

# Financial Statements Exercises With Answers

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 LongTerm Debt 25000 Common Stock 20000 Retained Earnings 35000

**Instructions** 1 Create a balance sheet for Company A in the standard format 2 2 Calculate the companys 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 DebttoEquity 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 120,000; Cash Paid to Suppliers 60,000; Cash Paid for Operating Expenses 30,000.
- Investing Activities: Purchase of Equipment 40,000; Sale of Investments 10,000.
- Financing Activities: Borrowing from Bank 20,000; Payment of Dividends 5,000.

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	2.0	1.0
Debt to Equity Ratio	0.5	1.0
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 company's ability to meet its short-term obligations. A higher ratio generally indicates better liquidity. The debt-to-equity 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 company's core business operations, while operating income considers all operating costs, providing a broader picture of the company's overall profitability.

Exercise 3

- a See attached statement of cash

flows b Net cash flow from operating activities represents the cash generated from the company's day-to-day 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 debt-to-equity 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 decision-making. Remember that the financial statements are just one piece of the puzzle when assessing a company's financial health. It's essential to consider other factors such as industry trends, competitive landscape, and management quality before making any investment decisions.

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interest

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