

CAPITULO 8

Comparative Financial Statements

8.2

Comment on the following statements:

- a) An increase in dollar sales should always be viewed favorably. b) The influence of price-level changes cannot be detected by using a comparative statement.
 e) An expansion of plant, property, and equipment should be financed by sales of capital stock.
 d) Intangible assets should be eliminated when the balance sheet is reconstructed for analytical purposes.
 e) An increase in liabilities should be viewed with alarm

8.4

Give brief answers to the following questions:

- a) When the analyst has available the percentage changes in financial statement items, would he also require the absolute data?
 b) Inasmuch as the fixed assets are usually stated at "cost less depreciation" rather than at realizable values, are the values of importance in an analysis?
 e) Is the analyst more interested in absolute changes in financial statement data than in percentage changes? Explain.
 d) What is the significance from the point of view of statement analysis of extraordinary items shown on the income statement?
 e) What treatment should be given to intangible assets in analyzing financial statements?

8.8

| FIELD MANUFACTURING CORPORATION | | | | |
|---|------------------|------------------|-------------------------------------|-------------|
| Balance Sheet Data | | | | |
| December 31, 1970 and 1971 | | | | |
| (manufacturers of glass and glassware) | | | | |
| | December 31 | | Increase (decrease*) during 1971 | |
| | 1970 | 1971 | (\$) | (%) |
| <i>Assets</i> | | | | |
| Current Assets: | | | | |
| Cash | \$ 26,472 | \$ 32,883 | 6,411 | 24.2 |
| Time deposits | 5,129 | 6,310 | 1,181 | 23.0 |
| Marketable securities | 18,874 | 26,074 | 7,200 | 38.1 |
| Notes receivable | 488 | 13 | 475* | 97.3* |
| Accounts receivable (net) | 19,536 | 23,145 | 3,609 | 18.5 |
| Inventories | 50,104 | 51,714 | 1,610 | 3.2 |
| Other current assets | 2,412 | 2,260 | 152* | 6.3* |
| Prepaid expenses | 2,966 | 2,727 | 239* | 8.1* |
| Total Current Assets | \$125,981 | \$145,126 | 19,145 | 15.2 |
| Land, plant, and equipment (net) | 153,037 | 147,057 | 5,980* | 3.9* |
| Intangibles | 15,055 | 14,773 | 282* | 1.9* |
| Long-term investments | 16,128 | 16,444 | 316 | 2.0 |
| Total Assets | \$310,201 | \$323,400 | 13,199 | 4.3 |
| <i>Liabilities</i> | | | | |
| Current Liabilities: | | | | |
| Accounts payable | \$ 6,223 | \$ 8,140 | 1,917 | 30.8 |
| Notes payable | 453 | 503 | 50 | 11.0 |
| Accrued payables, including income taxes | 12,151 | 17,405 | 5,254 | 43.2 |
| Unearned revenue | 463 | 464 | 1 | .2 |
| Total Current Liabilities | \$ 19,290 | \$ 26,512 | 7,222 | 37.4 |
| Long-term liabilities | 14,260 | 11,192 | 3,068* | 21.5* |
| Total Liabilities | \$ 33,550 | \$ 37,704 | 4,154 | 12.4 |
| <i>Owners' Equity</i> | | | | |
| Capital stock | \$149,504 | \$149,806 | 302 | .2 |
| Retained earnings† | 127,147 | 135,890 | 8,743 | 6.9 |
| Total Owners' Equity | \$276,651 | \$285,696 | 9,045 | 3.3 |
| Total Liabilities and Owners' Equity | \$310,201 | \$323,400 | | |
| † Entries in retained earnings: | | | | |
| Net income after federal income taxes | \$38,715 | \$36,343 | 2,372* | 6.1* |
| Dividends declared | 32,600 | 27,600 | 5,000 | 15.3* |

- a) Analyze the foregoing data and point out favorable and unfavorable financial tendencies.
 b) Should the analyst have available data from the income statement?

CAPITULO 9

Trend Percentages

9.1

Discuss or give a brief answer to the following statements or questions:

- a) Should the analyst compute trend percentages for all items on the financial statements?
- b) Should the analyst have available trend percentages for tonnage or physical volume of business?
- c) What year should be selected as the base for computing trends? d) Is the trend of total liabilities of significance in analyzing the financial condition of a business? If so, what other trends should be used in connection therewith?
- e) Should the analyst obtain trend percentages of price levels?

9.4

Comment on the following statements:

- a) The trend percentages should be computed for all items on the financial statements.
- b) Trend percentages are more useful than the absolute data which they measure.
- e) One of the major problems of a trend percentage study is the selection of the base year.
- d) Inefficiency of management is difficult to detect by trend percentages.

9.5

Study the following trend percentages together with the dollar amounts and indicate whether or not illogical conclusions might result if the trends are used without reference to the dollar data. Explain.

| | 1967 | 1968 | 1969 | 1970 | 1971 |
|---|------|------|------|------|------|
| Cash (\$000) | 984 | 287 | 260 | 271 | 256 |
| Trend (%) | 100 | 29 | 26 | 28 | 26 |
| Notes receivable (\$000) | 1 | 1 | 2 | 1 | 2 |
| Trend (%) | 100 | 100 | 200 | 100 | 200 |
| Merchandise inventory (\$000) | 410 | 500 | 600 | 730 | 820 |
| Trend (%) | 100 | 122 | 146 | 178 | 200 |

9.8

The accompanying financial statement dollar and trend percentage data were presented by the Steel Products Corporation. The company requests you to analyze the data supplied and interpret the changes that have taken place in the current and long-term financial status and in the operating results.

| STEEL PRODUCTS CORPORATION | | | | | | | |
|--|--------|--------|------|--------|------|--------|------|
| Financial Statement Data | | | | | | | |
| As of, or for the Years Ended, December 31, 1968-71 | | | | | | | |
| (dollar amounts in thousands) | | | | | | | |
| | 1968 | 1969 | | 1970 | | 1971 | |
| | (\$) | (\$) | (%)* | (\$) | (%)* | (\$) | (%)* |
| <i>Balance Sheet Data (as of December 31)</i> | | | | | | | |
| Cash | 2,600 | 4,555 | 175 | 1,859 | 71 | 1,878 | 72 |
| Receivables—net (trade) | 4,637 | 3,687 | 80 | 5,829 | 126 | 5,930 | 128 |
| Inventory | 14,904 | 16,183 | 109 | 20,460 | 137 | 20,790 | 139 |
| Other current assets | 1,215 | 1,011 | 83 | 980 | 81 | 992 | 82 |
| Total Current Assets | 23,356 | 25,436 | 109 | 29,128 | 125 | 29,590 | 127 |
| Long-term investments | 423 | 660 | 156 | 1,080 | 255 | 2,165 | 512 |
| Property, plant, and equipment—net | 8,290 | 9,915 | 121 | 15,825 | 193 | 20,910 | 255 |
| Other noncurrent assets (exclusive of intangible assets) | 125 | 151 | 121 | 245 | 196 | 125 | 100 |
| Total Assets | 32,104 | 36,162 | 113 | 46,276 | 144 | 52,788 | 164 |
| Current liabilities | 11,823 | 12,913 | 109 | 14,237 | 120 | 14,153 | 120 |
| Long-term debt (5%)*† | 4,750 | 5,234 | 110 | 5,821 | 186 | 10,011 | 211 |
| Total Liabilities | 16,573 | 18,147 | 109 | 23,058 | 139 | 24,164 | 146 |
| Capital stock (common) 791,500 shares of \$10 stated value | 7,915 | 7,915 | 100 | 7,915 | 100 | 7,915 | 100 |
| Retained earnings | 7,616 | 10,100 | 133 | 15,303 | 201 | 20,709 | 272 |
| Total Owners' Equity | 15,531 | 18,015 | 116 | 23,218 | 150 | 28,624 | 184 |
| Total Liabilities and Owners' Equity | 32,104 | 36,162 | 113 | 46,276 | 144 | 52,788 | 164 |
| <i>Income Statement Data (for the Year)</i> | | | | | | | |
| Net sales | 57,783 | 60,703 | 105 | 75,298 | 130 | 55,086 | 95 |
| Cost of goods sold | 47,705 | 52,055 | 109 | 65,890 | 138 | 47,190 | 99 |
| Gross margin on sales | 10,078 | 8,648 | 86 | 9,408 | 93 | 7,896 | 78 |
| Operating expenses | 4,185 | 4,814 | 115 | 5,275 | 126 | 5,731 | 137 |
| Operating income | 5,893 | 3,834 | 65 | 4,133 | 70 | 2,165 | 37 |
| Other items (net deduction) | 160 | 212 | 133 | 203 | 127 | 226 | 142 |
| Income before federal income taxes | 5,733 | 3,622 | 63 | 3,930 | 69 | 1,939 | 34 |
| Federal income taxes for the year | 2,300 | 1,511 | 66 | 1,542 | 67 | 842 | 37 |
| Net income after federal income taxes | 3,433 | 2,111 | 61 | 2,388 | 70 | 1,097 | 32 |
| Extraordinary items, net addition | 102 | 1,560 | 153 | 4,002 | 396 | 5,496 | 538 |
| Net Income Transferred to Retained Earnings | 3,535 | 3,671 | 104 | 6,390 | 181 | 6,593 | 187 |
| <i>Retained Earnings Data (for the Year)</i> | | | | | | | |
| Dividends Declared | 1,187 | 1,187 | 100 | 1,187 | 100 | 1,187 | 100 |

* Balance sheet amounts for December 31, 1968 and income statement items for the year 1968 equal 100 %
 † Principal increased on, and interest paid, January 2.

CAPITULO 10 Common-size Statements

10.1

Distinguish between (a) common-size and trend data; (b) ratios and common-size percentages; (c) comparative statement percentages and trend percentages.

10.3

What information is provided by:

- a) Comparative statements?
- b) Trend percentages?
- c) Common-size percentages?

10.9

Study the following data and suggest reasons for the variations among the companies..

| | A | | B | | C | |
|---------------------------------------|------------------|--------------|------------------|--------------|------------------|--------------|
| | (\$) | (%) | (\$) | (%) | (\$) | (%) |
| <i>Assets</i> | | | | | | |
| Current assets | 860,000 | 33.3 | 500,000 | 20.1 | 1,500,000 | 57.5 |
| Noncurrent assets | 1,720,000 | 66.7 | 1,990,000 | 79.9 | 1,110,000 | 42.5 |
| Total | <u>2,580,000</u> | <u>100.0</u> | <u>2,490,000</u> | <u>100.0</u> | <u>2,610,000</u> | <u>100.0</u> |
| <i>Liabilities and Owners' Equity</i> | | | | | | |
| Current liabilities | 400,000 | 15.5 | 350,000 | 14.1 | 1,200,000 | 46.0 |
| Long-term liabilities | 800,000 | 31.0 | 1,000,000 | 40.1 | 500,000 | 19.1 |
| Owners' Equity | 1,380,000 | 53.5 | 1,140,000 | 45.8 | 910,000 | 34.9 |
| Total | <u>2,580,000</u> | <u>100.0</u> | <u>2,490,000</u> | <u>100.0</u> | <u>2,610,000</u> | <u>100.0</u> |

10.12

- a) Compare, analyze, and interpret the following data for Companies A and B, manufacturers of similar iron and steel products.
- b) Write a report in which you list and discuss favorable and unfavorable financial and operating tendencies.

| | COMPANIES A AND B | | | | | | | |
|--|----------------------------|--------------|---------------|--------------|---------------|--------------|---------------|--------------|
| | Balance Sheet Data | | | | | | | |
| | December 31, 1966 and 1971 | | | | | | | |
| | (in thousands) | | | | | | | |
| | Company A | | | | Company B | | | |
| | 1971 | | 1966 | | 1971 | | 1966 | |
| | (\$) | (%) | (\$) | (%) | (\$) | (%) | (\$) | (%) |
| <i>Assets</i> | | | | | | | | |
| <i>Current Assets:</i> | | | | | | | | |
| Cash | 860 | 2.0 | 1,730 | 10.2 | 2,371 | 5.3 | 1,027 | 2.2 |
| Marketable securities | 214 | 0.5 | 406 | 2.4 | 59 | 0.1 | 845 | 1.8 |
| Accounts receivable—trade (net) | 4,078 | 9.4 | 1,675 | 9.9 | 3,090 | 6.9 | 1,691 | 3.6 |
| Notes receivable—trade | 500 | 1.1 | 200 | 1.2 | 400 | 1.0 | 100 | 0.2 |
| Merchandise inventory | 11,057 | 25.4 | 3,308 | 19.5 | 9,949 | 22.2 | 7,782 | 16.4 |
| Other current assets | 34 | 0.1 | 14 | 0.1 | 60 | 0.1 | 24 | 0.1 |
| Total Current Assets | 16,743 | 38.5 | 7,333 | 43.2 | 15,929 | 35.6 | 11,469 | 24.2 |
| Long-term investments | 124 | 0.3 | 65 | 0.4 | 4,516 | 10.1 | 1,953 | 4.1 |
| Land, buildings, and equipment (net) | 26,477 | 60.8 | 9,428 | 55.5 | 23,822 | 53.3 | 33,484 | 70.7 |
| Other assets | 193 | 0.4 | 153 | 0.9 | 436 | 1.0 | 460 | 1.0 |
| Total Assets | <u>43,537</u> | <u>100.0</u> | <u>16,979</u> | <u>100.0</u> | <u>44,703</u> | <u>100.0</u> | <u>47,366</u> | <u>100.0</u> |
| <i>Liabilities and Owners' Equity</i> | | | | | | | | |
| <i>Current Liabilities:</i> | | | | | | | | |
| Notes payable, bank | 450 | 1.1 | 25 | 0.2 | 1,500 | 3.4 | 700 | 1.5 |
| Accounts payable—trade | 3,326 | 7.6 | 1,818 | 10.7 | 1,819 | 4.0 | 396 | 0.8 |
| Other current liabilities | 2,013 | 4.6 | 644 | 3.8 | 1,887 | 4.2 | 947 | 2.0 |
| Total Current Liabilities | 5,789 | 13.3 | 2,487 | 14.7 | 5,206 | 11.6 | 2,043 | 4.3 |
| Long-term liabilities | 343 | 0.8 | 343 | 2.0 | 4,733 | 10.6 | 6,955 | 14.7 |
| Total Liabilities | 6,132 | 14.1 | 2,830 | 16.7 | 9,939 | 22.2 | 8,998 | 19.0 |
| <i>Owners' Equity:</i> | | | | | | | | |
| Preferred stock | 3,000 | 6.9 | 3,000 | 17.7 | 10,471 | 23.4 | 9,475 | 20.0 |
| Common stock | 20,855 | 47.9 | 3,820 | 22.5 | 9,816 | 22.0 | 25,350 | 53.5 |
| Capital in excess of stated value | 6,027 | 13.8 | 5,527 | 32.5 | 13,000 | 29.1 | 1,000 | 2.1 |
| Retained earnings | 7,523 | 17.3 | 1,802 | 10.6 | 1,477 | 3.3 | 2,543 | 5.4 |
| Total Owners' Equity | 37,405 | 85.9 | 14,149 | 83.3 | 34,764 | 77.8 | 38,368 | 81.0 |
| Total Liabilities and Owners' Equity | <u>43,537</u> | <u>100.0</u> | <u>16,979</u> | <u>100.0</u> | <u>44,703</u> | <u>100.0</u> | <u>47,366</u> | <u>100.0</u> |

CAPITULO 11
Working Capital and Section on Judging the Solvency of the Small
Business

11.1

Discuss the two definitions of working capital.

11.2

Should the amount of working capital increase or decrease in proportion to changes in sales volume? Explain.

11.6

Explain the meaning of the working capital cycle.

11.7

What determines the adequacy of working capital?

11.8

List several causes of inadequacy of working capital.

11.9

What are the uses of working capital?

11.10

Determine whether each of the following transactions would:

a) Increase working capital.

b) Decrease working capital.

c) Have no effect on working capital

(1) Paid \$4,000 cash for merchandise.

(2) \$1,000 of trade accounts receivable were written off.

(3) Borrowed cash from the bank; issued a 6 percent, \$10,000, 60-day note.

(4) Recorded estimated doubtful accounts expense at the end of the accounting period, \$1,000.

(5) Declared and distributed a \$20,000 stock dividend.

(6) Sold marketable securities which cost \$7,500 for \$9,000.

(7) Paid trade creditor accounts, \$55,000, discount allowed, 2 percent.

(8) Recorded estimated depreciation of buildings at the end of the accounting period, \$8,000.

(9) Borrowed cash from the bank; issued a \$10,000, 90-day, non-interest-bearing note; the bank discount rate was 6 percent.

(10) Received a 60-day, 6 percent, \$1,000 promissory note from a customer to apply on account.

(11) Fixed assets were sold for \$11,000 cash.

(12) A \$10,000 cash dividend on common stock was declared.

(13) The declared dividend (above) was paid.

(14) Purchased delivery equipment, \$18,500; issued a check for \$15,000 and a 90-day promissory note for the balance.

CAPITULO 12

Statement of Changes in Financial Position

12.1

Comment on the following questions:

- a)* What information can be obtained from the statement of changes in financial position that is not shown on a balance sheet?
- b)* What information can be obtained from the balance sheet that is not shown on a statement of changes in financial position?
- c)* Is it necessary to have the income statement when preparing the statement of changes in financial position? Why?

12.3

Explain how the following should be shown on the work sheet for the statement of changes in financial position.

- a)* Net loss for the year.
- b)* Depletion expense.
- c)* Amortization of patents.
- d)* Receipt of cash from defendant in lawsuit.
- e)* Stock dividend declared and distributed.
- f)* Write-off of goodwill.
- g)* Loss on the sale of marketable securities.
- h)* Issued for cash at a premium, 500 shares of \$100 par value preferred stock.
- i)* Appropriated retained earnings for sinking fund reserve.
- j)* Retired bonds at face value.
- k)* Profit on sale of long-term investments.

CAPITULO 13
Introduction to Standard Ratios

13.1

Discuss:

- a)* The nature of standard ratios.
- b)* "Variations from standard ratios may reflect either weakness or strength."
- c)* The merits and limitations of standard ratios.
- d)* To what extent do price-level changes influence standard ratios?
- e)* "An ideal or model balance sheet and income statement may be constructed by using standard ratios."
- f)* "The best standard of comparison is the ratios of the nearest rivals of the company or of a few carefully selected competitors whose operations are known to be similar in most respects."

13.3

A standard ratio is a representative common or average ratio for a large number of companies in the same line of business. Explain.

CAPITULO 14

Ratio Analysis of Working Capital

14.1

What is meant by the word "turnover"?

"The greater the turnover of merchandise, the greater the profit." Explain why this statement is or is not true.

14.2

Explain:

- a) A low current ratio may reflect an inadequacy of working capital. b) Do long-term liabilities maturing within one year of the balance sheet affect the current ratio?
- c) Is the so-called "acid-test ratio" actually an "acid test"?
- d) How should contingent liabilities be treated in analyzing the current financial condition of the business?
- e) Is the ratio of inventory to working capital important? Explain its computation, merits, and limitations.

14.3

Discuss the "ratio of net sales to working capital" showing how it is computed and indicating its merits and limitations.

14.4

The following statements may be *true* or *false*. If false, indicate the reasons therefor.

- a) The current debt-paying ability of a company may be measured by computing the current ratio.
- b) If creditors allow 60 days' credit and customers are granted 30 days' credit, the current ratio is strengthened.

14.5

Should long-term debt, which is due and payable within one year from the date of the balance sheet, be included as a current liability even though there is no sinking fund provision for the payment?

14.6

Give the reasons for the following:

- a) The current ratio for manufacturers of tobacco products should be higher than for manufacturers of office equipment.
- b) The current ratio for telephone companies is usually lower than for department stores.
- c) The current ratio for retail furniture stores is customarily higher than for railroad companies.
- d) The current ratio is affected by the terms granted by creditors and to customers.

14.9

The Kenmore financial statements show the following items:

| <i>December 31:</i> | <i>1970</i> | <i>1971</i> |
|---|-------------|-------------|
| Accounts receivable. | \$ 39,467 | \$ 59,172 |
| Estimated uncollectible receivables. | 1,326 | 2,016 |
| <i>For the year:</i> | | |
| Net sales | 339,471 | 389,145 |
| (2/3 of the sales were made on credit terms of 2/30, n/60) | | |

CAPITULO 15

Analysis of Long-term Financial Condition with a Section on Appraising Bonds for Long-term Investment

15.5

What ratios would be used to answer the following questions?

- a)* Are the claims of secured creditors adequately protected?
- b)* How have the assets been financed?
- c)* Is there a satisfactory distribution of assets?

CAPITULO 16 Analysis of Income

16.1

Should the analyst expect drastic changes in income statement ratios from year to year?

16.2

"It may easily happen that the actual sales volume of a company as expressed in physical units may increase while the total money consideration shows a downward trend." Explain the foregoing statement and indicate its importance in connection with ratio analysis.

16.3

Discuss the operating ratio with particular reference to its value as a test of the efficiency of management and of financial condition.

16.7

| BODINSON HARDWARE SALES COMPANY | | |
|---|-------------|-------------|
| Income Statement Data | | |
| For the Years Ended December 31, 1970-71 | | |
| (in thousands) | | |
| <i>Items</i> | <i>1970</i> | <i>1971</i> |
| Net sales | \$15,000 | \$16,365 |
| Cost of goods sold | 10,155 | 10,703 |
| Gross margin | 4,845 | 5,662 |
| Selling expenses | 1,170 | 1,178 |
| General and administrative expenses | 480 | 524 |
| Total operating expenses | 1,650 | 1,702 |
| Operating income | 3,195 | 3,960 |
| Other revenue | 30 | 33 |
| Other expense | 30 | 32 |
| Income before federal income taxes | 3,195 | 3,961 |
| Estimated federal income taxes | 1,215 | 1,964 |
| Net income after federal income taxes | 1,980 | 1,997 |
| <i>Expenses included in foregoing items:</i> | | |
| Maintenance and repairs | 420 | 442 |
| Depreciation | 450 | 458 |
| Taxes (other than income) | 270 | 295 |
| Uncollectible receivables expense | 15 | 15 |

Required:

- a) Compute dollar and percentage changes in the data during 1971.
- b) Compute common-size percentages for the two years.
- c) Write a report commenting on the changes that have taken place in the income statement items during the two-year period.

Fuente:
Financial Statements. Ford analysis and interpretative
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