Exam

Name___________________________________

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

1) Accounting standards vary around the world, and that makes comparing the financial results of firms located in different countries quite challenging. 1) ________

2) GAAP refers to the generally accepted accounting principles used by all international public companies for the reporting of financial results. 2) ________

3) Many countries have adopted a system of accounting principles known as international financial reporting standards (IFRS). 3) ________

4) Financial statements are accounting reports issued by a firm periodically (usually quarterly and annually) that present past information and a snapshot of the firm's financial position. 4) ________

5) The Securities and Exchange Commission (SEC) is the federal regulatory body in the United States that requires publicly listed companies to provide their stockholders with an annual stockholders' report. Similar listing authorities exist around the world. 5) ________

6) The income statement is a financial summary of the firm's operating results during a specified period while the balance sheet is a summary statement of the firm's financial position at a given point in time. 6) ________

7) Common stock dividends paid to stockholders are equal to the earnings available for common stockholders divided by the number of shares of common stock outstanding. 7) ________

8) Earnings per share represents amount earned during the period on each outstanding share of common stock. 8) ________

9) Earnings per share results from dividing earnings available for common stockholders by the number of shares of common stock authorized. 9) ________

10) Paid-in capital in excess of par refers to the amount of proceeds in excess of the par value received from the original sale of common stock. 10) ________

11) Paid-in capital in excess of par represents the firm's book value received from the original sale of common stock. 11) ________

12) Net fixed assets represent the difference between gross fixed assets and the total expense recorded for the depreciation over then entire lives of the firm's fixed assets. 12) ________

13) Retained earnings represent the cumulative total of all earnings retained and reinvested in the firm since its inception. 13) ________

14) The balance sheet is a statement which balances the firm's assets (what it owns) against its financing (debt or equity). 14) ________

15) The amount paid in by the original purchasers of common stock is shown by two entries in the firm's balance sheet—common stock and paid-in capital in excess of par on common stock. 15) ______

16) The original price per share received by the firm on a single issue of common stock is equal to the sum of the common stock and paid-in capital in excess of par accounts divided by the number of shares outstanding. 16) ______

17) The statement of cash flows reconciles the net income earned during a given year, and any cash dividends paid, with the change in retained earnings between the start and end of that year. 17) ______

18) The statement of cash flows provides insight into the firm's assets and liabilities and reconciles them with changes in its cash and marketable securities during the period of concern. 18) ______

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

19) The rule-setting body that has established independent standards for financial reporting, adopted by many countries around the world in recent years, is 19) ______

A) IASB. B) GAAP.
C) Federal Reserve System. D) SEC.

20) Accounting practices and procedures used to prepare financial statements are called 20) ______

A) SEC. B) IFRS. C) FASB. D) IRB.

21) The stockholder's annual report must include 21) ______

A) a statement of stockholders' equity.
B) an income statement.
C) a statement of cash flows.
D) a balance sheet.
E) all of the above.

22) The ________ provides a financial summary of the firm's operating results during a specified period. 22) ______

A) statement of cash flows B) income statement
C) statement of retained earnings D) balance sheet

23) Total assets less net fixed assets equals 23) ______

A) liabilities and equity. B) depreciation.
C) gross assets. D) current assets.

24) Gross profits are defined as 24) ______

A) operating profits minus depreciation.
B) sales revenue minus cost of goods sold.
C) sales revenue minus operating expenses.
D) operating profits minus cost of goods sold.

25) Operating profits are defined as 25) ______

A) gross profits minus operating expenses.
B) earnings before depreciation and taxes.
C) sales revenue minus depreciation expense.
D) sales revenue minus cost of goods sold.

26) Net profits after taxes are defined as 26) ______
A) sales revenue minus cost of goods sold.
B) gross profits minus operating expenses.
C) EBIT minus interest.
D) operating profits minus interest expense and taxes.

27) Operating profits are defined as 27) ______
A) earnings before interest and taxes.
B) earnings before depreciation and taxes.
C) earnings after tax.
D) sales revenue minus cost of goods sold.

28) Earnings available to common shareholders are defined as net profits 28) ______
A) after taxes minus preferred dividends.
B) before taxes.
C) after taxes minus common dividends.
D) after taxes.

29) All of the following are examples of current assets EXCEPT 29) ______
A) accounts receivable.
B) accruals.
C) inventory.
D) cash.

30) All of the following are examples of fixed assets EXCEPT 30) ______
A) equipment.
B) automobiles.
C) marketable securities.
D) buildings.

31) All of the following are examples of current liabilities EXCEPT 31) ______
A) accruals.
B) notes payable.
C) accounts payable.
D) accounts receivable.

32) The net value of fixed assets is also called its 32) ______
A) par value.
B) market value.
C) book value.
D) price.

33) The ________ represents a summary statement of the firm's financial position at a given point in time. 33) ______
A) balance sheet
B) statement of cash flows
C) statement of retained earnings
D) income statement

34) The ________ summarizes the firm's funds flow over a given period of time 34) ______
A) statement of retained earnings
B) balance sheet
C) statement of cash flows
D) income statement

35) The statement of cash flows may also be called the 35) ______
A) funds statement.
B) statement of retained earnings.
C) bank statement.
D) sources and uses statement.

36) Retained earnings on the balance sheet represents 36) ______
A) net profits after taxes minus preferred dividends.
B) the cumulative total of earnings reinvested in the firm.
C) net profits after taxes.
D) cash.

37) The statement of retained earnings reports all of the following EXCEPT 37) ______

A) preferred stock dividends.
B) interest.
C) common stock dividends.
D) net profits after taxes.

38) A firm had the following accounts and financial data for 2013 38) ______

Sales Revenue	$3,060	Cost of goods sold	$1,800
Accounts Receivable	500	Preferred stock dividends	18
Interest expense	126	Tax rate	40%
Total oper. expenses	600	Number of shares of common	1,000
Accounts payable	240	stocks outstanding	

The firm's earnings available to common shareholders for 2013 were ________.

A) US$516.60
B) US$302.40
C) US$195.40
D) -US$224.25

39) A firm had the following accounts and financial data for 2013: 39) ______

Sales Revenue	$3,060	Cost of goods sold	$1,800
Accounts receivable	500	Preferred stock dividends	18
Interest expense	126	Tax rate	40%
Total operating expenses	600	Number of common shares	1,000
Accounts payable	240	outstanding	

The firm's earnings per share, rounded to the nearest cent, for 2013 was ________.

A) US$0.5125
B) US$0.3204
C) US$0.5335
D) US$0.3024

40) A firm had the following accounts and financial data for 2013. 40) ______

Sales Revenue	$3,060	Cost of goods sold	$1,800
Accounts receivable	500	Preferred stock dividends	18
Interest expense	126	Tax rate	40%
Total operating expenses	600	Number of common shares	1,000
Accounts payable	240	outstanding	

The firm's net profit after taxes for 2013 was ________.

A) US$206.25
B) US$320.40
C) US$213.80
D) -US$206.40

41) On the balance sheet net fixed assets represent 41) ______

A) gross fixed assets at market value minus depreciation expense.
B) gross fixed assets at cost minus accumulated depreciation.
C) gross fixed assets at market value minus accumulated deprecation.
D) gross fixed assets at cost minus depreciation expense.

42) Paid-in-capital in excess of par represents the amount of proceeds 42) ______

A) at the current book value of common stock.
B) in excess of the par value from the original sale of common stock.
C) from the original sale of stock.
D) at the current market value of common stock.

43) Firm ABC had operating profits of US$100,000, taxes of US$17,000, interest expense of US$34,000 and preferred dividends of US$5,000. What was the firm's net profit after taxes? 43) ______

A) US$66,000 B) US$83,000 C) US$49,000 D) US$44,000

44) Khalil Corporation had pretax profits of US$1.2 million, an average tax rate of 34 percent, and it paid preferred stock dividends of US$50,000. There were 100,000 shares outstanding and no interest expense. What were Khalil Corporation's earnings per share? 44) ______

A) US$3.91 B) US$4.52 C) US$7.59 D) US$7.42

45) A corporation had year end 2012 and 2013 retained earnings balances of US$320,000 and US$400,000, respectively. The firm reported net profits after taxes of US$100,000 in 2013. The firm paid dividends in 2013 of ________. 45) ______

A) US$20,000 B) US$0 C) US$80,000 D) US$100,000

46) A corporation had a year end 2012 retained earnings balance of US$220,000. The firm reported net profits after taxes of US$50,000 in 2013 and paid dividends in 2013 of US$30,000. The firm's retained earnings balance at year end 2013 was ________. 46) ______

A) US$270,000 B) US$300,000 C) US$250,000 D) US$240,000

47) A firm had year end 2010 and 2011 retained earnings balance of US$670,000 and US$560,000, respectively. The firm reported net profits after taxes of US$100,000 in 2011. The firm paid dividends in 2011 of ________. 47) ______

A) US$100,000 B) US$10,000 C) US$110,000 D) US$210,000

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

48) Ag Silver Mining, Inc. has US$500,000 of earnings before interest and taxes at the year end. Interest expenses for the year were US$10,000. The firm expects to distribute US$100,000 in dividends. Calculate the earnings after taxes for the firm assuming a 40 percent tax on ordinary income.

49) At the end of 2013, the Long Life Light Bulb Company announced it had produced a gross profit of US$1 million. The company has also established that over the course of this year it has incurred US$345,000 in operating expenses and US$125,000 in interest expenses. The company is subject to a 30% tax rate and has declared US$57,000 total preferred stock dividends.

(a) How much is the earnings available for common stockholders?

(b) Compute the increased retained earnings for 2013 if the company were to declare a US$4.25 common stock dividend. The company has 15,000 shares of common stock outstanding.

50) Reliable Auto Parts has 5,000 shares of common stock outstanding. The company also has the following amounts in revenue and expense accounts.

Sales revenue	US$ 85,000
General and administrative expense	7,500
Interest expense	3,500
Depreciation expense	5,000
Preferred stock dividends	500
Selling expense	4,000
Cost of goods sold	50,000

Calculate
(a) gross profits.
(b) operating profits.
(c) net profits before taxes.
(d) net profits after taxes (assume a 40 percent tax rate).
(e) cash flow from operations.
(f) earnings available to common stockholders.
(g) earnings per share.

51) Casablanca Furniture's net profits before taxes for 2012 totaled US$354,000. The company's total retained earnings were US$338,000 for 2011 year end and US$389,000 for 2012 year end. Casablanca is subject to a 26 percent tax rate. How large was the cash dividend declared by Casablanca Furniture in 2012?

52) On December 31, 2012, the Basim Corporation had US$485,000 as an ending balance for its retained earnings account. During 2013, the corporation declared a US$3.50/share dividend to its stockholders. The Basim Corporation has 35,000 shares of common stock outstanding. When the books were closed for 2013 year end, the corporation had a final retained earnings balance of US$565,000. What was the net profit earned by Basim Corporation during 2013?

53) The Sunshine Company had a retained earnings balance of US$850,000 at the beginning of 2011. By the end of 2011, the company's retained earnings balance was US$950,000. During 2011, the company earned US$245,000 as net profits after paying its taxes. The company was then able to pay its preferred stockholders US$45,000. Compute the common stock dividend per share in 2011 assuming 10,000 shares of common stock outstanding.

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

Table 2.1

Balance Sheet ACE (Amman Computer Enterprises) December 31, 2012			
Cash	US$4,500	Accounts Payable	US$10,000
Accounts Receivable		Notes Payable	
Inventory		Accruals	1,000
Total Current Assets		Total Current Liabilities	
Net Fixed Assets		Long-Term Debt	
Total Assets		Stockholders' Equity	
		Total Liabilities & S.E.	

Information (2012 values)

1. Sales totaled US$110,000
2. The gross profit margin was 25 percent.
3. Inventory turnover was 3.0.
4. There are 360 days in the year.
5. The average collection period was 65 days.
6. The current ratio was 2.40.
7. The total asset turnover was 1.13.
8. The debt ratio was 53.8 percent.

54) Inventory for ACE in 2012 was ________. (See Table 2.1) 54) ______

A) US$27,500 B) US$36,667 C) US$ 9,167 D) US$32,448

55) Notes payable for ACE in 2012 was ________. (See Table 2.1) 55) ______

A) US$ 10,609 B) US$113,466 C) US$ 52,372 D) US$ 41,372

56) Accounts receivable for ACE in 2012 was ________. (See Table 2.1) 56) ______

A) US$18,333 B) US$19,861 C) US$14,056 D) US$14,895

57) Net fixed assets for ACE in 2012 were ________. (See Table 2.1) 57) ______

A) US$69,341 B) US$45,484 C) US$54,511 D) US$48,975

58) Total assets for ACE in 2012 were ________. (See Table 2.1) 58) ______

A) US$ 97,345 B) US$124,300 C) US$ 45,895 D) US$ 58,603

59) Long-term debt for ACE in 2012 was ________. (See Table 2.1) 59) ______

A) US$30,763 B) US$10,608 C) US$52,372 D) US$41,372

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

60) Time-series analysis is the evaluation of the firm's financial performance in comparison to other firm(s) at the same point in time. 60) ______

61) As a rule, the necessary inputs to an effective financial analysis include, at minimum, the income statement and the statement of cash flow. 61) ______

62) The firm's creditors are primarily interested in the short-term liquidity of the company and its ability to make interest and principal payments. 62) _______

63) Cross-sectional ratio analysis involves comparing the firm's ratios to those of firms in other industries at the same point in time. 63) _______

64) Benchmarking is a type of cross-sectional analysis in which the firm's ratio values are compared to those of firms in other industries, primarily to identify areas for improvement. 64) _______

65) Time-series analysis evaluates performance of firms at the same point in time using financial ratios. 65) _______

66) Benchmarking is a type of time-series analysis in which the firm's ratio values are compared to those of a key competitor or group of competitors, primarily to isolate areas of opportunity for improvement. 66) _______

67) Ratio analysis merely directs the analyst to potential areas of concern; it does not provide conclusive evidence as to the existence of a problem. 67) _______

68) In a cross-sectional comparison of firms operating in several lines of business, the industry average ratios of any of the firm's product lines may be used to analyze the multiproduct firm's financial performance. 68) _______

69) Due to inflationary effects, inventory costs and depreciation write-offs can differ from their true values, thereby distorting profits. 69) _______

70) In ratio analysis, the financial statements being used for comparison should be dated at the same point in time during the year. If not, the effect of seasonality may produce erroneous conclusions and decisions. 70) _______

71) The use of the audited financial statements for ratio analysis may not be preferable because there may be no reason to believe that the data contained in them reflect the firm's true financial condition. 71) _______

72) Both present and prospective shareholders are interested in the firm's current and future level of risk and return. These two dimensions directly affect share price. 72) _______

73) The comparison of a particular ratio to the standard (industry average) is made in order to isolate any deviations from the norm. In the case of ratios for which higher values are preferred, as long as the firm that is being analyzed has a value in excess of the industry average it can be viewed favorably. 73) _______

74) The use of differing accounting treatments—especially relative to inventory and depreciation—can distort the results of ratio analysis, regardless of whether cross-sectional or time-series analysis is used. 74) _______

75) Inflationary effects typically have a greater impact the larger the differences in the age of the assets of the firms being compared. Without adjustment, inflation tends to cause older firms (with older fixed assets) to appear more efficient and profitable than newer firms (with newer fixed assets). 75) _______

76) Present and prospective shareholders and lenders pay close attention to the firm's degree of indebtedness and ability to repay debt. Shareholders are concerned since the claims of creditors must be satisfied prior to the distribution of earnings to them. Lenders are concerned since the more indebted the firm, the higher the probability that the firm will be unable to satisfy the claims of all its creditors. 76) ______

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

77) Ratios provide a ________ measure of a company's performance and condition. 77) ______

A) qualitative B) definitive C) gross D) relative

78) ________ analysis involves the comparison of different firms' financial ratios at the same point in time. 78) ______

A) Marginal B) Time-series C) Quantitative D) Cross-sectional

79) ________ analysis involves comparison of current to past performance and the evaluation of developing trends. 79) ______

A) Quantitative B) Time-series C) Cross-sectional D) Marginal

80) The primary concern of creditors when assessing the strength of a firm is the firm's 80) ______

A) share price. B) leverage.
C) short-term liquidity. D) profitability.

81) Present and prospective shareholders are mainly concerned with a firm's 81) ______

A) liquidity. B) leverage. C) risk and return. D) profitability.

82) To analyze the firm's financial performance, the following types of ratio analyses EXCEPT ________ may be used. 82) ______

A) cross-section analysis B) marginal analysis
C) time-series analysis D) combined analysis

83) Time-series analysis is often used to 83) ______

A) reflect performance relative to some norm.
B) standardize results.
C) correct errors of judgment.
D) assess developing trends.

84) In ratio analysis, a comparison to a standard industry ratio is made to isolate ________ deviations from the norm. 84) ______

A) any B) positive C) standard D) negative

85) ________ evidence of the existence of a problem or outstanding management performance is provided by ratio analysis. 85) ______

A) Conclusive B) Definitive C) Complete D) Inconclusive

86) The analyst should be careful when conducting ratio analysis to ensure that 86) ______
A) audited statements are used.
B) the overall performance of the firm is not judged on a single ratio.
C) the same accounting procedures were used.
D) the dates of the financial statements being compared are the same.
E) all of the above.

87) The analyst should be careful when evaluating a ratio analysis that 87) ______
A) pre-audited statements are used.
B) the dates of the financial statements being compared are the same time.
C) neither A nor B.
D) both A and B.

88) ________ is where the firm's ratio values are compared to those of a key competitor or group of competitors, primarily to identify areas for improvement. 88) ______
A) Combined analysis B) Benchmarking
C) Time-series analysis D) None of the above

89) Cross-sectional ratio analysis is used to 89) ______
A) isolate the causes of problems.
B) reflect the symptoms of a possible problem.
C) provide conclusive evidence of the existence of a problem.
D) correct expected problems in operations.

90) Inflation can distort 90) ______
A) inventory costs. B) cost of goods sold.
C) salaries and wages. D) interest write-offs.

91) Without adjustment, inflation may tend to cause ________ firms to appear more efficient and profitable than ________ firms, all else being the same. 91) ______
A) older; newer B) large; smaller C) newer; older D) smaller; larger

92) The following groups of ratios primarily measure risk. 92) ______
A) liquidity, activity, and profitability B) activity, debt, and profitability
C) liquidity, activity, and common stock D) liquidity, activity, and debt

93) The ________ ratios are primarily measures of return. 93) ______
A) debt B) activity C) liquidity D) profitability

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

94) Discuss the limitations of ratio analysis and the cautions which must be taken when reviewing a cross-sectional and time-series analysis.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

95) The liquidity of a business firm refers to the solvency of the firm's overall financial position. 95) ______

96) The liquidity of a business firm is measured by its ability to satisfy its long-term obligations as they come due. 96) ______

97) The current ratio provides a better measure of overall liquidity only when a firm's inventory cannot easily be converted into cash. If inventory is liquid, the quick ratio is a preferred measure of overall liquidity. 97) ______

98) The average age of inventory is viewed as the average length of time inventory is held by the firm or as the average number of days' sales in inventory. 98) ______

99) Total asset turnover commonly measures the liquidity of a firm's total assets. 99) ______

100) The average age of inventory can be calculated as inventory divided by 365. 100) ______

101) The average age of inventory can be calculated as inventory turnover divided by 365. 101) ______

102) The average age of inventory can be calculated as 365 divided by inventory turnover. 102) ______

103) The average payment period can be calculated as accounts payable divided by average sales per day. 103) ______

104) The average payment period can be calculated as accounts payable divided by average purchases per day. 104) ______

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

105) The ________ of a business firm is measured by its ability to satisfy its short-term obligations as they come due. 105) ______

A) activity B) debt C) liquidity D) profitability

106) ________ ratios are a measure of the speed with which various accounts are converted into sales or cash. 106) ______

A) Profitability B) Activity C) Liquidity D) Debt

107) The ________ is useful in evaluating credit and collection policies. 107) ______

A) average payment period
B) average collection period
C) current asset turnover
D) current ratio

108) The ________ measures the activity, or liquidity, of a firm's inventory. 108) ______

A) inventory turnover
B) quick ratio
C) average collection period
D) current ratio

109) The two basic measures of liquidity are 109) ______

A) current ratio and total asset turnover.
B) inventory turnover and current ratio.
C) current ratio and quick ratio.
D) gross profit margin and ROE.

110) The ________ is a measure of liquidity which excludes ________, generally the least liquid asset. 110) ______

A) current ratio; inventory
B) quick ratio; accounts receivable
C) quick ratio; inventory
D) current ratio; accounts receivable

111) The ________ ratio may indicate the firm is experiencing stockouts and lost sales. 111) ______

A) quick
B) average payment period
C) inventory turnover
D) average collection period

112) The ________ ratio may indicate poor collections procedures or a lax credit policy. 112) ______

A) quick
B) inventory turnover
C) average payment period
D) average collection period

113) ABC Corp. extends credit terms of 45 days to its customers. Its credit collection would likely be considered poor if its average collection period was 113) ______

A) 57 days.
B) 47 days.
C) 30 days.
D) 36 days.

114) ________ are especially interested in the average payment period, since it provides them with a sense of the bill-paying patterns of the firm. 114) ______

A) Lenders and suppliers
B) Customers
C) Borrowers and buyers
D) Stockholders

115) A firm has a current ratio of 1; in order to improve its liquidity ratios, this firm might 115) ______

A) improve its collection practices and pay accounts payable, thereby decreasing current liabilities and increasing the current and quick ratios.
B) decrease current liabilities by utilizing more long-term debt, thereby increasing the current and quick ratios.
C) increase inventory, thereby increasing current assets and the current and quick ratios.
D) improve its collection practices, thereby increasing cash and increasing its current and quick ratios.

116) As a firm's cash flows become more predictable, 116) ______

A) the current ratio should expand.
B) the return on equity should increase.
C) current assets should decrease.
D) current liabilities should decrease.

117) If the inventory turnover is divided into 365, it becomes a measure of 117) ______

A) sales turnover.
B) the average collection period.
C) the average age of the inventory.
D) sales efficiency.

118) The ________ is useful in evaluating credit and collection policies. 118) ______

A) average collection period
B) current asset turnover
C) average payment period
D) current ratio

119) The two categories of ratios that should be utilized to assess a firm's true liquidity are the 119) ______

A) current and quick ratios.
B) liquidity and debt ratios.
C) liquidity and activity ratios.
D) liquidity and profitability ratios.

120) A firm with a total asset turnover that is lower than industry standard but with a current ratio which meets industry standard must have excessive 120) ______

A) debt.
B) inventory.
C) accounts receivable.
D) fixed assets.

121) A firm with a total asset turnover lower than industry standard may have 121) ______

A) excessive cost of goods sold.
B) insufficient sales.
C) insufficient fixed assets.
D) excessive debt.

122) If Nico Corporation has cost of goods sold of US$300,000 and inventory of US$30,000, then the inventory turnover is ________ and the average age of inventory is ________. 122) ______

A) 10; 36.5 B) 36.0; 10 C) 10; 36.0 D) 36.5; 10

123) If Nico Corporation has annual purchases of US$300,000 and accounts payable of US$30,000, then average purchases per day are ________ and the average payment period is ________. 123) ______

A) 821.9; 36.5 B) 36.0; 833.3 C) 833.3; 36.0 D) 36.5; 821.9

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

124) The magnification of risk and return introduced through the use of fixed-cost financing such as debt and preferred stock is called financial leverage. 124) ______

125) The less fixed-cost debt (financial leverage) a firm uses, the greater will be its risk and return. 125) ______

126) The higher the value of the times interest earned ratio, the higher the proportion of the firm's interest income compared to its contractual interest payments. 126) ______

127) In general, the more debt (other people's money) a firm uses in relation to its assets, the smaller its financial leverage. 127) ______

128) The lower the fixed-payment coverage ratio, the lower is the firm's financial leverage. 128) ______

129) The higher the debt ratio, the more financial leverage a firm has and, thus, the greater will be its risk and return. 129) ______

130) Typically, higher coverage ratios are preferred, but too high a ratio may indicate under-utilization of fixed-payment obligations, which may result in unnecessarily low risk and return. 130) ______

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

131) The ________ ratio measures the proportion of total assets financed by the firm's creditors. 131) ______

A) total asset turnover
B) current
C) debt
D) fixed asset turnover

132) The ________ ratio measures the firm's ability to pay contractual interest payments. 132) ______

A) average payment period
B) fixed-payment coverage
C) debt
D) times interest earned

133) The ________ ratio may indicate that the firm will not be able to meet interest obligations due on outstanding debt. 133) ______

A) times interest earned
B) return on total assets
C) debt
D) net profit margin

134) The higher the value of ________ ratio, the better able the firm is to fulfill its interest obligations. 134) ______

A) debt
B) average payment period
C) average collection period
D) times interest earned

135) ________ is a term used to describe the magnification of risk and return introduced through the use of fixed cost financing such as preferred stock and long-term debt. 135) ______

A) The acid-test
B) Financial leverage
C) Operating leverage
D) Fixed-payment coverage

136) When assessing the fixed-payment coverage ratio, 136) ______

A) the lower its value the more risky is the firm.
B) the lower its value, the lower is the firm's financial leverage.
C) the higher its value, the higher is the firm's liquidity.
D) preferred stock dividend payments can be disregarded.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

137) Gross profit margin measures the percentage of each sales amount left after the firm has paid for its goods and operating expenses. 137) ______

138) Net profit margin measures the percentage of each sales amount remaining after all costs and expenses, including interest, taxes, and preferred stock dividends, have been deducted. 138) ______

139) Earnings per share represent the dollar amount earned and distributed to shareholders. 139) ______

140) Return on total assets (ROA) measures the overall effectiveness of management in generating profits with the owners' investment in the firm. 140) ______

141) The price/earnings (P/E) ratio represents the degree of confidence that investors have in the firm's future performance. 141) ______

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

142) The ________ is a popular approach for evaluating profitability in relation to sales by expressing each item on the income statement as a percent of sales. 142) ______

A) common-size income statement
B) source and use statement
C) retained earnings statement
D) profit and loss statement

143) The ________ indicates the percentage of each sales dollar remaining after the firm has paid for its goods. 143) ______

A) net profit margin
B) earnings available to common shareholders
C) operating profit margin
D) gross profit margin

144) The ________ measures the percentage of profit earned on each sales dollar before interest and taxes. 144) ______

A) operating profit margin
B) gross profit margin
C) net profit margin
D) earnings available to common shareholders

145) The ________ measures the percentage of each sales dollar remaining after ALL expenses, including taxes, have been deducted. 145) ______

A) net profit margin
B) gross profit margin
C) earnings available to common shareholders
D) operating profit margin

146) The ________ measures the overall effectiveness of management in generating profits with its available assets. 146) ______

A) return on total assets
B) net profit margin
C) price/earnings ratio
D) return on equity

147) The ________ measures the return on owners' (both preferred and common stockholders) investment in the firm. 147) ______

A) net profit margin
B) return on equity
C) price/earnings ratio
D) return on total assets

148) The ________ ratio is commonly used to assess the owner's appraisal of the share value. 148) ______

A) debt
B) return on total assets
C) return on equity
D) price/earnings

149) Two of the frequently cited ratios of profitability that can be read directly from the common-size income statement are 149) ______

A) the gross profit margin and the earnings per share.
B) the gross profit margin and the net profit margin.
C) the gross profit margin and the return on total assets.
D) the earnings per share and the return on total assets.

150) A firm with a gross profit margin which meets industry standard and a net profit margin which is below industry standard must have excessive 150) ______

A) cost of goods sold.
B) principal payments.
C) dividend payments.
D) general and administrative expenses.

151) A firm with sales of US$1,000,000, net profits after taxes of US$30,000, total assets of US$1,500,000, and total liabilities of US$750,000 has a return on equity of 151) ______

A) 15 percent.
B) 4 percent.
C) 3 percent.
D) 20 percent.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

152) The financial leverage multiplier is the ratio of the firm's total assets to stockholders' equity. 152) ______

153) The DuPont formula allows the firm to break down its return into the net profit margin, which measures the firm's profitability on sales, and its total asset turnover, which indicates how efficiently the firm has used its assets to generate sales. 153) ______

154) The DuPont system allows the firm to break its return on equity into a profit-on-sales component, an efficiency-of-asset-use component, and a use-of-leverage component. 154) ______

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

155) The DuPont system merges the income statement and balance sheet into two summary measures of profitability 155) ______

A) net profit margin and return on equity.
B) net profit margin and return on total assets.
C) return on total assets and return on equity.
D) net profit margin and price/earning ratio.

156) ________ is used by financial managers as a structure for dissecting the firm's financial statements to assess its financial condition. 156) ______

A) Statement of cash flows
B) Cross-sectional analysis
C) A common-size income statement
D) The DuPont system of analysis

157) In the DuPont system, the return on total assets (asset) is equal to 157) ______

A) (net profit margin) × (fixed asset turnover).
B) (return on equity) × (total asset turnover).
C) (net profit margin) × (total asset turnover).
D) (return on equity) × (financial leverage multiplier).

158) The modified DuPont formula relates the firm's return on total assets (ROA) to the 158) ______

A) net profit margin.
B) total asset turnover.
C) return on equity (ROE).
D) financial leverage multiplier.

159) In the DuPont system, the return on equity is equal to 159) ______

A) (net profit margin) × (total asset turnover).
B) (return on total assets) × (financial leverage multiplier).
C) (stockholders' equity) × (financial leverage multiplier).
D) (return on total assets) × (total asset turnover).

160) A firm with a substandard net profit margin can improve its return on total assets by 160) ______

A) decreasing its fixed asset turnover.
B) increasing its debt ratio.
C) decreasing its total asset turnover.
D) increasing its total asset turnover.

161) A decrease in total asset turnover will result in ________ in the return on equity. 161) ______

A) an increase
B) an undetermined change
C) a decrease
D) no change

162) A firm with a substandard return on total assets can improve its return on equity, all else remaining the same, by 162) ______

A) decreasing its debt ratio.
B) decreasing its total asset turnover.
C) increasing its debt ratio.
D) increasing its total asset turnover.

163) The financial leverage multiplier is an indicator of how much ________ a corporation is utilizing. 163) ______

A) long-term debt
B) operating leverage
C) total assets
D) total debt

164) The financial leverage multiplier is an indicator of 164) ______

A) operating leverage.
B) current liabilities.
C) financial leverage.
D) long-term debt.

165) Using the DuPont system of analysis and holding other factors constant, an increase in financial leverage will result in ________ in the return on equity. 165) ______

A) an undetermined change
B) no change
C) an increase
D) a decrease

166) A firm with a total asset turnover lower than the industry standard and a current ratio which meets the industry standard may have 166) ______

A) excessive fixed assets.
B) excessive debt.
C) excessive accounts receivable.
D) excessive inventory.

167) A firm with a total asset turnover lower than the industry standard may have 167) ______

A) insufficient sales.
B) excessive debt.
C) insufficient fixed assets.
D) excessive cost of goods sold.

Table 2.2

Dana Dairy Products Key Ratios

	Industry Average	Actual 2012	Actual 2013
Current Ratio	1.3	1.0	
Quick Ratio	0.8	0.75	
Average collection Period	23 days	30 days	
Inventory Turnover	21.7	19	
Debt Ratio	64.7%	50%	
Times Interest Earned	4.8	5.5	
Gross Profit Margin	13.6%	12.0%	
Net Profit Margin	1.0%	0.5%	
Return on total assets	2.9%	2.0%	
Return on Equity	8.2%	4.0%	

Income Statement
Dana Dairy Products
For the Year Ended December 31, 2013

Sales Revenue	US$100,000
Less: Cost of Goods Sold	87,000
Gross Profits	$13,000
Less: Operating Expenses	11,000
Operating Profits	$2,000
Less: Interest Expense	500
Net Profits Before Taxes	$1,500
Less: Taxes (40%)	600
Net Profits After Taxes	$900

Balance Sheet
Dana Dairy Products
December 31, 2013

Assets		
Cash		US$ 1,000
Accounts Receivable		8,900
Inventories		4,350
Total Current Assets		$14,250
Gross Fixed Assets	$35,000	
Less: Accumulated Depreciation	13,250	
Net Fixed Assets		21,750
Total Assets		$36,000

Liabilities & Stockholders' Equity	
Accounts Payable	US$ 9,000
Accruals	6,675
Total Current Liabilities	$15,675
Long-term Debt	4,125
Total Liabilities	$19,800
Common Stock	1,000
Retained Earnings	15,200
Total Stockholders' Equity	$16,200
Total Liabilities & Stockholders Equity	$36,000

168) The current ratio for Dana Dairy Products in 2013 was ________. (See Table 2.2) 168) ______

A) 0.91 B) 1.10 C) 1.58 D) 0.63

169) Since 2012, the liquidity of Dana Dairy Products ________. (See Table 2.2) 169) ______

A) has improved B) has deteriorated
C) remained the same D) cannot be determined

170) The net working capital for Dana Dairy Products in 2013 was ________. (See Table 2.2) 170) ______

A) US$ 1,425 B) US$10,325 C) US$14,250 D) -US$ 1,425

171) The inventory turnover for Dana Dairy Products in 2013 was ________. (See Table 2.2) 171) ______

A) 20 B) 25 C) 5 D) 43

172) The inventory management at Dana Dairy Products ________ since 2012. (See Table 2.2) 172) ______

A) remained the same B) has improved slightly
C) has deteriorated D) cannot be determined

173) The average collection period for Dana Dairy Products in 2013 was (See Table 2.2) 173) ______

A) 35.9 days. B) 25.3 days. C) 11.8 days. D) 32.5 days.

174) If Dana Dairy Products has credit terms which specify that accounts receivable should be paid in 25 days, the average collection period ________ since 2012. (See Table 2.2) 174) ______

A) has deteriorated B) has improved
C) remained the same D) cannot be determined

175) Dana Dairy Products had a ________ degree of financial leverage than the industry standard, resulting in ________. (See Table 2.2) 175) ______

A) higher; higher return on total assets B) lower; lower return on total assets
C) lower; lower return on equity D) higher; higher return on equity

176) The debt ratio for Dana Dairy Products in 2013 was (See Table 2.2) 176) ______

A) 55 percent. B) 50 percent. C) 11 percent. D) 44 percent.

177) Dana Dairy Products' gross profit margin was inferior to the industry standard. This may have resulted from (See Table 2.2) 177) ______

A) a high sales price.
B) excessive interest expense.
C) the high cost of goods sold.
D) excessive selling and administrative expenses.

178) The gross profit margin and net profit margin for Dana Dairy Products in 2013 were (See Table 2.2) 178) ______

A) 2 percent and 0.9 percent, respectively. B) 13 percent and 1.5 percent, respectively.
C) 2 percent and 1.5 percent, respectively. D) 13 percent and 0.9 percent, respectively.

179) The return on total assets for Dana Dairy Products for 2013 was (See Table 2.2) 179) ______

A) 5.5 percent. B) 0.9 percent. C) 25 percent. D) 2.5 percent.

180) The return on equity for Dana Dairy Products for 2013 was (See Table 2.2) 180) ______

A) 5.6 percent. B) 50 percent. C) 0.6 percent. D) 0.9 percent.

181) Using the modified DuPont formula allows the analyst to break Dana Dairy Products return on equity into 3 components: the net profit margin, the total asset turnover, and a measure of leverage (the financial leverage multiplier). Which of the following mathematical expressions represents the modified DuPont formula relative to Dana Dairy Products' 2013 performance? (See Table 2.2) 181) ______

A) 2.5(ROE) = 5.6(ROA) × 0.44(Financial leverage multiplier)
B) 5.6(ROE) = 3.3(ROA) × 1.70(Financial leverage multiplier)
C) 4.0(ROE) = 2.0(ROA) × 2.00(Financial leverage multiplier)
D) 5.6(ROE) = 2.5(ROA) × 2.24(Financial leverage multiplier)

182) As the financial leverage multiplier increases this may result in 182) ______

A) a decrease in the net profit margin and return on investment, due to the decrease in interest expense as debt decreases.
B) an increase in the net profit margin and return on investment, due to the increase in interest expense as debt increases.
C) a decrease in the net profit margin and return on investment, due to the increase in interest expense as debt increases.
D) an increase in the net profit margin and return on investment, due to the decrease in interest expense as debt decreases.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

183)

Key Financial Data

Ratio (% of Sales)	Dreamscape, Inc. For the Year Ended December 31, 2012	Industry Average For the Year Ended December 31, 2013
Cost of goods sold	74.5%	70.0%
Gross profits	25.5	30.0
Selling expense	8.0	7.0
Gen. & admin. expense	5.1	4.9
Depreciation expense	2.4	2.0
Total operating expense	15.5	13.9
Operating profits	10.0	16.1
Interest expense	1.4	1.0
Net profits before taxes	8.6	15.1
Taxes	2.4	6.0
Net profits after taxes	5.2	9.1

Income Statement, Dreamscape, Inc.
For the Year Ended December 31, 2013

Sales revenue	US$1,000,000
Less: Cost of goods sold	750,000
Gross profits	$ 250,000
Less: Operating expenses	
Selling Expense	$70,000
Gen. & admin. expense	48,000
Depreciation expense	20,000
Total operating expense	$ 138,000
Operating profits	$ 112,000
Less: Interest expense	$ 20,000
Net profits before taxes	$ 92,000
Less: Taxes	$ 36,800
Net profits after taxes	$ 55,200

Prepare a common-size income statement for Dreamscape, Inc. for the year ended December 31, 2013. Evaluate the company's performance against industry average ratios and against last year's results.

184) In an effort to analyze Muscat Housing Company finances, Jalil realized that he was missing the company's net profits after taxes for the current year. Find the company's net profits after taxes using the following information.

Return on total assets = 2%
Total Asset Turnover = 0.5
Cost of Goods Sold = US$105,000
Gross Profit Margin = 0.30

185) Construct the DuPont system of analysis using the following financial data for Key Wahl Industries and determine which areas of the firm need further analysis.

Key Financial Data

Key Wahl Industries:	
Sales	US$4,500,000
Net profits after taxes	337,500
Total assets	6,750,000
Total liabilities	3,375,000
Industry Averages:	
Total asset turnover	0.71
Debt ratio	33.00%
Financial leverage multiplier	1.50
Return on total assets	6.75%
Return on equity	10.00%
Net profit margin	9.50%

186) Given the following balance sheet, income statement, historical ratios and industry averages, calculate the Pulp, Paper, and Paperboard, Inc. financial ratios for the most recent year. Analyze its overall financial situation for the most recent year. Analyze its overall financial situation from both a cross-sectional and time-series viewpoint. Break your analysis into an evaluation of the firm's liquidity, activity, debt, and profitability.

Income Statement
Pulp, Paper and Paperboard, Inc.
For the Year Ended December 31, 2013

Sales Revenue	US$2,080,976
Less: Cost of Goods Sold	1,701,000
Gross Profits	$379,976
Less: Operating Expenses	273,846
Operating Profits	$106,130
Less: Interest Expense	19,296
Net Profits Before Taxes	$86,834
Less: Taxes (40%)	34,810
Net Profits After Taxes	$52,024

Balance Sheet
Pulp, Paper and Paperboard, Inc.
December 31, 2013

Assets	
Cash	US$ 95,000
Accounts receivable	237,000
Inventories	243,000
Total current assets	$ 575,000
Gross fixed assets	500,000
Less: Accumulated depreciation	75,000
Net fixed assets	$ 425,000
Total assets	$1,000,000
Liabilities and stockholders' equity	
Current liabilities	
Accounts payable	US$ 89,000
Notes payable	169,000
Accruals	87,000
Total current liabilities	$ 345,000
Long-term debt	188,000
Total liabilities	$ 533,000
Stockholders' equity	
Common stock	255,000
Retained earnings	212,000
Total stockholders' equity	$ 467,000
Total liabilities and stockholders' equity	$1,000,000

Historical and Industry Average Ratios
Pulp, Paper and Paperboard, Inc.

Ratio	2011	2012	2013	Industry 2013
Current Ratio	1.6	1.7	-	1.6
Quick Ratio	0.9	1.0	-	0.9
Inventory Turnover	8.1	9.3	-	8.4
Average Collection Period	33 days	37 days	-	39 days
Total Asset Turnover	2.3	2.2	-	2.2
Debt Ratio	60%	56%	-	58%
Times Interest Earned	2.5	3.5	-	2.3
Gross Profit Margin	21%	19.7%	-	20.4%
Operating Profit Margin	4.7%	4.8%	-	4.7%
Net Profit Margin	1.8%	1.6%	-	1.4%
Return on total assets	4.1%	3.5%	-	3.08%
Return on Equity	10.3%	7.9%	-	7.3%

187) Complete the balance sheet for Riyadh Aviation, Inc. based on the following financial data.

Balance Sheet
Riyadh Aviation, Inc.
December 31, 2013

Assets	
Cash	US$ 8,005
Marketable securities	—
Accounts receivable	—
Inventories	—
Total current assets	—
Gross fixed assets	—
Less: Accumulated depreciation	$50,000
Net fixed assets	—
Total assets	—

Liabilities and Stockholders' Equity	
Accounts payable	US$28,800
Notes payable	—
Accruals	$18,800
Total current liabilities	—
Long-term debts	—
Total liabilities	—
Stockholders' equity	
Preferred stock	2,451
Common stock at par	30,000
Paid-in capital in excess of par	6,400
Retained earnings	90,800
Total stockholders' equity	—
Total liabilities and stockholders' equity	—

Key Financial Data (2013)

1. Sales totaled US$720,000.
2. The gross profit margin was 38.7 percent.
3. Inventory turned 6 times.
4. There are 360 days in a year.
5. The average collection period was 31 days.
6. The current ratio was 2.35.
7. The total asset turnover was 2.81.
8. The debt ratio was 49.4 percent.
9. Total current assets equal US$159,565.

1) TRUE
2) FALSE
3) TRUE
4) TRUE
5) TRUE
6) TRUE
7) FALSE
8) TRUE
9) FALSE
10) TRUE
11) FALSE
12) TRUE
13) TRUE
14) TRUE
15) TRUE
16) TRUE
17) FALSE
18) FALSE
19) A
20) B
21) E
22) B
23) D
24) B
25) A
26) D
27) A
28) A
29) B
30) C
31) D
32) C
33) A
34) C
35) D
36) B
37) B
38) B
39) D
40) B
41) B
42) B
43) C
44) D
45) A
46) D
47) D

48)

Earnings before interest and taxes	$500,000
Less: Interest	10,000
Earnings before taxes	$490,000
Less: Taxes (40%)	196,000
Earnings after taxes	$294,000

49)

(a)	Gross Profits	US$1,000,000
	Less: Operating expenses	(345,000)
	Operating Profits	$ 655,000
	Less: Interest	(125,000)
	Net Profits before taxes	$ 530,000
	Less: Taxes (30%)	(159,000)
	Net Profits After Taxes	$ 371,000
	Less: Preferred Stock Dividend	(57,000)
	Earnings Available for Common Stock	$ 314,000
(b)	Earnings Available for Common Stock	$ 314,000
	Dividend = (4.25)(15,000 shares)	(63,750)
	Increased Retained Earnings	$ 250,250

50)

(a) Sales revenue		US$85,000
- cost of goods sold		-50,000
Gross profits		$35,000
(b) Gross profits		$35,000
- operating expenses		
Selling expense	4,000	
General & adm. expense	7,500	
Depreciation expense	5,000	$16,500
Operating profits		$18,500
(c) Operating profits		$18,500
- interest expense		-3,500
Net profits before taxes		$15,000
(d) Net profits before taxes		$15,000
- taxes (40%)		-6,000
Net profits after taxes		$9,000
(e) Net profits after taxes		$9,000
+ depreciation expense		+5,000
Cash flow from operations		$14,000
(f) Net profits after taxes		$9,000
- preferred dividends		-500
earnings available for C.S.		$8,500
(g) Earnings available for C.S.		$8,500
______________________ =		= $1.70/share
# of common shares outstanding		5,000

51)

Net Profits Before Taxes	US$354,000
Less: Taxes (26%)	92,040
Net Profits After Taxes	$261,960
Retained Earnings (2011)	$338,000
Net Profits After Taxes (2012)	261,960
Dividends	X
----------------------	--------
Retained Earnings (2012)	$389,000
Dividends = $210,960	

52)

Dividends = ($3.50/share)(35,000 shares)	= $122,500
Retained Earnings (2012)	$485,000
Net Profits After Taxes (2013)	X
Dividends	122,500
---------------------	--------
Retained Earnings (2013)	$565,000
Net Profits After Taxes = $202,500	

53)

Retained Earnings (2010)	$850,000
Net Profits After Taxes (2011)	245,000
Preferred Stock Dividend	(45,000)
Common Stock Dividend	X
----------------------	--------
Retained Earnings (2011)	$950,000

Total common stock dividend = $100,000
Common stock dividend per share =100,000/10,000 = $10

54) A
55) A
56) B
57) B
58) A
59) A
60) FALSE
61) FALSE
62) TRUE
63) FALSE
64) FALSE
65) FALSE
66) FALSE
67) TRUE
68) FALSE
69) TRUE
70) TRUE
71) FALSE
72) TRUE

73) FALSE
74) TRUE
75) TRUE
76) TRUE
77) D
78) D
79) B
80) C
81) C
82) B
83) D
84) A
85) D
86) E
87) B
88) B
89) B
90) A
91) A
92) D
93) D
94) In summarizing a large number of ratios, all aspects of the firm's activities can be assessed. However, limitations of ratio analysis must be recognized. A comparison of current and past ratios may reveal mismanagement. But, the ratio does not give definitive cause to the problem. Additional investigation is necessary to confirm the possible problem. The analyst must be cautious of the following points: 1) a single ratio does not provide sufficient information to judge the overall performance of the firm, 2) the dates of the financial statements should be the same, 3) audited statements should be used, 4) similar accounting treatment of comparative data is essential, and 5) inflation and differing asset ages can distort ratio comparisons.
95) TRUE
96) FALSE
97) FALSE
98) TRUE
99) FALSE
100) FALSE
101) FALSE
102) TRUE
103) FALSE
104) TRUE
105) C
106) B
107) B
108) A
109) C
110) C
111) C
112) D
113) A
114) A
115) B
116) C

117) C
118) A
119) C
120) D
121) B
122) A
123) A
124) TRUE
125) FALSE
126) FALSE
127) FALSE
128) FALSE
129) TRUE
130) TRUE
131) C
132) D
133) A
134) D
135) B
136) A
137) FALSE
138) TRUE
139) FALSE
140) FALSE
141) TRUE
142) A
143) D
144) A
145) A
146) A
147) B
148) D
149) B
150) D
151) B
152) TRUE
153) TRUE
154) TRUE
155) C
156) D
157) C
158) C
159) B
160) D
161) C
162) C
163) D
164) C
165) C
166) A

167) A
168) A
169) B
170) D
171) A
172) B
173) D
174) A
175) C
176) A
177) C
178) D
179) D
180) A
181) D
182) C
183) Common-Size Income Statement
Dreamscape, Inc.
For the Year Ended December 31, 2013

Sales revenue		100%
Less: Cost of goods sold		75%
Gross profits		25%
Less: Operating expenses		
Selling Expense	7.0%	
Gen. & admin. expense	4.8%	
Depreciation expense	2.0%	
Total operating expense		13.8%
Operating profits		11.2%
Less: Interest expense		2.0%
Net profits before taxes		9.2%
Less: Taxes		3.68%
Net profits after taxes		5.52%

Dreamscape, Inc. performs significantly below industry average. All profitability ratios (gross profit margin, operating profit margin, and net profit margin) trail the industry norms. In 2012 expenses as a percent of sales were high. Dreamscape, Inc. improved the management of operating expenses in 2013 meeting industry averages. However, cost of goods sold as a percent of sales increased and is a full 5 percent above the industry average, further reducing the gross profit margin. Interest expense is two times the average indicating high cost of debt or a high debt level. The firm must concentrate on reducing the cost of goods sold and interest expense to improve performance.

184) Sales = CGS/(1 - GPM) = 105,000/(1 - 0.30) = US$150,000
Total Assets = Sales/(Total Asset Turnover)
= 150,000/0.50 = US$300,000
Net Profits After Taxes = (ROA) × (Total Assets)
= (0.02) × (300,000) = US$6,000

185) Ratios for Key Wahl Industries

$$\text{Total asset turnover} = \frac{4{,}500{,}000}{6{,}750{,}000} = 0.67$$

$$\text{Debt ratio} = \frac{3{,}375{,}000}{6{,}750{,}000} = 50\%$$

$$\text{Financial leverage multiplier} = \frac{1}{1 - 0.5} = 2$$

$$\text{ROA} = \frac{337{,}500}{6{,}750{,}000} = 5\%$$

ROE = ROA × Financial leverage multiplier = 10%

$$\text{Net profit margin} = \frac{337{,}500}{4{,}500{,}000} = 7.5\%$$

DuPont System of Analysis: Key Wahl Industries performs equally to industry averages according to the return on equity. However, when dissecting the financial data further into the three key components of the DuPont system (a profit-on-sale, efficiency-of-asset use, and a use-of-leverage component), some areas of improvement may be highlighted. Key Wahl Industries has a lower net profit margin and return on total assets than industry averages. Nevertheless, the firm makes up for the low profit margin through excessive use of leverage (a 50 percent debt ratio versus 33 percent for the industry). Financial risk could be reduced resulting in the same return on equity by increasing the net profit margin and reducing debt.

186)

Historical and Industry Average Ratios
Pulp, Paper and Paperboard, Inc.

Ratio	2011	2012	2013	Industry 2013
Current Ratio	1.6	1.7	1.67	1.6
Quick Ratio	0.9	1.0	0.96	0.9
Inventory Turnover	8.1	9.3	7.0	8.4
Average Collection Period	33 days	37 days	42 days	39 days
Total Asset Turnover	2.3	2.2	2.1	2.2
Debt Ratio	60%	56%	53%	58%
Times Interest Earned	2.5	3.5	5.5%	2.3
Gross Profit Margin	21%	19.7%	18.3%	20.4%
Operating Profit Margin	4.7%	4.8%	5.1%	4.7%
Net Profit Margin	1.8%	1.6%	2.5%	1.4%
Return on total assets	4.1%	3.5%	5.2%	3.08%
Return on Equity	0.3%	7.9%	11.1%	7.3%

LIQUIDITY: The liquidity of 3P is on target with the industry standard in 2013 and shows no trend since 2011.
ACTIVITY: Inventory and accounts receivable management has deteriorated since 2012 and is inferior when compared to the industry standard. The low inventory turnover may be caused by overstocking and/or obsolete inventories. The high average collection period may have resulted from poor collections procedures. Further investigation is necessary to determine the cause of the variances.
DEBT: 3P has less debt than the industry average. The trend since 2011 has been toward reducing the debt ratio. The firm, therefore, is subject to less financial risk than the average firm in the industry.
PROFITABILITY: Although the gross profit margin is inferior to the industry average, the operating and net profit margin far exceed the standards, boosting return on total assets and return on equity. The trend in the gross profit margin is unfavorable and may either be caused by a slide in product prices or an escalation in cost of sales. The cause of the poor gross profit margin should be investigated.
Overall, the firm needs to focus attention on inventory and accounts receivable management and the cause of the poor gross profit margin. In general, the firm is in good financial condition.

187) Balance Sheet
Riyadh Aviation, Inc.
December 31, 2013

Assets		
Cash		US$ 8,005
Marketable securities		16,000
Accounts receivable		62,000
Inventories		73,560
Total current assets		$159,565
Gross fixed assets	146,663	
Less: Accumulated depreciation	$50,000	
Net fixed assets		$ 96,663
Total assets		$256,228

Liabilities and Stockholders' Equity	
Current liabilities	
Accounts payable	US$28,800
Notes payable	20,300
Accruals	$18,800
Total current liabilities	$67,900
Long-term debts	58,677
Total liabilities	$126,577
Stockholders' equity	
Preferred stock	2,451
Common stock at par	30,000
Paid-in capital in excess of par	6,400
Retained earnings	90,800
Total stockholders' equity	$129,651
Total liabilities and stockholders' equity	$256,228