Chapter 12
Financial Statement Analysis

Exercise 12-1 (LO12-1, 12-2, 12-3, 12-4, 12-5, 12-6)

Items

g	1. Vertical analysis
e	2. Horizontal analysis
a	3. Liquidity
h	4. Solvency
f	5. Discontinued operation
d	6. Quality of earnings
b	7. Conservative accounting practices
c	8. Aggressive accounting practices

Descriptions

a. A company's ability to pay its current liabilities.

b. Accounting choices that result in reporting lower income, lower assets, and higher liabilities.

c. Accounting choices that result in reporting higher income, higher assets, and lower liabilities.

d. The ability of reported earnings to reflect the company's true earnings as well as the usefulness of reported earnings to help investors predict future earnings.

e. A tool to analyze trends in financial statement data for a single company over time.

f. The sale or disposal of a significant component of a company's operations.

g. A means to express each item in a financial statement as a percentage of a base amount.

h. A company's ability to pay its long-term liabilities.

Exercise 12-2 (LO12-1)

Federer Sports Apparel Income Statement For the Years Ended December 31				
	2022		2021	
	Amount	%	Amount	%
Net sales	$ 18,800,000	100.0	$ 15,500,000	100.0
Cost of goods sold	13,200,000	70.2	7,000,000	45.2
Gross profit	5,600,000	29.8	8,500,000	54.8
Operating expenses	1,600,000	8.5	1,200,000	7.7
Depreciation expense	1,000,000	5.3	1,000,000	6.5
Inventory write-down	200,000	1.1	0	0.0
Litigation expense	1,500,000	8.0	300,000	1.9
Income before tax	1,300,000	6.9	6,000,000	38.7
Income tax expense	450,000	2.4	2,000,000	12.9
Net income	$ 850,000	4.5	$ 4,000,000	25.8

Exercise 12-3 (LO12-2)

Federer Sports Apparel Income Statement For the Years Ended December 31				
	Year		Increase (Decrease)	
	2022	2021	Amount	%
Revenues	$ 18,800,000	$ 15,500,000	$3,300,000	21.3
Cost of goods sold	13,200,000	7,000,000	6,200,000	88.6
Gross profit	5,600,000	8,500,000	(2,900,000)	(34.1)
Operating expenses	1,600,000	1,200,000	400,000	33.3
Depreciation expense	1,000,000	1,000,000	0	0
Inventory write-down	200,000	0	200,000	N/A
Litigation expense	1,500,000	300,000	1,200,000	400
Income before tax	1,300,000	6,000,000	(4,700,000)	(78.3)
Income tax expense	450,000	2,000,000	(1,550,000)	(77.5)
Net income	$ 850,000	$ 4,000,000	$(3,150,000)	(78.8)

Exercise 12-4 (LO12-1, 12-2)

Requirement 1

Federer Sports Apparel Balance Sheet December 31				
	2022		2021	
Assets	Amount	%	Amount	%
Cash	$ 2,300,000	14.7	$ 800,000	5.8
Accounts receivable	1,500,000	9.6	1,200,000	8.8
Inventory	2,800,000	18.0	1,700,000	12.4
Buildings	11,000,000	70.5	11,000,000	80.3
Less: Accumulated depreciation	(2,000,000)	(12.8)	(1,000,000)	(7.3)
Total assets	$15,600,000	100.0	$13,700,000	100.0
Accounts payable	$ 1,450,000	9.3	$ 1,700,000	12.4
Litigation liability	1,500,000	9.6	0	0.0
Common stock	8,000,000	51.3	8,000,000	58.4
Retained earnings	4,650,000	29.8	4,000,000	29.2
Total liabilities and stockholders' equity	$15,600,000	100.0	$13,700,000	100.0

Requirement 2

Federer Sports Apparel Balance Sheet December 31				
	Year		Increase (Decrease)	
Assets	**2022**	**2021**	**Amount**	**%**
Cash	$ 2,300,000	$ 800,000	**$1,500,000**	**187.5**
Accounts receivable	1,500,000	1,200,000	**300,000**	**25.0**
Inventory	2,800,000	1,700,000	**1,100,000**	**64.7**
Buildings	11,000,000	11,000,000	**0**	**0**
Less: Accumulated depreciation	(2,000,000)	(1,000,000)	**(1,000,000)**	**100.0**
Total assets	$15,600,000	$13,700,000	**$1,900,000**	**13.9**
Accounts payable	$ 1,450,000	$ 1,700,000	**$ (250,000)**	**(14.7)**
Litigation liability	1,500,000	0	**1,500,000**	**N/A**
Common stock	8,000,000	8,000,000	**0**	**0**
Retained earnings	4,650,000	4,000,000	**650,000**	**16.3**
Total liabilities and stockholders' equity	$15,600,000	$13,700,000	**$1,900,000**	**13.9**

Exercise 12-6 (LO12-4)

Requirement 1

Profitability Ratios	Calculations	
Gross profit ratio	$\frac{(\$19,310,000 - \$12,250,000)}{\$19,310,000}$	**= 36.6%**
Return on assets	$\frac{\$1,700,000}{(\$7,800,000 + \$9,200,000) / 2}$	**= 20.0%**
Profit margin	$\frac{\$1,700,000}{\$19,310,000}$	**= 8.8%**
Asset turnover	$\frac{\$19,310,000}{(\$7,800,000 + \$9,200,000) / 2}$	**= 2.3 times**
Return on equity	$\frac{\$1,700,000}{(\$3,540,000 + \$4,880,000) / 2}$	**= 40.4%**

Requirement 2

Adrian Express is less profitable than the industry average. The gross profit ratio, return on assets, profit margin, and asset turnover are all below the industry average. Return on equity of 40% is an exception, exceeding the industry average of 35%.