

1. **Answer:** b) To assess the company's financial performance and position

**Explanation:** The main purpose of financial analysis is to evaluate a company's financial health by assessing its financial performance and position. This is done by analyzing financial statements such as the balance sheet, income statement, and cash flow statement. Financial analysis helps stakeholders (investors, creditors, and management) to make informed decisions, such as whether to invest in, lend to, or continue a business relationship with the company. Various tools like ratio analysis, trend analysis, and common-size statements are employed to interpret and understand the financial data.

2. **Answer:** a) Current ratio

**Explanation:** The current ratio is a liquidity ratio used to measure a company's ability to meet its short-term liabilities with its short-term assets. It is calculated by dividing current assets by current liabilities. A current ratio greater than 1 indicates that the company has more current assets than current liabilities, which suggests good liquidity. However, a very high ratio may indicate inefficient use of assets, while a very low ratio suggests potential liquidity problems.

3. **Answer:** c) To convert financial figures into percentage terms for easier comparison

**Explanation:** A common-size statement is a financial statement where each item is expressed as a percentage of a base item, such as total sales or total assets. The purpose of preparing a common-size statement is to make it easier to compare the financial performance of a company across different periods or with other companies in the industry. This analysis removes the effects of size, allowing comparisons between companies of different sizes or in different industries.

4. **Answer:** b) Debt-to-equity ratio

**Explanation:** The debt-to-equity ratio is a solvency ratio used to measure a company's financial leverage. It compares the company's total debt to its shareholders' equity. A higher debt-to-equity ratio indicates that the company relies more on borrowing to finance its operations, which could signal higher risk. A lower ratio indicates a more conservative approach with less reliance on debt. This ratio is crucial for assessing the long-term financial stability and risk of a company.

5. **Answer:** b) Ratios that measure operational efficiency

**Explanation:** Activity ratios, also known as efficiency ratios, measure how efficiently a company uses its assets to generate revenue. These ratios include inventory turnover, debtor turnover, payables turnover, and asset turnover ratios. They provide insights into the operational effectiveness of the company. For example, the inventory turnover ratio indicates how quickly a company sells its inventory, while the receivables turnover ratio

measures how effectively the company collects its receivables. High turnover ratios generally suggest efficient operations.

6 **Answer:** c) It relies on historical data

**Explanation:** One limitation of financial analysis is that it primarily relies on historical data, which may not always reflect the current market conditions or future performance of a company. Financial statements typically report past performance, and while they are helpful for analyzing trends, they may not account for recent changes in the market, technology, or competitive landscape. Therefore, financial analysis should be used in conjunction with other methods of evaluation for a comprehensive assessment.

7 **Answer:** d) All of the above

**Explanation:** Profitability ratios are used to measure a company's ability to generate profit relative to its sales, assets, or equity. The operating ratio, return on assets (ROA), and gross profit ratio all fall under this category. The operating ratio indicates how efficiently a company is managing its operating expenses, the ROA measures how effectively the company utilizes its assets to generate profit, and the gross profit ratio reflects the percentage of revenue that exceeds the cost of goods sold, giving an idea of the company's basic profitability.

8 **Answer:** b) It allows comparison of financial data over multiple periods

**Explanation:** Comparative statements are used to analyze financial data from multiple periods side by side. They provide a clear comparison of changes in financial performance over time, helping analysts and stakeholders assess trends and patterns. By comparing income statements and balance sheets across periods, users can easily identify increases or decreases in revenues, expenses, assets, and liabilities. This comparative analysis helps in making predictions about the company's future performance and in making better business decisions.

9 **Answer:** c) The liquidity ratio excludes inventory and receivables, while the current ratio includes all current assets

**Explanation:** The liquidity ratio (or quick ratio) is a more stringent measure of a company's liquidity than the current ratio. While the current ratio includes all current assets (such as inventory, receivables, and cash), the liquidity ratio excludes inventory and receivables because they may not be as readily converted to cash. The liquidity ratio focuses on a company's ability to cover its short-term liabilities with its most liquid assets, giving a clearer picture of its immediate financial health.

10 **Answer:** c) The amount of profit allocated to each outstanding share of common stock

**Explanation:** Earnings per share (EPS) is a profitability ratio that indicates the amount of profit allocated to each share of the company's common stock. It is calculated by dividing the net income of the company by the weighted average number of outstanding shares during a specific period. EPS is widely used by investors to gauge a company's profitability on a per-share basis and serves as a key metric for evaluating financial performance and comparing companies within the same industry.

11 **Answer:** a) Current Assets / Current Liabilities

**Explanation:** The current ratio is calculated by dividing current assets by current liabilities. This ratio helps assess a company's ability to pay off its short-term liabilities using its short-term assets. A ratio greater than 1 indicates that the company has more assets than liabilities, which is typically considered good. However, a very high current ratio may suggest inefficiency in utilizing assets, while a very low ratio might indicate liquidity problems.

12 **Answer:** b) Debt to equity ratio

**Explanation:** The debt-to-equity ratio is a solvency ratio that measures the financial leverage of a company. It compares the total debt of a company to its shareholders' equity. A higher ratio indicates that the company is more leveraged, meaning it relies more on debt to finance its assets. This may increase financial risk, as the company needs to service its debt regardless of business conditions. A lower ratio generally indicates a more conservative approach with lower risk.

13 **Answer:** a) Cost of Goods Sold / Average Inventory

**Explanation:** The inventory turnover ratio measures how quickly a company sells and replaces its inventory over a period. It is calculated by dividing the cost of goods sold (COGS) by the average inventory during that period. A high inventory turnover ratio indicates that the company is efficiently managing its inventory, while a low ratio may indicate overstocking or slow-moving products. This ratio is critical for businesses like retail and manufacturing, where inventory management is crucial to profitability.

14 **Answer:** c) They are purely based on historical data and may not represent current market conditions

**Explanation:** One major limitation of financial ratios is that they rely on historical data, which may not accurately reflect the current financial position of a company. Economic conditions, market changes, and other external factors can affect a company's performance in ways that financial ratios may not immediately capture. Hence, it is important to use financial ratios alongside other qualitative and market-based analyses for a comprehensive understanding.

15 **Answer:** c) Cash and cash equivalents

**Explanation:** Current assets are assets that are expected to be converted into cash or used up within one year. Examples include cash and cash equivalents, accounts receivable, inventory, and short-term investments. These are included when calculating the current ratio, which measures a company's ability to pay off its short-term liabilities using its short-term assets. Cash and cash equivalents are the most liquid form of current assets, making them a vital component in assessing liquidity.

16 **Answer:** b) Debt-to-equity ratio

**Explanation:** The debt-to-equity ratio is a key indicator of a company's financial leverage and its ability to manage debt. It compares the company's total liabilities to shareholders' equity, showing how much of the company's operations are funded by debt versus equity. A high debt-to-equity ratio means that a company relies more heavily on debt for financing, which may pose a higher risk for investors and creditors, particularly during periods of economic uncertainty.

17 **Answer:** b) They only present data in percentage terms

**Explanation:** One limitation of common-size statements is that they only present data in percentage terms, which can obscure the absolute figures. While these statements make it easier to compare companies of different sizes, they do not reflect the actual magnitude of financial performance. For instance, a company with a smaller percentage but larger revenue may have a better financial position than a company with a higher percentage but lower revenue, making context crucial when interpreting the data.

18 **Answer:** b) It shows the efficiency of a company in generating revenue from its operations

**Explanation:** The gross profit ratio is a profitability ratio that measures the efficiency of a company in generating revenue from its direct costs, primarily the cost of goods sold. It is calculated by dividing gross profit by total revenue, usually expressed as a percentage. A higher gross profit ratio indicates that the company is effectively managing its production costs relative to its sales, which is a sign of operational efficiency and profitability.

19 **Answer:** b) The company may be inefficiently using its resources

**Explanation:** A very high current ratio (above 3:1 or 4:1) may indicate that a company has too many assets tied up in current assets, such as cash or inventory, that are not being used effectively. While a high current ratio suggests that the company can cover its short-term liabilities, it may also signal inefficiency in utilizing its resources. This can lead to missed opportunities for growth or expansion, as excess cash or inventory could be better invested in generating more returns.

20 **Answer:** a) Return on assets

**Explanation:** Return on assets (ROA) is a profitability ratio that measures how efficiently a company uses its assets to generate profit. It is calculated by dividing net income by average total assets. A higher ROA indicates that the company is efficiently using its assets to produce profits. This ratio is important for investors, as it helps assess the overall efficiency and effectiveness of the company in utilizing its assets to generate earnings.

21 **Answer:** c) Ratios that evaluate the company's ability to meet short-term obligations

**Explanation:** Liquidity ratios are used to assess a company's ability to meet its short-term liabilities with its most liquid assets. The key liquidity ratios are the current ratio and quick ratio. The current ratio compares a company's current assets to its current liabilities, while the quick ratio (acid-test ratio) excludes inventory from current assets to give a more conservative view of liquidity. These ratios are crucial for assessing financial health in the short term.

22 **Answer:** b) To evaluate the company's financial performance and position

**Explanation:** The key purpose of financial analysis is to evaluate the financial performance and position of a company. Financial analysts use various tools such as financial ratios, common size statements, and comparative statements to assess a company's profitability, liquidity, solvency, and efficiency. This analysis helps investors, managers, and other stakeholders understand the company's financial health and make informed decisions regarding investments, credit, and management strategies.

23 **Answer:** b) Solvency ratio

**Explanation:** Solvency ratios are used to determine a company's ability to meet its long-term debt obligations. Key solvency ratios include the debt-to-equity ratio, which compares the company's total debt to shareholder equity, and the total assets-to-debt ratio, which compares the company's total assets to its total debt. These ratios help assess the company's financial stability and the degree of financial risk associated with its capital structure. A lower debt-to-equity ratio indicates lower financial leverage and risk.

24 **Answer:** c) To evaluate performance by comparing figures over different periods

**Explanation:** The primary objective of preparing comparative financial statements is to evaluate a company's financial performance by comparing figures from multiple periods. This analysis helps identify trends, patterns, and changes in the company's financial position and results. By comparing data across different time periods, stakeholders can assess the company's growth, profitability, and efficiency, as well as any significant fluctuations or areas that require attention.

25 **Answer:** a) Return on assets (ROA)

**Explanation:** Return on assets (ROA) is a profitability ratio that measures how efficiently a company uses its assets to generate profit. It is calculated by dividing the company's net income by its total assets. A higher ROA indicates that the company is effectively utilizing its assets to produce earnings. This ratio is important for investors to understand how well a company is generating profits relative to its asset base.

26 **Answer:** a) To assess the company's efficiency in generating profits from its sales

**Explanation:** The operating ratio is a profitability ratio that assesses how efficiently a company uses its resources to generate operating profits. It is calculated by dividing the operating expenses by the net sales. The operating ratio provides insights into the cost structure of the company and its ability to generate profit from its operations. A lower operating ratio indicates higher profitability and operational efficiency, while a higher ratio suggests that the company is spending a large portion of its revenue on operating expenses.

27 **Answer:** b) Quick ratio

**Explanation:** The quick ratio (or acid-test ratio) is an effective measure of a company's liquidity, as it evaluates its ability to meet short-term obligations with its most liquid assets, excluding inventory. It provides a conservative measure of liquidity because inventory is excluded, which may not be as easily converted into cash in the short term. The formula for quick ratio is:  $(\text{Current assets} - \text{Inventory}) / \text{Current liabilities}$ . A ratio greater than 1 indicates that the company has sufficient liquid assets to cover its short-term liabilities.

28 **Answer:** b) Solvency ratio

**Explanation:** Solvency ratios help investors assess the company's long-term financial stability and risk. The most commonly used solvency ratios are the debt-to-equity ratio and the total assets-to-debt ratio. These ratios indicate how much of the company's assets are financed by debt and whether it is capable of covering its long-term debt obligations. A higher debt-to-equity ratio suggests higher leverage and, consequently, higher financial risk. Investors often use these ratios to evaluate a company's ability to withstand financial difficulties.

29 **Answer:** c) It may not account for non-financial factors affecting performance

**Explanation:** One limitation of financial ratio analysis is that it primarily focuses on financial data and does not consider non-financial factors that may influence the company's performance. Non-financial factors such as market conditions, industry trends, customer satisfaction, and management quality can significantly impact a company's results but are not reflected in financial ratios. Therefore, ratio analysis

should be used in conjunction with qualitative assessments to provide a more comprehensive evaluation of a company's performance.

30 **Answer:** c) To evaluate the company's financial leverage and risk

**Explanation:** The debt-to-equity ratio is a solvency ratio that compares a company's total debt to its shareholder equity. This ratio helps assess the financial leverage of the company and the extent to which it relies on debt financing. A higher debt-to-equity ratio indicates that the company is heavily reliant on debt, which could pose a higher financial risk. Conversely, a lower ratio indicates that the company is more conservatively financed with equity, reducing the risk for investors and creditors.

31 **Answer:** b) Gross Profit Ratio

**Explanation:** The Gross Profit Ratio measures the relationship between gross profit and net sales. It helps assess how efficiently a company produces its goods or services by comparing the revenue from sales to the direct costs of production (i.e., cost of goods sold). The formula for the gross profit ratio is:  $(\text{Gross Profit} / \text{Net Sales}) \times 100$ . A higher gross profit ratio indicates the company is able to control its production costs and generate more profit from its sales.

32 **Answer:** b) To show financial data as percentages of a common figure for comparison

**Explanation:** Common-size financial statements present all items in a financial statement as a percentage of a common base. For the income statement, this is usually total revenue, while for the balance sheet, it is total assets or total liabilities. This allows for easy comparison of financial data across companies or over time, regardless of the size of the company. It helps analysts and investors to identify trends and evaluate performance more effectively by focusing on relative proportions rather than absolute figures.

33 **Answer:** c) To evaluate the company's ability to generate profits

**Explanation:** Profitability ratios are used to assess how well a company generates profit relative to its sales, assets, equity, or other financial metrics. These ratios provide insights into the efficiency of a company's operations and its ability to generate returns for its shareholders. Key profitability ratios include the net profit margin, return on assets (ROA), return on equity (ROE), and operating profit margin. A higher profitability ratio indicates a more profitable and efficiently run company.

34 **Answer:** c) Inventory Turnover Ratio

**Explanation:** The Inventory Turnover Ratio measures how many times a company's inventory is sold and replaced over a period. It is calculated by dividing the cost of goods sold by the average inventory. This ratio helps assess the efficiency of inventory

management, indicating whether a company is overstocking or experiencing issues with slow-moving inventory. A higher inventory turnover ratio generally reflects effective inventory management and good sales performance, while a lower ratio may suggest overstocking or weak sales.

35 **Answer:** b) Measure the company's short-term financial health

**Explanation:** Liquidity ratios focus on measuring a company's ability to meet its short-term obligations using its most liquid assets. These ratios include the current ratio and quick ratio, which provide insight into whether a company can cover its current liabilities with its current assets or liquid assets. High liquidity ratios typically indicate that the company is in good financial health and can easily meet its short-term obligations. A company with low liquidity may struggle to pay its short-term debts, potentially leading to financial distress.

36 **Answer:** b) The company's reliance on equity financing over debt financing

**Explanation:** The debt-to-equity ratio is a solvency ratio that measures the proportion of debt financing relative to equity financing in a company's capital structure. It is calculated by dividing total debt by total equity. A higher ratio indicates that the company is relying more heavily on debt to finance its operations, which increases financial risk. A lower ratio suggests a more conservative approach, relying more on equity financing, which is generally considered safer. This ratio helps assess the financial leverage and overall risk of the company.

37 **Answer:** c) To assess the profitability of the company from the shareholders' perspective

**Explanation:** Return on Equity (ROE) measures the profitability of a company in relation to shareholders' equity. It is calculated by dividing net income by average shareholders' equity. ROE indicates how effectively a company is using equity capital to generate profits. A higher ROE indicates that the company is efficiently utilizing its equity base to generate returns, making it an attractive investment for shareholders. It is an important metric for investors to evaluate the company's financial performance and potential for generating shareholder value.

38 **Answer:** c) Current liabilities

**Explanation:** The current ratio is a liquidity ratio used to evaluate a company's ability to meet its short-term obligations. It is calculated by dividing current assets by current liabilities. Current assets include cash, accounts receivable, and inventory, while current liabilities include accounts payable, short-term debt, and other obligations due within one year. A higher current ratio indicates better liquidity and the ability to pay short-term liabilities. A ratio of 2:1 is considered ideal, suggesting the company has twice as many assets as liabilities.

39 **Answer:** b) Income Statement

**Explanation:** The Income Statement (also known as the Profit and Loss Statement) provides information about a company's revenues, expenses, and profitability over a specific period, usually a quarter or year. It shows the net profit or loss after accounting for all revenues and expenses, including taxes and interest. This financial statement is critical for assessing a company's financial performance and determining how efficiently it generates profits from its operations.

40 **Answer:** b) Return on Assets (ROA)

**Explanation:** Return on Assets (ROA) is a key efficiency ratio that measures how effectively a company uses its assets to generate profit. It is calculated by dividing net income by total assets. A higher ROA indicates that the company is utilizing its assets efficiently to generate earnings. This ratio is useful for investors and analysts to assess how well the company is managing its asset base in relation to its profitability.

41 **Answer:** c) Debt to Equity Ratio

**Explanation:** Solvency ratios assess a company's ability to meet its long-term obligations. The Debt to Equity Ratio is a key solvency ratio that compares a company's total debt to its total equity, indicating the financial leverage used by the business. A high ratio suggests higher financial risk due to dependence on borrowed funds, while a lower ratio suggests financial stability. It is an important indicator for investors and creditors to evaluate the long-term financial sustainability of a company.

42 **Answer:** b) The efficiency in using working capital

**Explanation:** The Working Capital Turnover Ratio measures how efficiently a company uses its working capital (current assets minus current liabilities) to generate revenue. It is calculated as  $\text{Net Sales} / \text{Average Working Capital}$ . A higher ratio suggests better utilization of working capital, indicating operational efficiency, while a lower ratio may suggest inefficiencies in managing short-term assets and liabilities. This ratio is crucial for analyzing how well a business manages its short-term financial resources.

43 **Answer:** c) Current Ratio

**Explanation:** The Current Ratio measures a company's ability to meet short-term obligations using its current assets. It is calculated as  $\text{Current Assets} / \text{Current Liabilities}$ . A ratio above 1 indicates that the company has more current assets than liabilities, suggesting good short-term financial health. However, an excessively high ratio may indicate inefficient asset utilization. It is a fundamental ratio used by investors and creditors to evaluate liquidity risk.

44 **Answer:** a) Earnings per Share (EPS)

**Explanation:** Earnings per Share (EPS) is a profitability ratio that measures the portion of a company's profit allocated to each outstanding share of common stock. It is calculated as  $(\text{Net Profit} - \text{Preferred Dividends}) / \text{Number of Outstanding Shares}$ . EPS is a crucial metric for investors as it indicates the profitability of the company and is often used in stock valuation. A higher EPS suggests a more profitable company.

45 **Answer:** c) Balance Sheet

**Explanation:** The Balance Sheet is a financial statement that provides a detailed view of a company's financial position at a specific date. It consists of three main components: assets, liabilities, and shareholders' equity. The balance sheet follows the fundamental accounting equation:  $\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$ . It helps investors and creditors assess a company's financial strength and liquidity.

46 **Answer:** b) The proportion of shareholders' funds in total assets

**Explanation:** The Proprietary Ratio is a solvency ratio that indicates the proportion of total assets financed by shareholders' funds. It is calculated as  $\text{Shareholders' Equity} / \text{Total Assets}$ . A higher ratio suggests financial stability, as more assets are financed through equity rather than debt. It is useful for assessing a company's financial independence and risk level.

47 **Answer:** c) Debtors Turnover Ratio

**Explanation:** The Debtors Turnover Ratio (or Accounts Receivable Turnover Ratio) measures how efficiently a company collects debts from its customers. It is calculated as  $\text{Net Credit Sales} / \text{Average Accounts Receivable}$ . A higher ratio indicates faster collection of receivables, improving cash flow, while a lower ratio suggests inefficiencies in credit management. This ratio is crucial for businesses that rely on credit sales.

48 **Answer:** b) Net Profit Ratio

**Explanation:** The Net Profit Ratio is a profitability ratio that measures how much profit a company generates from its net sales. It is calculated as  $(\text{Net Profit} / \text{Net Sales}) \times 100$ . This ratio indicates the company's ability to control costs and generate earnings. A higher net profit ratio suggests efficient cost management and strong financial performance.

49 **Answer:** b) To compare financial performance across different periods

**Explanation:** Comparative Financial Statements display financial data for multiple periods, helping analysts and investors compare trends over time. By showing changes in financial position and performance, they provide insights into growth patterns, profitability, and financial stability. These statements are essential for making informed business and investment decisions.

50     **Answer:** b) Debt to Total Assets Ratio

**Explanation:** The Debt to Total Assets Ratio is a solvency ratio that measures the proportion of a company's assets financed by debt. It is calculated as  $\text{Total Debt} / \text{Total Assets}$ . A higher ratio suggests higher financial leverage and potential risk, while a lower ratio indicates financial stability. This ratio is important for assessing a company's ability to meet its long-term obligations.