13e

Financial Reporting & Analysis

Using Financial Accounting Information

CHARLES H. GIBSON

Liquidity

$$\text{Days' Sales in Receivables} = \frac{\text{Gross Receivables}}{\text{Net Sales}/365}$$

$$\text{Accounts Receivable Turnover} = \frac{\text{Net Sales}}{\text{Average Gross Receivables}}$$

$$\text{Accounts Receivable Turnover in Days} = \frac{\text{Average Gross Receivables}}{\text{Net Sales}/365}$$

$$\text{Days' Sales in Inventory} = \frac{\text{Ending Inventory}}{\text{Cost of Goods Sold}/365}$$

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

$$\text{Inventory Turnover in Days} = \frac{\text{Average Inventory}}{\text{Cost of Goods Sold}/365}$$

$$\text{Operating Cycle} = \begin{array}{c}\text{Accounts Receivable}\\\text{Turnover in Days}\end{array} + \begin{array}{c}\text{Inventory Turnover}\\\text{in Days}\end{array}$$

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Acid-Test Ratio} = \frac{\text{Cash Equivalents} + \text{Marketable Securities} + \text{Net Receivables}}{\text{Current Liabilities}}$$

$$\text{Cash Ratio} = \frac{\text{Cash Equivalents} + \text{Marketable Securities}}{\text{Current Liabilities}}$$

$$\text{Sales to Working Capital} = \frac{\text{Sales}}{\text{Average Working Capital}}$$

Formula for operating cash flow/current maturities of long-term debt and current notes payable is as follows:

$$\frac{\text{Operating Cash Flow}}{\text{Current Maturities of Long-Term Debt and Current Notes Payable}}$$

Long-Term Debt-Paying Ability

$$\text{Times Interest Earned} = \frac{\begin{array}{c}\text{Recurring Earnings, Excluding Interest Expense, Tax}\\\text{Expense, Equity Earnings, and Noncontrolling Interest}\end{array}}{\text{Interest Expense, Including Capitalized Interest}}$$

$$\text{Fixed Charge Coverage} = \frac{\begin{array}{c}\text{Recurring Earnings, Excluding Interest Expense, Tax}\\\text{Expense, Equity Earnings, and Noncontrolling Interest}\\+ \text{Interest Portion of Rentals}\end{array}}{\begin{array}{c}\text{Interest Expense, Including Capitalized Interest} +\\\text{Interest Portion of Rentals}\end{array}}$$

$$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

$$\text{Debt/Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Shareholders' Equity}}$$

$$\text{Debt to Tangible Net Worth Ratio} = \frac{\text{Total Liabilities}}{\text{Shareholders' Equity} - \text{Intangible Assets}}$$

$$\text{Operating Cash Flow/Total Debt} = \frac{\text{Operating Cash Flow}}{\text{Total Debt}}$$

Profitability

$$\text{Net Profit Margin} = \frac{\text{Net Income Before Noncontrolling Interest, Equity Income, and Nonrecurring Items}}{\text{Net Sales}}$$

$$\text{Total Asset Turnover} = \frac{\text{Net Sales}}{\text{Average Total Assets}}$$

$$\text{Return on Assets} = \frac{\text{Net Income Before Noncontrolling Interest and Nonrecurring Items}}{\text{Average Total Assets}}$$

$$\text{Operating Income Margin} = \frac{\text{Operating Income}}{\text{Net Sales}}$$

$$\text{Operating Asset Turnover} = \frac{\text{Net Sales}}{\text{Average Operating Assets}}$$

$$\text{Return on Operating Assets} = \frac{\text{Operating Income}}{\text{Average Operating Assets}}$$

$$\text{DuPont Return on Operating Assets} = \text{Operating Income Margin} \times \text{Operating Asset Turnover}$$

$$\text{Sales to Fixed Assets} = \frac{\text{Net Sales}}{\text{Average Net Fixed Assets (Exclude Construction in Progress)}}$$

$$\text{Return on Investment} = \frac{\text{Net Income Before Noncontrolling Interest and Nonrecurring Items} + [(\text{Interest Expense}) \times (1 - \text{Tax Rate})]}{\text{Average (Long-Term Liabilities} + \text{Equity)}}$$

$$\text{Return on Total Equity} = \frac{\text{Net Income Before Nonrecurring Items} - \text{Dividends on Redeemable Preferred Stock}}{\text{Average Total Equity}}$$

$$\text{Return on Common Equity} = \frac{\text{Net Income Before Nonrecurring Items} - \text{Preferred Dividends}}{\text{Average Common Equity}}$$

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

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Dedication

This book is dedicated to my wife, Patricia, and daughters Anne Elizabeth and Laura.

Special Dedication

To hardworking students mastering financial reporting and analysis.

About the Author

Charles Gibson is a certified public accountant who practiced with a Big Four accounting firm for four years and has had more than 30 years of teaching experience. His teaching experience encompasses a variety of accounting courses, including financial, managerial, tax, cost, and financial analysis.

Professor Gibson has taught seminars on financial analysis to financial executives, bank commercial loan officers, lawyers, and others. He has also taught financial reporting seminars for CPAs and review courses for both CPAs and CMAs. He has authored several problems used on the CMA exam.

Charles Gibson has written more than 60 articles in such journals as the *Journal of Accountancy, Accounting Horizons, Journal of Commercial Bank Lending, CPA Journal, Ohio CPA, Management Accounting, Risk Management, Taxation for Accountants, Advanced Management Journal, Taxation for Lawyers, California Management Review*, and *Journal of Small Business Management*. He is a co-author of the Financial Executives Research Foundation Study entitled, "Discounting in Financial Accounting and Reporting."

Dr. Gibson co-authored *Cases in Financial Reporting* (PWS-KENT Publishing Company). He has also co-authored two continuing education courses consisting of books and cassette tapes, published by the American Institute of Certified Public Accountants. These courses are entitled "Funds Flow Evaluation" and "Profitability and the Quality of Earnings."

Professor Gibson is a member of the American Accounting Association, American Institute of Certified Public Accountants, Ohio Society of Certified Public Accountants, and Financial Executives Institute. In the past, he has been particularly active in the American Accounting Association and the Ohio Society of Certified Public Accountants.

Dr. Gibson received the 1989 Outstanding Ohio Accounting Educator Award jointly presented by the Ohio Society of Certified Public Accountants and the Ohio Regional American Accounting Association. In 1993, he received the College of Business Research Award at the University of Toledo. In 1996, Dr. Gibson was honored as an "Accomplished Graduate" of the College of Business at Bowling Green State University. In 1999, he was honored by the Gamma Epsilon Chapter of Beta Alpha Psi of the University of Toledo.

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