

**BOAOA1 – OAC Accounting
Analyzing Financial Statements – Mock Exam**

Instructions: Study the following financial statements carefully. Compute the indicated ratios using figures from these financial statements and provide a comment on each ratio in the spaces provided. For each ratio, first state the formula and then show calculations in full solutions.

**PREMIUM ALCOHOLIC BEVERAGES INC.
Consolidated Income Statement
For the Years Ended December 31, 2000 and December 31, 2001**

Revenues	2001	2000
Net Sales	\$580,000.00	\$518,000.00
Commissions	<u>97,400.00</u>	<u>85,000.00</u>
Total Revenues	\$677,400.00	\$603,000.00
Operating Expenses		
Cost of Sales	182,000.00	195,000.00
Marketing, Sales, and Administration	98,000.00	89,000.00
Loss on Disposal	<u>38,000.00</u>	<u>24,000.00</u>
Total Operating Expenses	318,000.00	308,000.00
Earnings from Operations	<u>359,400.00</u>	<u>295,000.00</u>
Interest Expense, Net	70,200.00	68,000
Earnings before Income Taxes	<u>289,200.00</u>	<u>227,000.00</u>
Income Taxes	65,900.00	52,000.00
Net Income (Loss)	<u>\$223,300.00</u>	<u>\$175,000.00</u>

1. Accounts Receivable Turnover Rate

$$\begin{aligned} & \frac{\text{Net Sales}}{\text{Average Accounts Receivables}} \\ &= \frac{\$580000}{(\$18000 + \$24000) \div 2} \\ &= \frac{\$580000}{\$21000} \\ &= 27.6 \end{aligned}$$

$$\begin{aligned} & \frac{\text{Average Days to Collect Receivables}}{\text{Number of Days in a Year}} \\ &= \frac{365}{\text{Accounts Receivable Turnover Rate}} \\ &= \frac{365}{27.6} \\ &= 13 \text{ days} \end{aligned}$$

Average is 30 days to collect A/R.

2. Operating Expense Ratio

$$\begin{aligned} & \frac{\text{Operating Expense}}{\text{Net Sales}} \\ &= \frac{\$318000}{\$580000} \\ &= 0.55 = 55\% \end{aligned}$$

Average is under 50%, much better if under 25%.

3. Return on Assets

$$\begin{aligned} & \frac{\text{Operating Income}}{\text{Average Total Assets}} \\ &= \frac{\$359400}{(\$5620000 + \$6380000) \div 2} \\ &= \frac{\$359400}{\$6000000} \\ &= 0.0599 = 6.0\% \end{aligned}$$

Average is between 10-15%.

4. Interest Coverage Ratio

$$\begin{aligned} & \frac{\text{Operating Income}}{\text{Annual Interest Expenses}} \\ &= \frac{\$359400}{\$70200} \\ &= 5.1 \end{aligned}$$

Average is between 2 and 6.

5. Return on Common Shareholder's Equity

$$\frac{\text{Net Income Applicable to Common Shareholders}}{\text{Average Common Shareholders' Equity}}$$

$$= \frac{\$223300 - (\$8 \times 2500)}{\$338350}$$

$$= \frac{\$223300 - \$20000}{\$338350} = 60\%$$

Equity of Common Shareholders =
Total Shareholders' Equity – Call Price
of Preferred Stocks – Dividends in
Arrears

$$\frac{\text{Average Common Shareholders' Equity}}{\text{Common Shareholders' Equity in 2000} + \text{Common Shareholders' Equity in 2001}}$$

$$= \frac{2}{2}$$

$$= \frac{[\$526700 - (\$120 \times 2500 \text{ shares})] + [\$750000 - (\$120 \times 2500 \text{ shares})]}{2}$$

$$= \frac{(\$526700 - \$300000) + (\$750000 - \$300000)}{2} = \$338350$$

If the return is >10%, it is average. If the return is 15% to 20%, it is good.

6. Earnings Per Share of Common Stock

$$\frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Shares of Common Stock Outstanding}}$$

$$= \frac{\$223300 - (\$8 \times 2500)}{50000 \text{ shares}}$$

$$= \frac{\$223300 - \$20000}{500000 \text{ shares}}$$

$$= \$0.41$$

Average ranges from \$1 to \$5 per share.

7. Book Value Per Share of Common Stock

$$\frac{\text{Common Shareholders' Equity}}{\text{Shares of Common Stock Outstanding}}$$

$$= \frac{\$750000 - (\$120 \times 2500 \text{ shares})}{50000 \text{ shares}}$$

$$= \frac{\$750000 - \$300000}{50000 \text{ shares}}$$

$$= \$9 / \text{share}$$

Usually under \$10. Stocks should trade at 2 times the book value.