Section Six
Revision

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True & False Questions

1. The Sources and Uses of Funds Statement is the same as the Cash Flow Statement.
Answer: False

2. A company's net income from operations would typically be included as a 'use' of funds.
Answer: False

True & False Questions

3. A current ratio of 2:1 indicates that a company has twice as many liabilities as assets.

Answer: False

4. If a company's quick ratio is greater than 1, it means it has sufficient liquid assets to cover its current liabilities.

Answer: True

True & False Questions

5. Dividends paid to shareholders would appear under the 'sources' section of the statement

Answer: False

6. The purchase of new machinery would be recorded as a 'use' of funds.

Answer: True

True & False Questions

7. A low days sales outstanding (DSO) ratio indicates that a company is collecting its receivables more quickly.

Answer: True

8. The fixed asset turnover ratio measures how effectively a company uses its fixed assets, such as buildings and equipment, to generate revenue.

Answer: True

True & False Questions

9. The final stage of preparing the Sources & Uses statement is to compile the information about changes in assets, liabilities, and equity into a formal Sources & Uses statement.

Answer: True

10. The Sources & Uses statement is not concerned with the specific classification of changes in assets, liabilities, and equity.

Answer: False

True & False Questions

11. A debt ratio of 0.5 means that half of the company's assets are financed through debt.

Answer: True

12. The interest coverage ratio measures a company's ability to pay its interest expenses with its operating income.

Answer: True

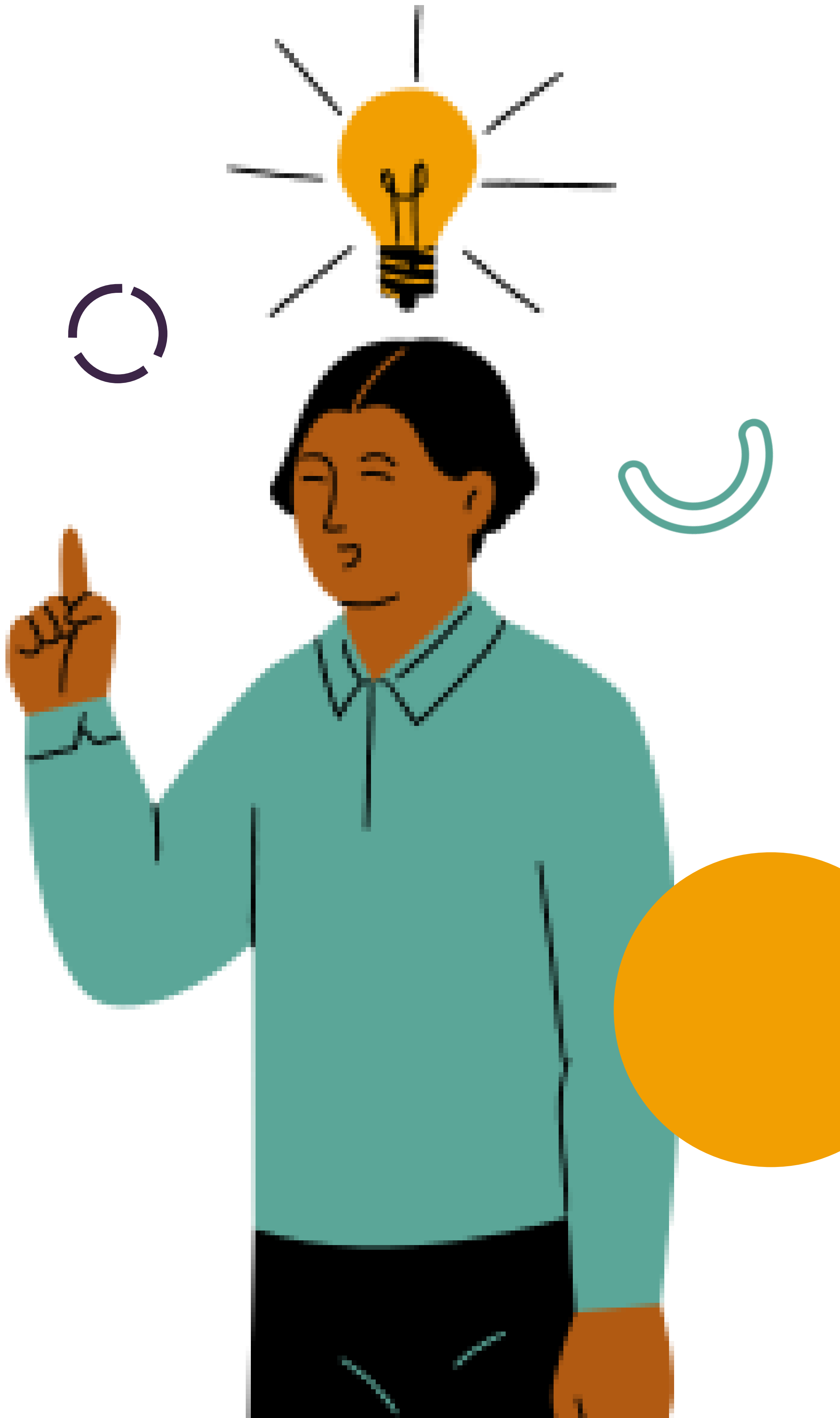
True & False Questions

13. A source of funds includes a decrease in assets, an increase in liabilities, and an increase in equity.

Answer: True

14. A use of funds includes an increase in assets, a decrease in liabilities, and a decrease in equity.

Answer: True



True & False Questions

15. The profit margin ratio measures the percentage of revenue that becomes profit after all expenses are deducted.

Answer: True

16. A higher gross profit margin indicates that a company is managing its direct production costs effectively.

Answer: True

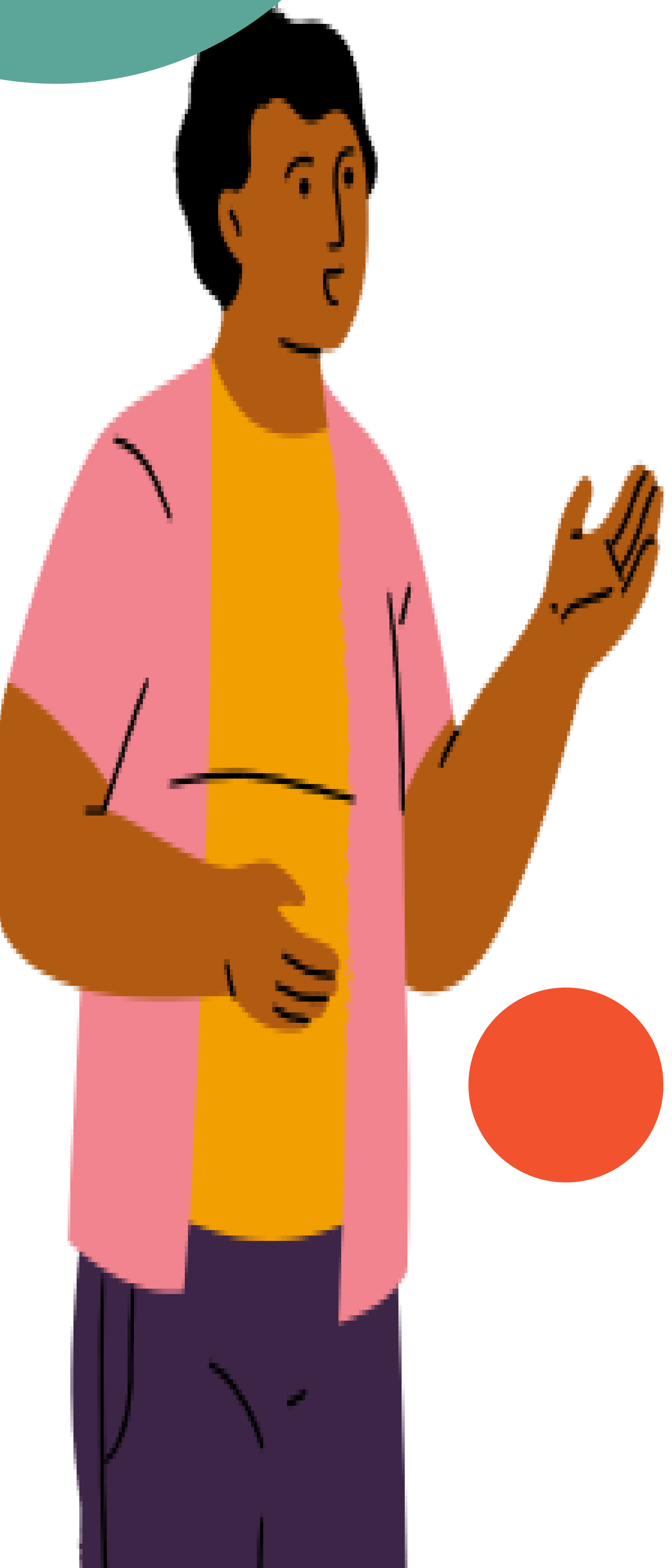
True & False Questions

17. The Sources & Uses statement is usually prepared for a period of one year.

Answer: True

18. The preparation of the Sources & Uses statement involves using data from the current year's income statement and balance sheet only.

Answer: False



True & False Questions

19. The return on assets (ROA) ratio can be used to compare the profitability of companies in different industries, regardless of their asset structures.

Answer: False

20. The return on equity (ROE) can be influenced by the amount of debt a company uses in its capital structure.

Answer: True

Multiple Choices

1. Which of the following is a *source* of funds?

A) Repayment of debt

B) Sale of assets

C) Payment of dividends

D) Purchase of inventory

Answer: B) Sale of assets

Multiple Choices

2. Which of the following would be classified as a *use* of funds?

A) Issuance of new shares

B) Increase in accounts payable

C) Payment of dividends

D) Increase in short-term debt

Answer: C) Payment of dividends

Multiple Choices

3. When a company refinances its existing debt by issuing new bonds to replace older bonds, the net effect on the *Sources and Uses of Funds Statement* is typically:

A) A source of funds due to the new issuance of bonds

B) A use of funds due to the redemption of the old bonds

C) Both a source and a use of funds, as the company raises new capital while paying off old debt

D) No impact, as it is a non-cash financing activity

Answer: C) Both a source and a use of funds, as the company raises new capital while paying off old debt

Multiple Choices

4. When a company increases its long-term debt to fund an acquisition, this is reflected as:

A) A use of funds, as it is related to investing activities

B) A source of funds under financing activities

C) A non-cash transaction, as no funds are received

D) A source of funds under investing activities

Answer: B

Multiple Choices

5. In the *Sources and Uses of Funds Statement*, which of the following activities would be classified as an *investing activity*?

A) Issuance of stock

B) Repayment of debt

C) Purchase of property, plant, and equipment

D) Payment of dividends

Answer: C) Purchase of property, plant, and equipment

Multiple Choices

6. A decrease in inventory is generally classified as:

A) Source of funds

B) Use of funds

C) Non-cash item

D) Operating activity

Answer: A) Source of funds

Multiple Choices

7. An increase in accounts payable is generally considered a:

A) Use of funds

B) Source of funds

C) Non-cash transaction

D) Investing activity

Answer: B) Source of funds

Multiple Choices

8. Which of the following transactions would *not* affect the Sources and Uses of Funds Statement?

A) Purchase of a new building

B) Depreciation on fixed assets

C) Sale of land

D) Issuance of stock

Answer: B) Depreciation on fixed assets

Multiple Choices

9. The conversion of convertible bonds into equity is classified as:

A) A source of funds
B) A use of funds
C) A non-cash transaction
D) Operating activity

Answer: C) A non-cash transaction

Multiple Choices

10. A company purchasing treasury stock is classified as:

A) A source of funds

B) A use of funds

C) An operating activity

D) A non-cash transaction

Answer: B) A use of funds

Multiple Choices

11. Which of the following liquidity ratios measures a company's ability to pay off its current liabilities with its most liquid assets?

a) Quick Ratio
b) Current Ratio
c) Cash Ratio
d) Debt Ratio

Answer: A

Multiple Choices

12. Which ratio includes all current assets (including inventory) to assess liquidity?

a) Cash Ratio
b) Quick Ratio
c) Current Ratio
d) Debt to Equity Ratio

Answer: C

Multiple Choices

13. The inventory turnover ratio measures:

a) How quickly inventory is sold and replaced
b) The value of inventory held by a company
c) How long a company holds its inventory
d) The percentage of sales attributed to inventory

Answer: A

Multiple Choices

14. The cash conversion cycle measures:

a) The time it takes to convert cash into inventory
b) The time it takes to convert sales into cash
c) The time it takes to sell fixed assets
d) The time it takes to pay accounts payable

Answer: B

Multiple Choices

15. Which of the following ratios measures the profitability of a company relative to its equity?

a) Return on Assets (ROA)

b) Return on Equity (ROE)

c) Gross Profit Margin

d) Operating Profit Margin

Answer: B

Multiple Choices

16. Low Carb Diet Supplement Inc. has two divisions. Division A has a profit of $156,000 on sales of $2,010,000. Division B is able to make only $28,800 on sales of $329,000. Based on the profit margins (returns on sales), which division is superior?

A. Division B is superior.
B. Division A is superior.
C. Both A and B are equal
D. Neither A nor B

Answer: A

Multiple Choices

17. Polly Esther Dress Shops Inc. can open a new store that will do an annual sales volume of $837,900. It will turn over its assets 1.9 times per year. The profit margin on sales will be 8 percent. What would net income and return on assets (investment) be for the year?

A. 15.2 % - 67032 $
B. 76032 $ - 12.5 %
C. 12.5 % - 76032 $
D. 67032 $ – 15.2%

Answer: D

The balance sheet for Stud Clothiers is shown next. Sales for the year were $2,400,000, with 90 percent of sales sold on credit.

STUD CLOTHIERS			
Balance Sheet 20X1			
Assets		Liabilities and Equity	
Cash……………………	$ 60,000	Accounts payable…………….	$ 220,000
Accounts receivable…...	240,000	Accrued taxes…………………	30,000
Inventory………………	350,000	Bonds payable (long-term)……………………	150,000
Plant and equipment…...	410,000	Common stock………………..	80,000
		Paid-in capital……………….	200,000
		Retained earnings…………….	380,000
Total assets………..	$1,060,000	Total liabilities and equity…	$1,060,000

Compute the following ratios:

a. Current ratio.

b. Quick ratio.

c. Debt-to-total-assets ratio.

d. Asset turnover.

e. Average collection period.

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

$$= \frac{\$650{,}000}{\$250{,}000}$$

$$= 2.6\text{x}$$

Multiple Choices

$$\text{Quick ratio} = \frac{(\text{Current assets} - \text{inventory})}{\text{Current liabilities}}$$

$$= \frac{\$650,000 - \$350,000}{\$250,000}$$

$$= \frac{\$300,000}{\$250,000}$$

$$= 1.2\text{x}$$

$$\text{Debt to total assets} = \frac{\text{Total debt}}{\text{Total assets}}$$

$$= \frac{\$400,000}{\$1,060,000}$$

$$= 37.74\%$$

$$\text{Asset turnover} = \frac{\text{Sales}}{\text{Total assets}}$$

$$= \frac{\$2{,}400{,}000}{\$1{,}060{,}000}$$

$$= 2.26\text{x}$$

$$
\begin{aligned}
\text{Average collection period} &= \frac{\text{Accounts receivable}}{\text{Average daily credit sales}} \\
&= \$240{,}000 \,/\, \frac{(\$2{,}400{,}000 \times 0.90)}{360 \text{ days}} \\
&= \frac{\$240{,}000}{\$6{,}000 \text{ per day}} \\
&= 40 \text{ days}
\end{aligned}
$$

Construct the current assets section of the balance sheet from the following data.

Yearly sales (credit) $420,000

Inventory turnover 7 times

Current liabilities $80,000

Current ratio 2

Average collection period 36 days

Current assets: $

Cash ______

Accounts receivable ______

Inventory ______

Total current assets ______

Solution:

Inventory = \$420,000/7

= \$60,000

Current assets = 2 × \$80,000

= \$160,000

Account rec. = (\$420,000/360) × 36

= \$42,000

Cash = \$160,000 – \$60,000 – \$42,000

= \$ 58,000

Thank For Your Good Listening!