

## FA Module 4 Profitability ratios practice exam questions

covering long-term debt, short term debt, other liabilities, common stock, additional paid-in capital, retained earnings, shareholders' equity, financial leverage, net income, shareholder dividends, return on equity.

(The attached PDF file has better formatting.)

A firm's balance sheet shows

	<i>December 31, 20X1</i>	<i>December 31, 20X2</i>
Long-term and short term debt	84	91
Other liabilities	14	37
Common stock + additional paid-in capital	85	72
Retained earnings	32	49

The firm declared and paid shareholder dividends of 33 in 20X2.

Question 4.1: Shareholders' equity

What is shareholders' equity at December 31, 20X1 and 20X2?

Answer 4.1: (add stock and retained earnings)

! December 31, 20X1:  $85 + 32 = 117$

! December 31, 20X2:  $72 + 49 = 121$

Question 4.2: Total assets

What are total assets at December 31, 20X1 and 20X2?

Answer 4.2: (total assets = debt + other liabilities + shareholders' equity)

! December 31, 20X1:  $84 + 14 + 117 = 215$

! December 31, 20X2:  $91 + 37 + 121 = 249$

Question 4.3: Financial leverage

What is the financial leverage at December 31, 20X1 and 20X2?

Answer 4.3: (financial leverage = total assets / shareholders' equity)

! December 31, 20X1:  $215 / 117 = 1.838$

! December 31, 20X2:  $249 / 121 = 2.058$

Question 4.4: Net income

What is net income in 20X2?

Answer 4.4:  $33 + (49 - 32) = 50$

(net income = shareholder dividends + (retained earnings) )

Question 4.5: Return on equity

What is the return on equity in 20X2?

Answer 4.5:  $50 / ((117 + 121) / 2) = 42.02\%$

(return on equity = net income / average shareholders' equity)

Question 4.6: Return on assets

What is the return on assets in 20X2?

Answer 4.6:  $50 / ((215 + 249) / 2) = 21.55\%$

(return on assets = net income / average assets)