

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

Module 1 – Framework for Analysis and Valuation

1. Which of the following organizations does *not* contribute to the formation of GAAP?

- a. FASB (Financial Accounting Standards Board)
- b. IRS (Internal Revenue Service)
- c. AICPA (American Institute of Certified Public Accountants)
- d. SEC (Securities and Exchange Commission)

Answer: b

2. Rocky Beach reports the following dollar balances in its retained earnings account.

(\$ millions)	2017	2016
Retained earnings.....	8,968.1	8,223.9

During 2017, Rocky Beach reported net income of \$1,351.4 million. What amount of dividends, if any, did Rocky Beach pay to its shareholders in 2017?

- a. \$607.2 million
- b. No dividends paid
- c. \$301.2 million
- d. \$744.2 million

Answer: a

Computation of dividends

Beginning retained earnings, 2017	\$8,223.9
+ Net income	1,351.4
– Cash dividends.....	(?)
= Ending retained earnings, 2017	<u>\$8,968.1</u>

Thus, dividends were \$607.2 million for 2017.

3. At the beginning of a recent year, **The Walt Disney Company's** liabilities equaled \$26,197 million. During the year, assets increased by \$400 million and year-end assets equaled \$50,388 million. Liabilities decreased \$100 million during the year.

What were beginning and ending amounts for Walt Disney's equity?

- a. \$26,197 million beginning equity and \$24,291 million ending equity
- b. \$23,791 million beginning equity and \$27,042 million ending equity
- c. \$23,791 million beginning equity and \$24,291 million ending equity
- d. \$27,042 million beginning equity and \$25,183 million ending equity

Answer: c

Using the accounting equation at the *beginning* of the year:

$$\begin{aligned} \text{Assets}(\$50,388 - \$400) &= \text{Liabilities}(\$26,197) + \text{Equity}(?) \\ \text{Thus: Beginning Equity} &= \underline{\$23,791} \end{aligned}$$

Using the accounting equation at the *end* of the year:

$$\begin{aligned} \text{Assets}(\$50,388) &= \text{Liabilities}(\$26,197 - \$100) + \text{Equity}(?) \\ \text{Thus: Ending Equity} &= \underline{\$24,291} \end{aligned}$$

4. Assume that **Starbucks** reported net income for a recent year of \$564 million. Its stockholders' equity is \$2,229 million and \$2,090 million, respectively.

Compute its return on equity.

- a. 13.0%
- b. 22.8%
- c. 26.1%
- d. 32.7%

Answer: c

$$\begin{aligned} \text{ROE} &= \text{Net income} / \text{Average stockholders' equity} \\ &= \$564 \text{ million} / [(\$2,229 \text{ million} + \$2,090 \text{ million}) / 2] = 26.1\% \end{aligned}$$

5. **Nokia** manufactures, markets, and sells phones and other electronics. Assume that Nokia reported net income of €3,582 on sales of €34,191 and total stockholders' equity of €14,576 and €14,871, respectively.

What is Nokia's return on equity?

- a. 24.3%
- b. 42.3%
- c. 17.7%
- d. 10.5%

Answer: a

Return on equity is net income divided by the average total stockholders' equity.
Nokia's ROE: $\text{€}3,582 / [(\text{€}14,576 + \text{€}14,871) / 2] = 24.3\%$.

6. The total assets of **Dell, Inc.** equal \$15,470 million and its equity is \$4,873 million. What is the amount of its liabilities, and what percentage of financing is provided by Dell's owners?
- \$20,343 million, 24.0%
 - \$10,597 million, 31.50%
 - \$10,597 million, 68.5%
 - \$20,343 million, 76.0%

Answer: b

(\$ millions)

Assets	=	Liabilities	+	Equity
\$15,470		<u>\$10,597</u>		\$4,873

Dell receives more of its financing from nonowners (\$10,597 million) versus owners (\$4,873 million). Its owner financing comprises 31.5% of its total financing (\$4,873 million/ \$15,470 million).

7. The total assets of **Ford Motor Company** equal \$315,920 million and its liabilities equal \$304,269 million. What is the amount of Ford's equity and what percentage of financing is provided by its owners?
- \$ 11,651 million, 3.9%
 - \$620,189 million, 49.1%
 - \$620,189 million, 50.9%
 - \$ 11,651 million, 3.7%

Answer: d

(\$ millions)

Assets	=	Liabilities	+	Equity
\$315,920		\$304,269		<u>\$11,651</u>

Ford receives more of its financing from nonowners (\$304,269 million) versus owners (\$11,651 million). Its owner financing comprises 3.7% of its total financing (\$11,651 million/ \$315,920 million). The relatively low level of equity capital is primarily the result of the fact that Ford is actually a blend of two companies: the automotive manufacturing company and the financial subsidiary. The financial subsidiary has a balance sheet similar to that of a bank, that is, relatively little equity capital. The blend of these two operating entities results in a balance sheet that is more dependent on borrowed funds than would be the case if Ford consisted solely of the manufacturing company.

8. Following are selected ratios of Canary Corp. for 2017 and 2016.

Return on Assets (ROA) Component	2017	2016
Profitability (Net income/Sales)	26%	22%
Productivity (Sales/Average net assets)	1.2	1.1

Compute the company's return on assets (ROA) for 2017.

- a. 30.0%
- b. 19.2%
- c. 12.1%
- d. 31.2%

Answer: d

ROA = Profit margin \times asset turnover. 2017 ROA = 26% \times 1.2 = 31.2%.

9. Nickle Company reports net income of \$800 million for its fiscal year ended January 2017. At the beginning of that fiscal year, Nickle Company had \$5,000 million in total assets. By fiscal year-end 2017, total assets had grown to \$6,500 million.

What is Nickle's return on assets (ROA)?

- a. 13.9%
- b. 16.0%
- c. 12.3%
- d. 10.7%

Answer: a

$$\begin{aligned}
 \text{Return on assets (ROA)} &= \text{Net income} / \text{Average assets} \\
 &= \$800 / [(\$5,000 + \$6,500) / 2] \\
 &= \underline{13.9\%}
 \end{aligned}$$

10. The following table contains financial statement information for Izzy Corporation.

(\$ millions)	Total Assets	Net Income	Sales	Equity
2016	\$105,000	\$10,000	\$95,000	\$30,000
2017	\$125,000	\$11,000	\$100,000	\$31,000

Compute the return on equity (ROE) and return on assets (ROA) for 2017.

- a. 25.5% ROE, 10.0% ROA
- b. 31.9% ROE, 11.2% ROA
- c. 36.1% ROE, 9.6% ROA
- d. 37.2% ROE, 13.1% ROA

Answer: c

$$\begin{aligned}
 2017 \text{ ROE} &= \$11,000 / [(\$31,000 + \$30,000) / 2] = \underline{36.1\%} \\
 2017 \text{ ROA} &= \$11,000 / [(\$125,000 + \$105,000) / 2] = \underline{9.6\%}
 \end{aligned}$$