

Financial Statements Exercises With Answers

Financial Statements Exercises With Answers This document provides a comprehensive set of exercises designed to enhance your understanding and application of financial statements. The exercises cover a range of topics including Balance Sheet Understanding assets, liabilities, and equity, analyzing relationships between balance sheet items, Income Statement Calculating revenue, expenses, and net income, identifying key profitability ratios, Statement of Cash Flows Understanding cash inflows and outflows, analyzing cash flow activities, Analysis and Interpretation Applying financial statement data to make informed business decisions. Each exercise includes detailed explanations and stepbystep solutions. The exercises are designed to be progressively more challenging, allowing you to build your skills and confidence.

Exercise 1 Understanding the Balance Sheet a Scenario Company A has the following balances at the end of the year:

Cash	10000
Accounts Receivable	20000
Inventory	30000
Property, Plant, and Equipment (PPE)	50000
Accounts Payable	15000
Salaries Payable	5000
Long-Term Debt	25000
Common Stock	20000
Retained Earnings	35000

Instructions 1 Create a balance sheet for Company A in the standard format. 2 Calculate the company's total assets, total liabilities, and total equity. 3 Verify that the accounting equation Assets = Liabilities + Equity holds true.

b Analysis Explain the significance of the following relationships:

- Current Assets to Current Liabilities
- Current Ratio
- Total Liabilities to Total Equity
- Debt-to-Equity Ratio

Exercise 2 Analyzing the Income Statement a Scenario Company B reports the following revenue and expense data for the year:

Sales Revenue	100000
Cost of Goods Sold (COGS)	50000
Operating Expenses	20000
Interest Expense	5000
Income Tax Expense	10000

Instructions 1 Prepare an income statement for Company B. 2 Calculate the company's gross profit, operating income, and net income. b Analysis Explain the difference between gross profit and operating income. What does each measure tell you about the company's performance?

Exercise 3 Understanding the Statement of Cash Flows a Scenario Company C reports the following cash flow activities for the year:

Operating Activities: Cash Received from Customers	120000
Operating Activities: Cash Paid to Suppliers	60000
Operating Expenses	30000
Investing Activities: Purchase of Equipment	40000
Sale of Investments	10000
Financing Activities: Borrowing from Bank	20000
Payment of Dividends	5000

Instructions 1 Prepare a statement of cash flows for Company C using the direct method. 2 Identify the net cash flow from each activity. 3 Explain the significance of the net cash flow from operating activities.

b Analysis How can the statement of cash flows be used to assess a company's financial health and future prospects?

Exercise 4 Applying Financial Statement Analysis a Scenario You are analyzing the financial statements of two companies, Company D and Company E. Their key financial ratios are as follows:

Ratio	Company D	Company E
Current Ratio	2.5	1.8
Debt-to-Equity Ratio	0.5	0.8
Net Profit Margin	5%	4%
Return on Assets	12%	10%
Return on Equity	20%	18%

Company E Current Ratio 20 10 DebttoEquity Ratio 05 10 Gross Profit Margin 40 30 Net Profit Margin 10 5 Instructions 1 Compare the financial health of Company D and Company E based on the provided ratios 2 Identify any potential areas of concern for each company b Application Based on your analysis which company would you consider a more attractive investment Justify your choice Answers Exercise 1 a See attached balance sheet b The current ratio measures a companys ability to meet its shortterm obligations A higher ratio generally indicates better liquidity The debttoequity ratio measures the extent to which a company is financed by debt A higher ratio suggests greater financial risk Exercise 2 a See attached income statement b Gross profit is the difference between revenue and COGS while operating income is the difference between gross profit and operating expenses Gross profit reflects the profitability of the companys core business operations while operating income considers all operating costs providing a broader picture of the companys overall profitability 4 Exercise 3 a See attached statement of cash flows b Net cash flow from operating activities represents the cash generated from the companys daytoday operations A positive net cash flow indicates the company is generating sufficient cash to sustain its business Exercise 4 a Company D appears to be in a stronger financial position than Company E It has a higher current ratio indicating better liquidity and a lower debttoequity ratio suggesting lower financial risk Company D also has higher profit margins reflecting greater profitability b Based on the provided ratios Company D would be a more attractive investment Its stronger financial health and greater profitability suggest it has better growth potential and less risk compared to Company E Conclusion By working through these exercises you will gain a deeper understanding of financial statements and their importance in business decisionmaking Remember that the financial statements are just one piece of the puzzle when assessing a companys financial health Its essential to consider other factors such as industry trends competitive landscape and management quality before making any investment decisions

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