



# Navigating Accounting<sup>®</sup>

## Income Statements and Return on Assets: How Do I Use the Numbers?

### Industry Comparisons 01

Comparing and contrasting income, common size statements, and ratios across industries and time.

### Search



This exercise requires you to search for information.

### Compute



This exercise requires you to compute information.

### Usage



This exercise helps you learn how accounting reports are used by investors, creditors, and other stakeholders.

### Judgement



This exercise helps you learn how to use judgement.

## Part 1 Question

- Fill in the blank boxes (with red borders) in the data template in the Excel file for this exercise following the guidance below.

## Part 1 Guidance

- If you have not already done so, go to [NavigatingAccounting.com](http://NavigatingAccounting.com) and then click your way to the materials for this exercise:
  - Click “Analyzing Financial Statements Across Time and Industries”
  - Industry Comparisons Exercises: Series 01
  - Click “Exercise 2: Income Statements and Return on Assets”
- Download the Excel and Word files.
- Search the internet for information needed to fill in the blank boxes:
  - You will find most of this information on the companies’ balance sheets and income statements. These are reported in their annual reports or extended versions of these reports they submit to the Securities and Exchange Commission (SEC) called Form 10-Ks. To learn how to locate and download these documents and find the balance sheets therein, watch *Searching and Locating Annual Reports 1*, which is included in the Videos section of the materials for this exercise.
  - You will need to know some very basic Excel skills to complete the data template. If you are not familiar with Excel, watch *Using Excel 1: Basics*, which is included in the Videos section of the materials for this exercise.

## Part 2 Question

- Compare and contrast the financial performance for the five companies in the data template during the three years in the template, ignoring fiscal-year-end differences.

## Part 2 Guidance

- **Limit your analyses of the companies’ performances to:**
  - The ratios in the data template.
  - Your understanding of the companies’ businesses and the ways they were likely impacted by the financial crisis during this period. Your understanding of the companies’ businesses should be informed by related excerpts from the Management Discussion and Analysis (MD&A) section of the 10-K.
- **Organize your responses with the following titles and guidance:**
  - (a) **Sales Growth Comparisons: Analysis and Conclusions.** Compare and contrast the companies’ sales growth (or, more precisely revenue growth) during the three years, ignoring fiscal-year-end differences. Additionally, explain sales growth patterns over time for individual companies and differences in these patterns across companies in terms of your understanding of the companies’ businesses and the ways they were likely affected by the financial crisis.
    - Assume revenues are measured reasonably reliably: (1) objective experts would approve the companies’ revenue recognition policies; (2) their revenue estimates given these policies would likely be closely dispersed; and (3) the companies’ reported revenues are based on honest and objective analyses (and thus fall within experts’ hypothetical distributions).

- Assume revenues from discontinued operations are relatively inconsequential and can be ignored. They are not included in the data template.

**Caveat:** To the extent these assumptions are valid, you can put a great deal of confidence in conclusions based on revenues in the data template. However, in later chapters you will learn that the reliability of reported revenues can vary dramatically across companies:

- For the purposes of this assignment assume revenue can only be recognized when: (i) Customers have paid for goods or services or there is reasonable assurance they will pay for them in the future. (ii) Sellers have delivered the goods and services and can reliably estimate future product returns, rebates, and other sales incentives that could ultimately decrease the net proceeds collected from customers. We will discuss revenue recognition criteria more precisely in later chapters.
  - Determining when revenue recognition criteria are met requires varying degrees of judgment, depending on the business context. Additionally, once the criteria are met, measuring revenue entails forecasting customer collections, sales returns, rebates, and other sales incentives, which also requires varying degrees of judgment, depending on the business context. Similar caveats apply for parts (b)-(c).
- (b) **Net Profit Comparisons: Analysis and Conclusions.** Compare and contrast the companies' net profit margins and net profit growth during the three years, ignoring fiscal-year-end differences:
- Explain patterns in net profit margins for individual companies and differences in these patterns across companies in terms of gross profit margins, operating profit margins, and profit margins before taxes. As you do so, relate these differences to your understanding of the companies' businesses and the ways they were likely affected by the financial crisis.
  - Explain patterns in net profit growth and operating profit growth for individual companies and differences across companies in terms of your understanding of the companies' businesses and the ways they were likely affected by the financial crisis.
  - Assume all related measures in the data template are measured reliably and do not discuss related caveats about the validity of this assumption discussed above.
  - Assume all related measures from discontinued operations are relatively inconsequential and can be ignored. They are not included in the data template.
- (c) **Return on Assets Comparisons: Analysis and Conclusions.** Compare and contrast the companies' return on assets during the three years, ignoring fiscal-year-end differences:
- Explain patterns in return on assets for individual companies and differences across companies in terms net profit margins and sales turnover. As you do so, relate these differences to your understanding of the companies' businesses and the ways they were likely affected by the financial crisis.
  - Return on assets equals sales turnover multiplied by net profit margin. Thus, to analyze return on assets, which measures how much profit the company is earning per dollar of assets, you can combine your analysis of how efficiently the company is using its assets, which is measured by sales per dollar of assets, with your analysis of its profit margin from part (b).

- Assume all related measures in the data template are measured reliably and do not discuss related caveats about the validity of this assumption discussed above.
- Assume all related measures from discontinued operations are relatively inconsequential and can be ignored. They are not included in the data template.