

Financial Statement Analysis & Valuation, 5th Edition
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Practice Quiz Solutions

Module 2 – Review of Business Activities and Financial Statements

1. Following are selected income statement and balance sheet data for companies in different industries.

\$ millions	Sales	Cost of goods sold	Gross profit	Net income	Assets	Liabilities	Equity
Harley-Davidson	\$ 5,342	\$ 3,302	\$ 2,040	\$ 960	\$ 5,255	\$ 2,171	\$ 3,084
Nike, Inc.	13,740	7,624	6,116	1,212	8,794	3,149	5,645
Starbucks Corp.	6,369	2,605	3,764	494	3,514	1,423	2,091
Target Corp.	51,271	34,927	16,344	2,408	34,995	20,790	14,205

Which company reports the highest ratio of net income to equity?

- a. Harley-Davidson
- b. Nike, Inc.
- c. Starbucks Corp.
- d. Target Corp.

Answer: a

Harley-Davidson = 31.1%; Nike = 21.5%; Starbucks = 23.6%; Target = 17.0%

Harley enjoys the highest profitability as measured by net income to equity, followed by Starbucks and Nike. These are all premium brands that have effectively differentiated their products and can, therefore, enjoy above-average returns on stockholder investment. Although Target is well run, it operates in the highly competitive retail segment where it is nearly impossible to differentiate products. Its returns on shareholder investment are the lowest of the four companies, although still above the median of 12% for all publicly traded companies.

2. Following are selected income statement and balance sheet data for companies in different industries.

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Which company has financed itself with the highest percentage of liabilities to equity?

- a. Harley-Davidson
- b. Nike, Inc.
- c. Starbucks Corp.
- d. Target Corp.

Answer: d

Harley-Davidson = 70.4%; Nike = 55.8%; Starbucks = 68.1%; Target = 146.4%

Target has the highest proportion of debt in its capital structure mostly because it has its own, proprietary credit card. The credit card industry is similar to a bank – high debt levels and relatively low margins. Target consolidates its credit card operations with those of its retail sales. This inflates Target's consolidated debt level above what we typically observe for stand-alone retail operations. Finally, companies that enjoy relatively stable cash flows can afford higher debt levels because there is some assurance that future cash flows will be sufficient to cover fixed debt payments. The other three companies operate with a greater proportion of equity than of debt.

3. Following are selected income statement accounts for Apple Inc.

(\$ millions)	
Sales	\$233,715
Cost of goods sold	<u>140,089</u>
Gross profit	93,626
Total expenses	<u>40,232</u>
Net income	<u>\$ 53,394</u>

Compute Apple's gross profit margin.

- a. 22.7%
- b. 40.0%
- c. 17.2%
- d. 11.2%

Answer: b

Gross Profit Margin = $\$93,626 / \$233,715 = 40.0\%$

4. Indicate which of the following items would be reported in the balance sheet.

- | | | |
|-------------------------|-----------------------------|---------------------|
| A. Net income | D. Accumulated depreciation | G. Interest expense |
| B. Retained earnings | E. Wages expense | H. Interest payable |
| C. Depreciation expense | F. Wages payable | I. Sales |

- a. C, E, G, I
- b. A, D, F, G
- c. B, C, E, H
- d. B, D, F, H

Answer: d

Retained earnings, Accumulated depreciation, Wages payable, and Interest payable would all be reported in the balance sheet.

5. Indicate which of the following items would be reported in the income statement.

- | | | |
|-------------------------|------------------------|---------------------|
| A. Sales | D. Accounts receivable | G. Inventories |
| B. Retained earnings | E. Dividends | H. Accounts payable |
| C. Depreciation expense | F. Cost of goods sold | I. Net income |

- a. C, E, G, I
- b. A, C, F, I
- c. B, C, E, H
- d. A, E, F, I

Answer: b

Sales, depreciation expense, Cost of goods sold, and Net income would all be reported in the income statement.

6. Daniels Company reports the following year-end account balances at December 31, 2017.

Accounts payable	\$20,000	Inventory	\$40,000
Accounts receivable	\$40,000	Land	\$100,000
Bonds payable, long-term	\$250,000	Goodwill	\$10,000
Buildings	\$160,000	Retained earnings	\$115,000
Cash	\$50,000	Sales revenue	\$500,000
Common stock	\$100,000	Supplies inventory	\$5,000
Cost of goods sold	\$200,000	Supplies expense	\$20,000
Equipment	\$80,000	Wages expense	\$100,000

What is Daniels Company's net income for 2017?

- a. \$380,000
- b. \$375,000
- c. \$180,000
- d. \$300,000

Answer: c

Sales revenue.....		\$500,000
Expenses		
Cost of goods sold	\$200,000	
Wages expense	100,000	
Supplies expense	<u>20,000</u>	
Total expenses		<u>320,000</u>
Net income.....		<u>\$180,000</u>

7. Following is selected financial information for Aiello, Inc. for the years 2017 and 2016.

(\$ millions)	2017	2016
Beginning retained earnings	\$?	\$245,870
Net income (loss)	88,030	79,980
Dividends	25,120	?
Ending retained earnings	?	290,570

What is Aiello, Inc.'s ending retained earnings balance for 2017?

- a. \$403,720
- b. \$227,660
- c. \$353,480
- d. \$290,570

Answer: c

Beginning retained earnings = Prior year's ending retaining earnings.

2017 Beginning retained earnings	\$290,570
Add Net income	88,030
Less Dividends	<u>(25,120)</u>
2017 Ending retained earnings	<u>\$353,480</u>

8. Selected balance sheet amounts for Reed Corporation for 2017 follow.

Current assets	Long-term assets	Total assets	Current liabilities	Long-term liabilities	Total liabilities	Equity
\$9,540	?	?	\$14,520	\$12,340	?	\$15,990

What is the balance sheet amount for Long-term assets?

- a. \$42,850
- b. \$33,310
- c. \$26,860
- d. \$29,500

Answer: b

Total assets = Total liabilities (current liabilities + long-term liabilities) + Equity
 $\$14,520 + \$12,340 + \$15,990 = \$42,850$ total assets - $\$9,540$ current assets
 $= \$33,310$ long-term assets

9. Foot Locker, Inc. is a retailer of athletic footwear and apparel. During a recent fiscal year, Foot Locker purchased merchandise inventory costing \$4,047 (\$ millions). Assume that Foot Locker makes all purchases on credit, and that its accounts payable is only used for inventory purchases.

The following T-accounts reflect information contained in the company's balance sheets (\$ millions).

Inventories		Accounts Payable	
Beg. Bal.	1,151	381	Beg. Bal.
End. Bal.	1,254	361	End. Bal.

What amount did Foot Locker pay in cash to its suppliers during the fiscal year?

- a. \$4,067 million
- b. \$20 million
- c. \$103 million
- d. \$381 million

Answer: a

$\$381 + 4,047 - \$361 = \text{Payments} = \$4,067$. This is the amount in cash payments derived using the information in the accounts payable account.

10. On December 31, 2016, the accounts of Leuz Architect Services showed credit balances in its Common Stock and Retained Earnings accounts of \$60,000 and \$30,000, respectively. The company's stock issuances for 2017 totaled \$12,000, and it paid \$10,000 cash dividends in 2017. During 2017, the company had net income of \$33,000.

What is the total stockholders' equity for Leuz Architect Services at December 31, 2017?

- a. \$ 72,000
- b. \$ 53,000
- c. \$125,000
- d. \$135,000

Answer: c

Leuz Architect Services Statement of Stockholders' Equity For Year Ended December 31, 2017			
	Common Stock	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2016	\$60,000	\$30,000	\$ 90,000
Stock issuance	12,000		12,000
Dividends		(10,000)	(10,000)
Net income		33,000	33,000
Balance at December 31, 2017	<u>\$72,000</u>	<u>\$53,000</u>	<u>\$125,000</u>

11. Selected T-account balances for Bloomfield Company are shown below as of January 31, 2017; accounting adjustments have already been posted. The firm uses a calendar-year accounting period but prepares *monthly* adjustments.

Truck	Accumulated Depreciation-Truck
Jan. 31 Bal. 10,200	Jan. 31 Bal. 2,040

If the truck has a useful life of five years (or 60 months), how many months has Bloomfield owned the truck?

- a. 3 months
- b. 24 months
- c. 12 months
- d. 18 months

Answer: c

Monthly depreciation expense = \$10,200 / 60 months = \$170.
 Bloomfield has owned the truck for 12 months (\$2,040 / \$170 = 12).

12. The following information is taken Aiello Corporation's fiscal 2016 annual report.

Selected Balance Sheet Data	2016	2015
Inventories.....	\$221,418	\$226,893
Accounts Receivable.....	\$121,333	\$122,087

Aiello Corporation spent \$3,296,240 to purchase and manufacture inventories during its 2016 fiscal year.

What is the cost of goods sold for Aiello's fiscal year end?

- a. \$3,301,715
- b. \$3,296,240
- c. \$3,290,765
- d. \$3,300,000

Answer: a

We calculate COGS using the opening and closing inventory balances and the purchases during the year as follows: \$226,893 + 3,296,240 - 221,418 = \$3,301,715.

13. The following information is taken Aiello Corporation's fiscal 2016 annual report.

Selected Balance Sheet Data	2016	2015
Inventories.....	\$221,418	\$226,893
Accounts Receivable.....	\$121,333	\$122,087

Assume that Aiello Corporation had \$1,003,881 sales on credit during fiscal year 2016. What amount did the company collect from credit customers during the year?

- a. \$1,003,881
- b. \$1,004,635
- c. \$1,003,127
- d. \$1,247,301

Answer: b

We calculate cash received from credit customers using the opening and closing accounts receivable balances and the credit sales during the year, as follows: $\$122,087 + 1,003,881 - 121,333 = \$1,004,635$.

14. Plumlee Corporation has the following account balances at December 31, 2017.

	Debit	Credit
Service Fees Earned		\$92,500
Interest Income		2,200
Salaries Expense	\$41,800	
Advertising Expense	4,300	
Depreciation Expense	8,700	
Income Tax Expense	9,900	
Retained Earnings		42,700

Prepare entries to close these accounts in journal entry form. Set up T-accounts for each of the ledger accounts and post the entries to them. After these entries are posted, what is the balance of the Retained Earnings account?

- a. \$ 42,700
- b. \$ 72,700
- c. \$ 12,700
- d. \$137,400

Answer: b

Dec. 31	Service Fees Earned	92,500	
	Interest Income	2,200	
	Retained Earnings		94,700
	<i>To close the revenue accounts.</i>		

Dec. 31	Retained Earnings	64,700	
	Salaries Expense		41,800
	Advertising Expense		4,300
	Depreciation Expense		8,700
	Income Tax Expense		9,900
	<i>To close the expense accounts.</i>		

Retained Earnings			
	42,700	Bal.	
(2)	64,700	94,700	(1)
		72,700	Bal.

Service Fees Earned			
(1)	92,500	92,500	Bal.
		0	Bal.

Interest Income			
(1)	2,200	2,200	Bal.
		0	Bal.

Salaries Expense			
Bal.	41,800	41,800	(2)
Bal.	0		

Advertising Expense			
Bal.	4,300	4,300	(2)
Bal.	0		

Income Tax Expense			
Bal.	9,900	9,900	(2)
Bal.	0		

Depreciation Expense			
Bal.	8,700	8,700	(2)
Bal.	0		

After the temporary accounts are closed, the balance in the Retained Earnings account is \$72,700.

15. Flex Fitness is a health and fitness club that operates gym facilities throughout the United States. Flex Fitness members pay their membership dues annually. Selected fiscal-year information from the company's balance sheets follows (\$ thousands).

Selected Balance Sheet Data	2016	2015
Deferred membership income (liability)	500,558	453,881

During fiscal 2016, Flex Fitness collected \$1,119,833 cash for membership fees.

Calculate the membership fee revenue that Flex Fitness recognized during the year.

- a. \$ 500,558 thousand
- b. \$1,166,510 thousand
- c. \$1,119,833 thousand
- d. \$1,073,156 thousand

Answer: d

We calculate membership fee income using the opening and closing deferred membership income balances and the cash received from members during the year, as follows: $\$453,881 + 1,119,833 - 500,558 = \$1,073,156$.