

Chapter 3 Introduction to Accounting

Section 5

Basic Ratio Analysis



Based on the following information, answer Questions 1 to 2:

	\$
Sales	550,000
Gross Profit	300,000
Net Profit	100,000

1. What is the gross profit margin? (Correct to 2 decimal places)
 - A. 18.18%
 - B. 45.45%
 - C. 53.85%
 - D. 54.55%

2. What is the net profit margin? (Correct to 2 decimal places)
 - A. 18.18%
 - B. 45.45%
 - C. 53.85%
 - D. 54.55%

3. Faith Limited earns a gross profit margin of 20%. The following shows the information about the business in this year:

Item	\$
Carriage inwards	2,500
Carriage outwards	2,000
Closing inventory	5,000
Discounts allowed	4,000
Opening inventory	12,000
Purchases	60,000

The amount of sales for the year is _____ .

- A. \$78,750
- B. \$84,375
- C. \$86,250
- D. \$86,875

4. Which of the following is correct if return on capital employed (ROCE) increases?
- The liquidity of the company increases.
 - The company is more profitable.
 - The company holds more liabilities.
 - The company holds more current assets in hand.

Based on the following information, answer Questions 5 to 6.

	20X7	20X8
	\$	\$
Sales	500,000	600,000
Net Profit	40,000	30,000
Opening balance of capital account	100,000	130,000
Drawings	10,000	20,000

5. What is the return on capital employed (ROCE) for 20X7? (Correct to 2 decimal places)
- 22.22%
 - 28.57%
 - 34.78%
 - 40.00%
6. What is the return on capital employed (ROCE) for 20X8? (Correct to 2 decimal places)
- 18.75%
 - 22.22%
 - 34.78%
 - 44.44%

Based on the following information, answer Questions 7 to 10.

	20X7	20X8
	\$	\$
Inventory	10,000	50,000
Accounts receivable	50,000	60,000
Accounts payable	20,000	30,000
Bank	10,000	2,000
Cash in hand	3,000	5,000
Fixtures and fittings	30,000	45,000

7. What is the amount of current assets for 20X7?
- \$63,000
 - \$73,000
 - \$93,000
 - \$123,000

8. What is the working capital ratio for 20X7? (Correct the numerator to 2 decimal places)
- A. 1.15 : 1
 - B. 3.15 : 1
 - C. 3.65 : 1
 - D. 5.15 : 1
9. What is the working capital ratio for 20X8? (Correct the numerator to 2 decimal places)
- A. 1.53 : 1
 - B. 2.23 : 1
 - C. 2.53 : 1
 - D. 3.90 : 1
10. Based on the working capital ratio, which of the following suggestions should be given to the company?
- A. The company should hold more inventory in hand.
 - B. The company should hold more current assets to avoid short-term liquidity problem.
 - C. The company should liquidate some assets and put them into investments.
 - D. The company should offer more cash discounts to debtors.
11. Which of the following is the difference between current assets and quick assets?
- A. Inventory is included in current assets but excluded in quick assets.
 - B. Accounts receivable are included in current assets but excluded in quick assets.
 - C. Accounts payable are included in current assets but excluded in quick assets.
 - D. Cash in hand is included in current assets but excluded in quick assets.
12. Which of the following is the implication if the quick ratio is less than 1?
- A. The company does not fully utilise its assets to generate profits.
 - B. The company is holding too many quick assets which are idle.
 - C. The company may face liquidity problem.
 - D. The company should hold more current liabilities.
13. Which of the following ratios is not relevant to the profitability of the company?
- A. acid test ratio
 - B. gross profit ratio
 - C. return on capital employed
 - D. net profit ratio

Based on the following information, answer Questions 14 to 24.

The following are the income statements as well as the statements of financial position of Jenny and Judy's businesses for the same year.

Income Statements for the year ended 31 December 20X7

	Jenny	Judy
	\$	\$
Sales	100,000	90,000
Less: Cost of goods sold	40,000	30,000
Gross Profit	60,000	60,000
Add: Other revenues	20,000	15,000
Less: Expenses	30,000	20,000
Net Profit	50,000	55,000

Statements of Financial Position as at 31 December 20X7

	Jenny		Judy	
	\$	\$	\$	\$
Non-current Assets				
Fixtures		200,000		300,000
Current Assets				
Inventory	10,000		40,000	
Accounts receivable	40,000		20,000	
Bank	13,000		24,000	
Cash in hand	1,000		-	
	64,000		84,000	
Less: Current Liabilities				
Accounts payable	10,000		20,000	
Bank overdraft	-		1,000	
Net current assets		54,000		63,000
		254,000		363,000
Financed by:				
Capital				
Opening Balance		250,000		400,000
Add: Net profit		50,000		55,000
		300,000		455,000
Less: Drawings		46,000		92,000
		254,000		363,000

14. What is the current ratio for Jenny's business? (Correct the numerator to 2 decimal places)

- A. 0.16 : 1
- B. 5.40 : 1
- C. 6.40 : 1
- D. 26.40 : 1

15. What is the current ratio for Judy's business ? (Correct the numerator to 2 decimal places)
- A. 0.25 : 1
 - B. 2.10 : 1
 - C. 2.86 : 1
 - D. 4.00 : 1
16. What is the acid test ratio for Jenny's business? (Correct the numerator to 2 decimal places)
- A. 0.19 : 1
 - B. 5.40 : 1
 - C. 6.40 : 1
 - D. 25.40 : 1
17. What is the acid test ratio for Judy's business ? (Correct the numerator to 2 decimal places)
- A. 1.14 : 1
 - B. 2.10 : 1
 - C. 3.05 : 1
 - D. 4.00 : 1
18. What is the return on capital employed (ROCE) for Jenny's business? (Correct to 2 decimal places)
- A. 19.69%
 - B. 19.84%
 - C. 23.62%
 - D. 23.81%
19. What is the return on capital employed (ROCE) for Judy's business? (Correct to 2 decimal places)
- A. 12.69%
 - B. 13.75%
 - C. 14.42%
 - D. 15.15%
20. What is the gross profit ratio for Jenny's business? (Correct to 2 decimal places)
- A. 13.75%
 - B. 15.15%
 - C. 50.00%
 - D. 60.00%

21. What is the gross profit ratio for Judy's business? (Correct to 2 decimal places)
- A. 15.73%
 B. 16.53%
 C. 61.11%
 D. 66.67%
22. What is the net profit ratio for Jenny's business? (Correct to 2 decimal places)
- A. 19.69%
 B. 19.84%
 C. 50.00%
 D. 60.00%
23. What is the net profit ratio for Judy's business? (Correct to 2 decimal places)
- A. 14.42%
 B. 15.15%
 C. 61.11%
 D. 66.67%
24. Which of the following statements is/are correct?
- (1) Judy's business has a higher ability to use its capital to generate profits.
 (2) Judy's business is less able to meet its immediate debts than Jenny's business.
- A. (1) only
 B. (2) only
 C. (1) and (2)
 D. None of the above

Based on the following information, answer Questions 25 to 28.

The following are the account balances of Henry, a sole proprietor, as at 31 December 20X7:

	\$
Accounts receivable	60,000
Accounts payable	5,000
Bank loan (repayable in March 20X9, taken out in January 20X7)	15,000
Bank overdraft	3,500
Cash	6,000
Capital, 1 January 20X7	104,000
Closing inventory	20,500
Drawings	8,000
Furniture and fixtures	90,000
Introduction of capital during 20X7	23,500
Mortgage loan (repayable in July 20X8, taken out in May 20X7)	15,500
Net profit for the year	20,500
Rental deposit	2,500

25. Henry's working capital at the year end is _____ .
- A. \$44,500
 - B. \$62,500
 - C. \$65,000
 - D. \$80,500
26. Henry's current ratio is _____ . (Correct the numerator to 2 decimal places)
- A. 2.86 : 1
 - B. 3.60 : 1
 - C. 3.71 : 1
 - D. 10.47 : 1
27. Henry's liquid ratio is _____ . (Correct the numerator to 2 decimal places)
- A. 2.75 : 1
 - B. 2.85 : 1
 - C. 3.71 : 1
 - D. 8.06 : 1
28. Henry's return on capital employed is _____ . (Correct to 2 decimal places)
- A. 14.64%
 - B. 15.83%
 - C. 16.80%
 - D. 17.60%

Based on the following information, answer Questions 29 to 31.

The following are the account balances of Candy Company as at 31 March 20X6:

	Dr	Cr
	\$	\$
Carriage inwards	1,000	
Carriage outwards	2,300	
Inventory, 1 April 20X5	4,000	
Purchases	25,000	
Rental income		3,000
Returns	550	750
Sales		40,000
Sundry expenses	9,000	

It is given that the amount of closing inventory was twice as much as that of the opening inventory.

29. The cost of goods sold for the year ended 31 March 20X6 is _____ .
- A. \$21,250
 - B. \$22,550
 - C. \$29,250
 - D. \$29,450
30. The gross profit margin of Candy Company is _____ . (Correct to 2 decimal places)
- A. 42.84%
 - B. 45.50%
 - C. 46.13%
 - D. 46.88%
31. The net profit margin of Candy Company is _____ . (Correct to 2 decimal places)
- A. 21.50%
 - B. 21.78%
 - C. 24.75%
 - D. 25.10%
32. As at 31 March 20X5, Wakaka had current liabilities amounting to \$80,000 with current ratio 4 : 1 and quick ratio 2 : 1. What was the amount of its inventory on that day?
- A. \$40,000
 - B. \$80,000
 - C. \$160,000
 - D. \$320,000
33. As at 28 February 20X6, BB Company had total current assets amounting to \$120,000, half of which was inventory. Given that the quick ratio was 2 : 1, what was the amount of working capital on that day?
- A. \$30,000
 - B. \$60,000
 - C. \$90,000
 - D. \$120,000
34. Which of the following accounting ratios cannot be found when only the statement of financial position is provided?
- A. return on capital employed
 - B. current ratio
 - C. liquid ratio
 - D. net profit ratio

35. Given an income statement, which of the following accounting ratios can be calculated?
- (1) current ratio
 - (2) gross profit ratio
 - (3) return on capital employed
- A. (1) only
 - B. (2) only
 - C. (1) and (3) only
 - D. (2) and (3) only

Based on the following information, answer Questions 36 to 37.

	Aliens Company	BeBe Company	Industry average
Current ratio	3.2 : 1	2.5 : 1	2.0 : 1
Acid test ratio	0.8 : 1	1.4 : 1	1.1 : 1

36. Which of the following comments on the liquidity of Aliens Company are correct?
- (1) The liquidity of Aliens Company is better than the industry average.
 - (2) Aliens Company does not have sufficient liquid assets to meet its immediate debts.
 - (3) Aliens Company is tied up with excessive inventories.
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)
37. Which of the following comments on the liquidity of BeBe Company as compared with Aliens Company are **INCORRECT**?
- (1) BeBe Company has a greater amount of current assets to meet short-term obligations.
 - (2) BeBe Company has a lower liquidity.
 - (3) BeBe Company has a lower proportion of funds tied up in inventory.
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)

Based on the following information on Honey Company, answer Questions 38 to 41.

Sales	\$2,000,000
Gross profit ratio	60%
Net profit ratio	20%

38. The cost of goods sold of Honey Company for the year is _____ .
- A. \$400,000
B. \$800,000
C. \$1,200,000
D. \$1,600,000
39. Honey Company's net profit for the year is _____ .
- A. \$400,000
B. \$800,000
C. \$1,200,000
D. \$1,600,000
40. Honey Company's gross profit for the year is _____ .
- A. \$400,000
B. \$800,000
C. \$1,200,000
D. \$1,600,000
41. Given that there are no other revenues, the amount of operating expenses of Honey Company for the year is _____ .
- A. \$400,000
B. \$800,000
C. \$1,200,000
D. \$1,600,000

Based on the following information, answer Questions 42 to 43.

John is the owner of Aloha Company. The following is the information about his business this year:

	Aloha Company	Industry Average
Sales	\$1,000,000	\$1,050,000
Gross profit margin	40%	60%
Net profit margin	5%	40%

42. Which of the following are possible reasons why the gross profit margin is much lower than the industry average?
- (1) relatively low selling prices
 - (2) relatively high production costs
 - (3) ineffective control on operating expenses
- A. (1) and (2) only
B. (1) and (3) only
C. (2) and (3) only
D. (1), (2) and (3)
43. Which of the following are possible reasons why the net profit margin is much lower than the industry average?
- (1) relatively low selling prices
 - (2) relatively high production costs
 - (3) ineffective control on operating expenses
- A. (1) and (2) only
B. (1) and (3) only
C. (2) and (3) only
D. (1), (2) and (3)
44. Which of the following activities can affect the calculation of the gross profit ratio?
- (1) purchasing furniture of \$32,000 for business use on credit
 - (2) mistakenly recording a trade discount of \$320 received from a supplier as a discount received
 - (3) writing off the value of obsolete goods amounting to \$3,000 in the closing inventory
- A. (1) only
B. (2) only
C. (1) and (3) only
D. (2) and (3) only
45. The activities stated in Question 44 are not yet recorded in the books. If the original gross profit ratio is 40%, with net sales being \$60,000, what is the new value of cost of goods sold?
- A. \$26,680
B. \$32,680
C. \$38,680
D. \$56,680

46. Which of the following about accounting ratios is/are correct?
- (1) If a company does not hold inventory, current ratio and quick ratio will be the same.
 - (2) Using cash at bank to pay bank loan repayable within one year will make no changes to the current ratio.
 - (3) Net profit ratio is always lower than the gross profit ratio.
- A. (1) only
 - B. (2) only
 - C. (1) and (2) only
 - D. (2) and (3) only
47. As at 31 March 20X7, Julia Company has inventory and current liability amounting to \$60,000 and \$120,000 respectively. The quick ratio is 1.5 : 1. The current ratio is (i) while the amount of quick assets is (ii) .
- | | <u>(i)</u> | <u>(ii)</u> |
|----|------------|-------------|
| A. | 4 : 1 | \$240,000 |
| B. | 1 : 2 | \$180,000 |
| C. | 2 : 1 | \$240,000 |
| D. | 2 : 1 | \$180,000 |
48. The current gross profit margin is 20%. Using the information below, calculate the net purchases for the year.

	\$
Carriage inwards	4,500
Closing inventory	29,000
Discounts received	1,200
Opening inventory	34,000
Sales	86,000
Returns outwards	2,500
Returns inwards	3,300

- A. \$56,660
- B. \$59,160
- C. \$61,160
- D. \$95,160