1. **Using Financial Reports: Evaluating Financial Information as a Bank Loan Officer**

Stoscheck Moving Corporation has been in operation since January 1, 2012. It is now December 31, 2012, the end of the annual accounting period. The company has not done well financially during the first year, although revenue has been fairly good. The three stockholders manage the company, but they have not given much attention to recordkeeping. In view of a serious cash shortage, they have applied to your bank for a Ksh.30, 000 loans. You requested a complete set of financial statements. The following 2012 annual financial statements were prepared by a clerk and then were given to the bank.

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| **Stoscheck Moving Corp.**  **Balance sheet**  **As at December 31, 2012**  **Assets** Ksh. 000  Cash 2,000.00  Receivables 3,000.00  Supplies 4,000.00  Equipment 40,000.00  Prepaid insurance 6,000.00  Remaining assets 27,000.00  **Total assets 82,000.00**  Accounts payable 9,000.00  **Stockholders’ equity**  Contributed capital 35,000.00  Retained earnings 38,000.00  **Total liabilities/ stockholders’ equity 82,000.00** | **Stoscheck Moving Corp.**  **Income Statement**  **For the period ended December 31, 2012**  Ksh.  Transportation revenue 85,000.00  Expenses:  Salaries expense 17,000.00  Supplies expense 12,000.00  Other expenses 18,000.00  Total expenses 47,000.00  **Net Income 38,000.00** |

After briefly reviewing the statements and “looking into the situation,” you requested that the statements be redone (with some expert help) to “incorporate depreciation, accruals, inventory counts, income taxes, and so on.” As a result of a review of the records and supporting documents, the following additional information was developed:

*a.* The Supplies of Ksh.4, 000 shown on the balance sheet has not been adjusted for supplies used during 2012. A count of the supplies on hand on December 31, 2012, showed Ksh.1, 800.

*b.* The insurance premium paid in 2012 was for years 2012 and 2013. The total insurance premium was debited in full to Prepaid Insurance when paid in 2012 and no adjustment has been made.

*c.* The equipment cost Ksh.40, 000 when purchased January 1, 2012. It had an estimated annual depreciation of Ksh.8, 000. No depreciation has been recorded for 2012.

*d.* Unpaid (and unrecorded) salaries at December 31, 2012, amounted to Ksh.3, 200.

*e.* At December 31, 2012, transportation revenue collected in advance amounted to Ksh.7, 000. This amount was credited in full to Transportation Revenue when the cash was collected earlier during 2012.

*f.* The income tax rate is 35 percent.

***Required:***

1. Record the six adjusting entries required on December 31, 2012, based on the preceding additional information.

2. Rewrite the preceding statements after taking into account the adjusting entries. You do not need to use classifications on the statements.

3. The only non-current assets for the corporation are the equipments. Compute;

* Current ratio
* The Quick ratio given that the inventories were Ksh. 7,000.00

(Comment on the state of the company based on the ratios)

1. You have the opportunity to invest Ksh.10, 000 in one of two companies from a single industry. The only information you have follows. The word *high* refers to the top third of the industry; *average* is the middle third; *low* is the bottom third. Which company would you select? Write a brief paper justifying your recommendation, and highlighting how each of the formulas is computed.

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| --- | --- | --- |
| Ratio | Company A | Company B |
| Current | Low | Average |
| Quick | Average | Average |
| Debt-to-equity | Low | Average |
| Inventory turnover | High | Average |
| Price/earnings | High | Average |
| Dividend yield | Low | Average |
|  |  |  |

b.

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| --- | --- | --- |
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| **Income Statement**  Sales revenue (1/3 on credit) Ksh.447,000 Ksh.802,000  Cost of goods sold (241,000) (398,000)  Expenses (including interest and income tax) (161,000) (311,000)  Net income Ksh. 45,000 Ksh. 93,000  **Selected data from the 2011 statements**  Accounts receivable (net) Ksh. 18,000 Ksh. 38,000  Inventory 94,000 44,000  Long-term debt 60,000 48,000  **Other data**  Per share price at end of 2012 (offering price) Ksh. 17 Ksh. 15  Average income tax rate 30% 30%  Dividends declared and paid in 2012 Ksh. 33,000 Ksh.148,000 | | |
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The companies are in the same line of business and are direct competitors in a large metropolitan area. Both have been in business approximately 10 years, and each has had steady growth. The management of each has a different viewpoint in many respects. Waterhouse is more conservative, and as its president has said, “We avoid what we consider to be undue risk.” Neither company is publicly held. Price Company has an annual audit by a CPA but Waterhouse Company does not.

**Required:**

1. Complete a schedule that reflects a ratio analysis of each company. Compute the ratios relevant from the data.

2. A client of yours has the opportunity to buy 10 percent of the shares in one or the other company at the per share prices given and has decided to invest in one of the companies. Based on the data given, prepare a comparative written evaluation of the ratio analyses (and any other available information) and give your recommended choice with the supporting explanation.