BUSINESS
2023/2024
REVIEW QUESTIONS
LESSON 2 – PART 1

1. Discuss how the following transactions affect the three main elements of the Balance Sheet (assets, liabilities and equity).

a. Purchase of office furniture on short-term loan.
b. Purchase of motorcycles for staff paying half cash, half short-term loan.
c. Loan from bank.
d. Receive a subsidy.
e. Sale of products to be immediately charged.
f. Sale of products to be charged in short-term.
g. Common stock is increased by new shareholders.

2. Classify the following information about *Fiberrific*, a company that sells video games, into assets, liabilities and equity.

Account	Amount
Retained Earnings	€ 113,000
Accounts Receivable	€ 200,000
Accrued Salaries	€ 90,000
DVDs Inventory	€ 335,000
Notes Payable	€ 8,000
Land	€ 40,000
Buildings	€ 110,000
Equipment	€ 40,000
Furniture	€ 16,000
Notes Receivable	€ 50,000
Accounts Payable	€ 40,000
Accrued Taxes	€ 150,000
Common Stock	€ 100,000
Cash	€ 35,000

3. Use the following information to calculate ROS, AT, ROA and ROE.

- **Balance Sheet**

Current assets	
Cash	960,000
Acc receivable	800,000
Inventories	1,440,000
Fixed assets	4,800,000
TOTAL ASSETS	8,000,000
Current liabilities	
Acc payable	1,000,000
Long-term debt	3,200,000
Common stock	640,000
Retained earnings	3,160,000
TOTAL LIAB+EQUITY	8,000,000

- **Income Statement**

Sales	24,000,000
Operating expense	18,240,000
EBIT	5,760,000
Interest expense	416,000
EBT	5,344,000
Taxes	2,138,000
Net income	3,206,000

4. The assets of two firms, *ALPHA, plc.* and *BETA, plc.*, have the same value, that is €1,000,000. While ALPHA is completely financed with owners' equity, BETA finances 50% of the assets with debt, which has an average interest rate of 10%. Earnings before interest and taxes (EBIT) amount to €200,000 in both firms.

Calculate Return on Assets (ROA), Return on Equity (ROE) and Financial Leverage (FL) for both companies.

5. The assets of *COOMBE, plc.* are €2,000,000. The debt represents 75% of total assets. Revenues were €475,000, while the sum of cost of sold products and selling, general and administrative costs was €250,000. Finally, interests paid for the debt amounted €75,000. Calculate Return on Assets (ROA), Return on Equity (ROE) and Financial Leverage (FL).

If you were the CFO (Chief Financial Officer) of this company what would you recommend to the Board of the company: increase or decrease debt-to-equity ratio?

6. The *PINTEL Company* has determined that its ROE is 15%. Management is interested in the various components that went into this calculation. You are given the following information: total debt / total assets = 0.35, interest rate = 0.12 and assets turnover = 2.8.

Calculate Return on Sales (ROS) and profit margin.

7. *Rick's Travel Service* has asked you to help piece together financial information on the firm for the most current year. Managers give you the following data: operating profit = €300,000; sales = €700,000; assets = €1,000,000; interest rate = 15%. In addition, they tell you that debt is 50% larger than equity.

Using this information, calculate Rick's Assets Turnover (AT) and Return on Equity (ROE).

8. The CEO of *Lescott & Rivers, plc* wonders which one is the best option to increase the profitability of its shareholders.

- Using €10,000 of the equity to buy a new printer that would increase the Return on Sales by 18%.
- Buying a €100,000 new packing machine that will be paid by means of a new loan at an interest rate of 5% (the same interest rate that the firm always pays for former loans). This machine will increase Assets Turnover by 16%.

The assets of the firm sum up €500,000, former liabilities sum up €200,000 and Return on Assets before these investments is 10%. Could you assess the better investment?

9. Red Castle, Inc had a return on assets of 14% and a return on equity of 10% in 2020. The following year, 2021, the firm was able to raise return on equity and it was 12%. Additionally, operating profit increased by 5% without affecting to the investments or financial structure of the firm (the additional profits will be paid out as dividends).

- Calculate the return on assets in 2021.
- Should the firm reduce the debt to equity ratio?
- Calculate this ratio (just the ratio, not the debt or the equity).

10. Discuss the following questions:

a. A firm has a ROA of 20%. The industry average ROA is 12%. Is this a good or poor sign about the management of the firm?
b. Two companies that compete in the same industry have the same ROA. However, the first one's ROS is much larger. What does it mean in relation to the strategy of both firms?
c. A company shows in its accounts a Financial Leverage of 2%. Moreover, from inspection of its Balance Sheet, one can see that liabilities represent only 5% of the total assets. What can you say about the financial structure of this firm?