A.1. Financial Statement Analysis

Question

How is *gross margin* calculated?

FC-01501 CSO: 2A1a LOS: 2A1a #1

Answer

$$\text{Gross margin} = \frac{\text{Sales (net)} - \text{Cost of goods sold}}{\text{Sales (net)}}$$

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A.1. Financial Statement Analysis

Question

How does a "multiple-step" income statement differ from a "single-step" income statement?

FC-01520 CSO: 2A1a LOS: 2A1a #2

Answer

- A multiple-step income statement reports operating revenues and expenses separately from nonoperating revenues and expenses and other gains and losses.
- On a single-step income statement's presentation of income from continuing operations, total expenses are subtracted from total revenues without separation between operating and nonoperating revenues and expenses.

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A.1. Financial Statement Analysis

Question

What is meant by a "classified" balance sheet?

FC-01521 CSO: 2A1a LOS: 2A1a #3

Answer

A classified balance sheet distinguishes *current* and *non-current* assets and liabilities.

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A.1. Financial Statement Analysis

Question

How is horizontal analysis of the income statement used?

FC-02285 #4

Answer

Horizontal analysis focuses on account balance increases or decreases in relation to a specific base year to identify patterns and trends that can be used to make business decisions.

Management can choose different income statement accounts and use this type of analysis to review the growth of those targeted line items over time.

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A.2. Financial Ratios: Part 1

Question

What are the types of financial ratios?

FC-00192 CSO: 2A2a LOS: 2A2a #5

Answer

Liquidity ratios: measure short-term ability to pay obligations
Activity ratios: measure effective use of assets
Profitability ratios: measure the financial performance of an entity
Investor ratios: measure performance and market-based metrics
Coverage ratios: measure security for long-term creditors/investors

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A.2. Financial Ratios: Part 1

Question

What are some limitations of using financial ratios?

FC-00193 CSO: 2A2a LOS: 2A2a #6

Answer

Although ratios are useful, they have the following limitations:

- Few industry benchmarks exist for comparison.
- Dissimilar business units make analysis difficult.
- Management may manipulate financial data and ratios.
- Inflation can reduce comparability of balance sheet items.
- The choice or change in accounting principles can affect ratios and reduce comparability.

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A.2. Financial Ratios: Part 1

Question

How are the current ratio and quick ratio calculated?

FC-00194 CSO: 2A2a LOS: 2A2a #7

Answer

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\text{Quick ratio} = \frac{\text{Cash and cash equivalents + Short-term marketable securities + Receivables (net)}}{\text{Current liabilities}}$$

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A.2. Financial Ratios: Part 1

Question

How are accounts receivable turnover and inventory turnover calculated?

FC-00195 CSO: 2A2c LOS: 2A2c #8

Answer

$$\text{Accounts receivable turnover} = \frac{\text{Sales (net)}}{\text{Average accounts receivable (net)}}$$

$$\text{Inventory turnover} = \frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

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A.2. Financial Ratios: Part 1

Question

How are the net profit margin and the return on total assets calculated?

FC-00196 CSO: 2A2d LOS: 2A2d #9

Answer

$$\text{Profit margin} = \frac{\text{Net income}}{\text{Sales (net)}}$$

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Average total assets}}$$

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A.2. Financial Ratios: Part 1

Question

How are earnings per share (EPS) and the price/earnings (P/E) ratio calculated?

FC-00197 CSO: 2A2e LOS: 2A2e #10

Answer

$$\text{Basic EPS} = \frac{\text{Income available to common shareholders}}{\text{Weighted average of common shares outstanding}}$$

$$\text{P/E ratio} = \frac{\text{Price per share}}{\text{Basic earnings per share}}$$

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