocery industry using Porter's Five Forces framework. For **each** component force provide support for your conclusion. In addition, at the completion of your analysis provide a conclusion, along with support, of whether **you** expect the grocery industry to report high or low profitability in the near future.

Suggested solution:

You may want to have students think about grocery chains different strategies. For example, Wal-Mart and Kroger's seem to be attempting to be the low cost providers (fewer brand choices, less service, less attractive stores), while Whole Foods and Harris Teeter are attempting to be full service providers (many brands, nicer looking stores, more services).

Here is a suggested solution for the Wal-mart/Kroger grocery segment:

Buyer Power--HIGH--It appears that consumers are sensitive to price as many grocery chains have similar offerings in each grocery chain. There is a high level of discounting so consumers do not appear to be brand loyal. However, many grocery chains offer additional discounts to frequent buyers or members which increase brand loyalty.

Supplier Power--MEDIUM to LOW--Given that there are fewer grocery chains, due to consolidation and bankruptcies it is likely that these companies exert more and more influence over suppliers, leading to low supplier power.

Rivalry among existing firms--HIGH--There is intense rivalry among grocery chains, which is evidenced by heavy advertising and discounting/coupons. In addition, the market is mature so additional market share must come from other competitors leading to intense competition.

Threat of new entrants--MEDIUM--There have been very few new U.S. grocery chains started, however there does appear to be more non-U.S. companies entering the U.S. market. Ahold, Tesco and Aldi are foreign companies that have recently started competing in the U.S. market.

Threat of substitutes--MEDIUM/LOW--With the rise of the Whole Foods segment many consumers are going upscale to obtain better services in exchange for higher prices. The general state of the economy plays an important role in how substitutes are viewed when examining the Wal-Mart/ Kroger segment of the grocery industry.

93. Tremble Company manufactures outdoors wear for women. During 2009, the company reported the following items that affected cash.

Required:

Indicate whether each of these items is a cash flow from operating activities (O), investing activities (I), or financing activities (F).

- _____ A. Paid cash for supplies
- _____ B. Purchased equipment by paying cash
- _____ C. Collected cash on account from customers
- _____ D. Paid dividends to stockholders
- _____ E. Paid suppliers for fabric
- _____ F. Borrowed money from a bank on a long-term note
- _____ G. Paid interest to bank on the note
- _____ H. Paid wages to employees
- _____ I. Sold shares of common stock to new stockholders

- A. O
- B. I
- C. O
- D. F
- E. O
- F. F
- G. O
- H. O
- I. F

94. During 2011, Waggoner Company performed services for which customers paid or promised to pay \$587,000. Of this amount, \$552,000 had been collected by year end. Waggoner paid \$340,000 in cash for employee wages and owed the employees \$15,000 at the end of the year for work that had been done but had not paid for. Waggoner paid interest expense of \$3,000 and \$195,000 for other service expenses. The income tax rate was 35%, and income taxes had not yet been paid at the end of the year. Waggoner declared and paid dividends of \$20,000. There were no other events that affected cash.

Required:

1. What was the amount of the increase or decrease in cash during the year?
2. Prepare an income statement for Waggoner for the year (December 31 year-end).

1. $\$552,000 - \$340,000 - \$3,000 - \$195,000 - \$20,000 = \$6,000$ decrease in cash

2.

Waggoner Company
Income Statement
For the Year Ended December 31, 2011
(in dollars)

Revenues:		
Service Revenues	\$587,000	\$587,000
Expenses:		
Wages Expense	355,000	
Service Expense	195,000	
Interest Expense	3,000	
Total Expenses		553,000
Pretax Income		34,000
Income Tax Expense		11,900
Net Income		\$22,100

95. The following selected financial data pertain to four companies: a hotel, a travel agency, a meat packing company and a pharmaceutical company.

Required: Match each with the financial information and explain why you made your choice as you did.

Balance Sheet Data (component percentages)	Company 1	Company 2	Company 3	Company 4
Cash	7.2	22.0	6.0	11.2
Accounts Receivable	28.0	40.0	3.4	23.0
Inventory	21.4	0.5	0.9	27.4
Property, Plant & Equipment	32.0	19.0	75.1	25.0
Income Statement Data (component percentages)				
Gross Profit	15.2	Not Applicable	Not Applicable	44.0
Profit before Taxes	1.8	3.3	2.5	7.0
Ratios				
Current ratio (over the last five years)	1.6	1.3	0.5	1.8
Inventory turnover ratio	27.8	Not Applicable	Not Applicable	3.4
Debt-to-equity ratio	1.8	2.3	5.8	1.4

Company 1: Meat packing company (high inventory turnover)

Company 2: Travel agency (no gross profit and essentially no inventory, but has high receivables)

Company 3: Hotel (high property & equipment, but no gross profit or essentially no inventory)

Company 4: Pharmaceutical company (high gross profit, but low inventory turnover and low debt)

96. Nickel Industries reported the following amounts on its balance sheet on December 31, 2011:

Cash	\$180,000
Notes payable	100,000
Inventory	325,000
Contributed Capital	750,000
Net Property, Plant & Equipment	600,000
Accounts Receivable	30,000
Accounts Payable	75,000
Retained Earnings	?

Required:

1. What is the amount of Nickel's total assets at the end of 2011?
2. Identify the items listed above that are liabilities.
3. What is the amount of Nickel's retained earnings at the end of 2011?
4. Prepare a balance sheet for Nickel Industries using U.S. GAAP as of December 31, 2011.
5. Nickel Industries wishes to purchase merchandise from your company on account. The amount of the purchases would probably be about \$11,000 per month, and the terms would require Nickel to make payment in full within 30 days. Would you recommend that your company grant credit to Nickel under these terms? Explain the reasoning for your response.

1. Total assets = \$325,000 + 180,000 + 600,000 + 30,000 = \$1,135,000

2. Liabilities: Accounts payable and Notes payable.

3. Assets = Liabilities + Shareholders' Equity

$\$1,135,000 = (100,000 + 75,000 + \text{Shareholders' Equity})$

Stockholders' equity = \$960,000 = Contributed Capital + Retained Earnings

$\$750,000 + \text{Retained Earnings} = \$960,000$

Retained Earnings = \$210,000

Nickel Industries		
Balance Sheet		
As of Fiscal Year End December 31, 2011 (in dollars)		
Assets		
Cash	\$180,000	
Accounts Receivable	30,000	
Inventory	325,000	
Net Property, Plant & Equipment	600,000	
Total Assets		\$1,135,000
Liabilities		
Accounts Payable	\$75,000	
Notes Payable	100,000	
Total Liabilities		\$175,000
Shareholders' Equity		
Contributed Capital	\$750,000	
Retained Earnings	210,000	
Total Shareholders' Equity		960,000
Total Liabilities and Shareholders' Equity		\$1,135,000

5. The balance sheet of Nickel Industries shows that the company is capable of paying its short-term liabilities. There is cash of \$180,000, which is more than enough to settle the accounts payable of \$75,000. Therefore the recommendation should be made that your company grants credit to Nickel Industries.

97. Comparative financial statement data for Donovan Company and Maltese Company, two competitors in the same industry, appear below. All balance sheet data are as of December 31, 2012, and December 31, 2011.

	Donovan Company	Maltese Company	
	2012	2011	2011
Net sales	\$1,549,035		
Cost of goods sold	1,080,490		
Operating expenses	302,275		
Interest expense	8,980		
Income tax expense	54,500		
Current Assets	325,975	312,410	879,467
Common Stock, \$10 par	500,000	500,000	1120,000
Retained earnings	173,460	146,595	328,998
Non-current liabilities	108,500	90,000	225,000

Current liabilities	65,325	75,815	30,281

REQUIRED:

- (a) Prepare a common-size 2012 income statement using the data for Donovan Company and Maltese Company in columnar form.
- (b) Comment on the relative profitability of the companies by computing the return on assets (Net income/(Average total assets) and the return on total equity (Net income / (Average Shareholders' Equity) ratios for both companies.

	Donovan Company Condensed Income Statement For the Year Ended December 31, 2012	Maltese Company Condensed Income Statement For the Year Ended December 31, 2012		
	Dollars	%	Dollars	%
Net sales	\$1,549,035	100.0%	\$339,038	100.0%
Cost of goods sold	1,080,490	69.8%	241,000	71.1%
Gross Profit	468,545	30.2%	98,038	28.9%
Operating Expenses	302,275	19.5%	79,000	23.3%
Income from operations	166,270	10.7%	19,038	5.6%
Other income and expense:				
Interest expense	8,980	0.6%	2,252	0.7%
Income before income taxes	157,290	10.1%	16,786	4.9%
Income tax expense	54,500	3.5%	6,650	1.9%
Net income	\$102,790	6.6%	\$10,136	3.0%

(b) Donovan Company appears to be more profitable. It has higher relative gross profit, income from operations, income before taxes, and net income.

Donovan's return on total assets of 12.4% ($\$102,790 \div \$829,848$)^a is higher than Maltese's return on total assets of 4.7% ($\$10,136 \div \$214,172$)^b. Also, Donovan's return on total equity of 15.6% ($\$102,720 \div \$660,028$)^c is higher than Maltese's return on total equity of 6.6% ($\$10,136 \div \$154,047$)^d.

Calculations:

^a $\$102,790$ is Donovan's 2012 net income. Donovan's 2012 average total assets are calculated as:

	ASSETS	= LIABILITIES+Shareholders' EQUITY
2012	(TOTAL ASSETS - 325,975)	= (108,500+65,325) + (500,000 + 173,460)
	TOTAL ASSETS	= <u>\$847,285</u>
2011	(TOTAL ASSETS - 312,410)	= (90,000+75,815) + (500,000 + 146,595)
	TOTAL ASSETS	= <u>\$812,410</u>
	AVERAGE TOTAL ASSETS	= $\$1,659,695 \div 2 =$ <u>\$829,848</u>

^b $\$10,136$ is Maltese's 2012 net income. Maltese's 2012 average total assets are calculated as:

	ASSETS	= LIABILITIES + Shareholders' EQUITY
2012	(TOTAL ASSETS - 83,336)	= (29,620+35,348) + (120,000+ 38,096)
	TOTAL ASSETS	= <u>\$223,064</u>
2011	(TOTAL ASSETS - 79,467)	= (25,000+30,281) + (120,000+ 29,998)
	TOTAL ASSETS	= <u>\$205,279</u>
	AVERAGE TOTAL ASSETS	= $\$428,343 \div 2 =$ <u>\$214,172</u>

98. Use the current asset section of the balance sheets of the El Paso Company as of January 31, 2012 and 2011 presented below to answer the questions that follow.

	2012	2011
Cash and cash equivalents	\$ 75,000	\$ 58,800
Trade accounts receivable, net	157,500	193,200
Inventory	208,200	253,400
Other current assets	18,400	15,500
Total current assets	\$ 459,100	\$ 520,900
Total assets	\$2,650,000	\$3,430,000

Required:

(a) In the spaces provided below, complete a Percentage Change analysis of the current asset section of El Paso Company's balance sheet for 2012, using the following format to provide your answers for the amount of dollar change and the amount of percentage change, rounding "% Change" to one decimal place, e.g., 8.3%.

Accounts \$ Change % Change

(b) Provide a short evaluation of this analysis.

(a)

	\$ Change	% Change
Cash and cash equivalents	\$ 16,200	27.6%
Trade accounts receivable, net	(35,700)	(18.5%)
Inventory	(45,200)	(17.8%)
Other current assets	2,900	18.7%
Total current assets	(61,800)	(11.9%)

(b) El Paso Company experienced a large gain in cash and cash equivalents, which indicates the company is more liquid than the previous accounting period. Accounts receivable decreased, perhaps as a result of decreased sales or better collections by the credit department. The increase in other current assets is also large, although compared to the dollar amount of cash, is not as significant. Inventory declined which could mean goods are moving faster, which in turn generates additional sales. Overall, the decline in total current assets may indicate a need for the company to seek out investment opportunities for cash that is not immediately needed in operations.

99. Comparative financial statements for Larson Company, prepared on December 31 are shown below:

Income Statement	2012	2011
Sales revenue	\$190,000	\$167,000
Cost of goods sold	<u>112,000</u>	<u>100,000</u>
Gross profit	78,000	67,000
Operating expenses and interest expense	<u>56,000</u>	<u>53,000</u>
Pretax income	22,000	14,000
Income tax	<u>8,000</u>	<u>4,000</u>
Net income	<u>14,000</u>	<u>10,000</u>

Balance Sheet		
Cash	\$4,000	\$7,000
Accounts receivable (net)	14,000	18,000
Inventory	40,000	34,000
Operational assets (net)	<u>45,000</u>	<u>38,000</u>
	<u>103,000</u>	<u>97,000</u>
Current liabilities (no interest)	\$16,000	\$17,000
Long-term liabilities (10% interest)	45,000	45,000
Common stock (par \$5)	30,000	30,000
Retained earnings	<u>12,000</u>	<u>5,000</u>
	<u>103,000</u>	<u>97,000</u>

Required:

Assume that one-third of sales are on credit and that cash dividends of \$3,000 were declared and paid in 2012. Then, complete a percentage change income statement and a percentage change balance sheet for the company, using both amount and percentage changes from 2011 to 2012.

	2012	2011	Amount	%
Income Statement				
Sales revenue	\$190,000	\$167,000	\$23,000	13.77
Cost of goods sold	<u>112,000</u>	<u>100,000</u>	<u>12,000</u>	<u>12.00</u>
Gross profit	78,000	67,000	11,000	16.42
Operating expenses and interest expense	<u>56,000</u>	<u>53,000</u>	<u>3,000</u>	<u>5.66</u>
Pretax income	22,000	14,000	8,000	57.14
Income tax	<u>8,000</u>	<u>4,000</u>	<u>4,000</u>	<u>100.00</u>
Net income	<u>14,000</u>	<u>10,000</u>	<u>\$ 4,000</u>	<u>40.00</u>
Balance Sheet				
Cash	\$ 4,000	\$ 7,000	(\$3,000)	(42.86)
Accounts receivable (net)	14,000	18,000	(4,000)	(22.22)
Inventory	40,000	34,000	(6,000)	17.65
Operational assets (net)	<u>45,000</u>	<u>38,000</u>	<u>7,000</u>	<u>18.42</u>
Total Assets	<u>103,000</u>	<u>97,000</u>	<u>\$ 6,000</u>	<u>6.19</u>
Current liabilities (no interest)	\$ 16,000	\$17,000	(\$1,000)	(5.88)
Long-term liabilities (10% interest)	45,000	45,000	0	0
Common stock (par \$5)	30,000	30,000	0	0
Retained earnings	<u>12,000</u>	<u>5,000</u>	<u>7,000</u>	<u>140.00</u>
Total Liabilities and Shareholders' Equity	<u>103,000</u>	<u>97,000</u>	<u>\$ 6,000</u>	<u>6.19</u>