Chapter 02 Analysis of Financial Statements

TRUEFALSE

1. The information contained in the annual report is used by investors to form expectations about future earnings and dividends.

(A) True

(B) False

Answer : (A)

2. Noncash assets are expected to produce cash over time but the amount of cash they eventually produce could be higher or lower than the values at which the assets are carried on the books.

(A) True

(B) False

Answer : (A)

3. The book value of shares are often equal to their market value.

(A) True

(B) False

Answer : (B)

4. Funds supplied by common stockholders mainly include capital stock, paid-in capital, and retained earnings, while total equity is comprised of common equity plus preferred stock.

(A) True

(B) False

Answer : (A)

5. The balance sheet is a financial statement measuring the flow of funds into and out of various accounts over time while the income statement measures the progress of the firm at a point in time.

(A) True

(B) False

Answer : (B)

6. The values or accounting numbers that are reported on the balance sheet are market values.

(A) True

(B) False

Answer : (B)

7. Retained earnings is the amount of cash that has been generated by the firm through its operations but has not been paid out to stockholders as dividends. Retained earnings are kept in cash or near cash accounts and thus, these cash accounts, when added together, will always be equal to the total retained earnings of the firm.

(A) True

(B) False

Answer : (B)

8. A firm's net income reported on its income statement must equal the operating cash flows on the statement of cash flows.

(A) True

(B) False

Answer : (B)

9. A firm's net income is the most appropriate measure to determine whether the management is maximizing the firm's stock price.

(A) True

(B) False

Answer : (B)

10. Ratio analysis involves a comparison of the relationships between financial statement accounts to analyze the financial position and strength of a firm.

(A) True

(B) False

Answer : (A)

11. A decline in the inventory turnover ratio suggests that the firm's liquidity position is improving.

(A) True

(B) False

Answer : (B)

12. The degree to which the managers of a firm attempt to magnify the returns to owners' capital through the use of financial leverage is captured in debt management ratios.

(A) True

(B) False

Answer : (A)

13. Determining whether a firm's financial position is improving or deteriorating requires analysis of more than one set of financial statements. Trend analysis is one method of measuring a firm's performance over time.

(A) True

(B) False

Answer : (A)

14. A simple approach to trend analysis is to construct graphs.

(A) True

(B) False

Answer : (A)

15. Different accounting practices will not have an impact on the comparative ratio analysis of the firms.

(A) True

(B) False

Answer : (B)

16. The balance sheet will have historical values and that will have an impact on the ratios of the firm.

(A) True

(B) False

Answer : (A)

17. The Securities and Exchange Commission (SEC) was created to develop and approve a set of common international accounting rules.

(A) True

(B) False

Answer : (B)

18. In 2010, the Securities and Exchange Commission (SEC) announced its support for Generally Accepted Accounting Principles (GAAP).

(A) True

(B) False

Answer : (B)

19. The Securities and Exchange Commission (SEC) allowed publicly traded foreign companies to use the International Financial Reporting Standards (IFRS) rather than the Generally Accepted Accounting Principles (GAAP).

(A) True

(B) False

Answer : (A)

MULTICHOICE

20. Which of the following financial statements is included in the annual reports of a company?

(A) Statement of changes in long-term financing

(B) Fund flow statement

(C) Statement of principles

(D) Proxy statement

(E) Statement of cash flows

Answer : (E)

21. Which of the following statements is true about the annual report of a company?

(A) The annual report contains four basic financial statements: the income statement; balance sheet; statement of cash flows; and statement of changes in long-term financing.

(B) The annual report does not provide any information about a firm's future prospects.

(C) The key importance of annual report information is that it is used by investors when they form their expectations about the firm's future earnings and dividends.

(D) The annual report provides no relevant information for use by financial analysts or by the investing public.

(E) The annual report is a report issued by each of the shareholders to the corporation and it contains information about the performance of the shares of the firm held by the shareholders.

Answer : (C)

22. Which of the following information in an annual report describes the firm's performance during the past year and also provides information regarding new developments that will affect future performance of the firm?

(A) Articles of association

(B) Discussion of operations

(C) Proxy statements

(D) DuPont chart

(E) Memorandum of understanding

Answer : (B)

23. Which of the following financial statements shows a firm's financing activities (how funds were generated) and investment activities (how funds were used) over a particular period of time?

(A) Balance sheet

(B) Income statement

(C) Statement of retained earnings

(D) Statement of cash flows

(E) Proxy statement

Answer : (D)

24. Which of the following financial statements is prepared to show the changes in the common equity accounts between balance sheet dates?

(A) Balance sheet

(B) Income statement

(C) Statement of retained earnings

(D) Statement of cash flows

(E) Proxy statement

Answer : (C)

25. Which of the following financial statements includes information about a firm's assets, equity, and liabilities?

(A) Income statement

(B) Cash flow statement

(C) Balance sheet

(D) Statement of retained earnings

(E) Statement of changes in long-term financing

Answer : (C)

26. Which of the following actions can be considered a source of cash when constructing a statement of cash flows?

(A) Decrease in equity

(B) Decrease in accounts payable

(C) Increase in inventory

(D) Increase in long-term bonds

(E) Increase in fixed assets

Answer : (D)

27. Which of the following is an example of a current asset?

(A) Inventory

(B) Retained earnings

(C) Accounts payable

(D) Plant and equipment

(E) Common stock

Answer : (A)

28. Which of the following accounts contains the actual money that can be spent by a firm?

(A) Retained earnings

(B) Notes payable

(C) Net worth

(D) Common stock

(E) Cash and equivalents

Answer : (E)

29. In which order will assets be listed in a balance sheet?

(A) In ascending order of the value of the asset

(B) In alphabetical order

(C) In ascending order of the date of purchase of asset

(D) In order of liquidity

(E) In order of importance for the company

Answer : (D)

30. _____ is an example of a long-term investment of a firm.

(A) Retained earnings

(B) Equipment

(C) Accounts receivable

(D) Common stock

(E) Long-term bonds

Answer : (B)

31. How is the book value per share calculated?

(A) Book value per share = Common equity ÷ Total number of shares outstanding

(B) Book value per share = Total shares issued × Per share par value

(C) Book value per share = Current assets - Current liabilities

(D) Book value per share = Total assets ÷ Total number of shares outstanding

(E) Book value per share = Earnings available to common stockholders ÷ Total number of shares outstanding

Answer : (A)

32. The book value of 4 million shares of Zircon Global Ltd. is $34 million. What is the book value per share of Zircon Global Ltd?

(A) $136.00 per share

(B) $8.50 per share

(C) $4.00 per share

(D) $0.60 per share

(E) $30.00 per share

Answer : (B)

33. The book value per share of Topaz General Ltd. is $10 per share and the company has a total of 4 million shares. Calculate the total book value of common equity of the company.

(A) $4 million

(B) $10 million

(C) $400 million

(D) $40 million

(E) $100 million

Answer : (D)

34. Which of the following statements is true about net worth?

(A) A firm's net worth should be higher than the stockholders' equity.

(B) A firm's net worth should be equal to 50 percent of the value of the total assets of the firm.

(C) A firm's net worth is equal to total assets minus total liabilities.

(D) On liquidation of a firm, the common stockholders' will receive the exact amount shown in the equity section of the balance sheet.

(E) The net worth of a firm is the amount to be paid by the shareholders to the firm on liquidation of the firm.

Answer : (C)

35. Amber Devices Ltd. has total assets worth $900 million and total liabilities worth $475 million at the end of December 31, 2016. What is the amount of money received by the stockholders, if Amber liquidates all of its assets for $850 and pays off all of its outstanding debt?

(A) $850 million

(B) $475 million

(C) $1,325 million

(D) $425 million

(E) $375 million

Answer : (E)

36. The funds provided by common stockholders that consist of common stock, paid-in capital and retained earnings are referred to as the firm's:

(A) net worth.

(B) net cash flows.

(C) cash equivalents.

(D) accruals.

(E) market value.

Answer : (A)

37. How is the net worth of a firm calculated?

(A) Net worth = Current assets minus current liabilities

(B) Net worth = Total assets minus current liabilities

(C) Net worth = Total liabilities minus current assets

(D) Net worth = Total assets minus total liabilities

(E) Net worth = Total liabilities minus current liabilities

Answer : (D)

38. Which of the following is considered as a liability in the balance sheet of a firm?

(A) Accounts receivable

(B) Corporate bonds

(C) Retained earnings

(D) Common stock

(E) Plant and equipment

Answer : (B)

39. Ruby Enterprises Ltd. has long-term bonds worth $20 million, retained earnings of $45 million, accounts payable of $10 million, notes payable of $12 million, and inventory worth $18 million. What is the value of total liabilities of Ruby Enterprises?

(A) $42 million

(B) $105 million

(C) $87 million

(D) $60 million

(E) $85 million

Answer : (A)

40. Which of the following is an example of a firm's long-term debt?

(A) Common stock

(B) Retained earnings

(C) Accounts payable

(D) Corporate bonds

(E) Accounts receivable

Answer : (D)

41. Which of the following is true about the book value and market value of a firm's debt?

(A) The book value of a firm's debt will be higher than the market value of the firm's debt.

(B) The book value of a firm's debt will be equal to the market value of the firm's debt.

(C) The book value of a firm's debt will be equal to the market value of firm's assets.

(D) The market value of a firm's debt will be higher than the book value of firm's assets.

(E) The market value of a firm's debt will be equal to the market value of a firm's assets.

Answer : (B)

42. How is the net working capital calculated?

(A) Net working capital = total liabilities minus retained earnings

(B) Net working capital = total assets minus current assets

(C) Net working capital = total liabilities minus current liabilities

(D) Net working capital = current assets minus current liabilities

(E) Net working capital = total equity minus retained earnings

Answer : (D)

43. Which of the statements is true about the values recorded in the balance sheet of a firm?

(A) The book values of a firm's assets will be equal to the market values of the firm's assets.

(B) The book values of a firm's liabilities will be higher than the market values of the firm's liabilities.

(C) The equity section of a firm's liability represents the difference between the market value of the firm's assets and the market value of the firm's liabilities.

(D) The book values of a firm's assets will be higher than the market values of the firm's assets.

(E) The book values of a firm's debt will be very close to the market values of the firm's liabilities.

Answer : (E)

44. Which of the following is true about a common size balance sheet?

(A) The assets, liabilities, and equities are reported at its market value.

(B) The assets, liabilities, and equities are reported as a percentage of common stock.

(C) The assets, liabilities, and equities are reported as a percentage of total assets.

(D) The assets, liabilities, and equities are arranged in the alphabetical order.

(E) The assets, liabilities, and equities are reported as a percentage of the assets, liabilities, and equities of a competing firm.

Answer : (C)

45. The equity section of a firm's balance sheet contains _____.

(A) retained earnings

(B) current assets

(C) corporate bonds

(D) dividends

(E) noncash assets

Answer : (A)

46. Retained earnings is the total amount of:

(A) income that is distributed as dividends to the shareholders.

(B) debt not repaid in the current year.

(C) depreciation charged on the firm's assets.

(D) income that is saved and reinvested in assets.

(E) profit retained by a firm to pay taxes.

Answer : (D)

47. The firm's statement of retained earnings reports changes in:

(A) the amount of dividends paid.

(B) the common equity accounts.

(C) the interest on debt account.

(D) the amount of net income.

(E) the amount of depreciation.

Answer : (B)

48. How is a firm's retained earnings at the end of the year calculated?

(A) Retained earnings = Beginning balance of retained earnings minus net income in the current year plus net loss in the previous year

(B) Retained earnings = Beginning balance of retained earnings plus net income in the current year plus dividends paid in the current year

(C) Retained earnings = Beginning balance of retained earnings plus net income in the current year minus dividends paid in the current year

(D) Retained earnings = Beginning balance of retained earnings minus net loss in the previous year minus dividends paid in the current year

(E) Retained earnings = Beginning balance of retained earnings minus net income in the current year plus dividends paid in the current year

Answer : (C)

49. Helium Brands Ltd. has a beginning balance of retained earnings of $185 million. Helium has a net income of $48 million and has paid a dividend of $15 million in the current year. The ending balance of retained earnings is:

(A) $248 million.

(B) $185 million.

(C) $170 million.

(D) $137 million.

(E) $218 million.

Answer : (E)

50. The statement of retained earnings for Redwood Systems Ltd. shows a retained earnings balance of $300 million on December 31, 2016. In 2016, Redwood had a net income of $60 million and the firm had paid dividends of $20 million to its stockholders. What was the beginning balance of retained earnings for Redwood on January 1, 2016?

(A) $300 million

(B) $260 million

(C) $380 million

(D) $340 million

(E) $220 million

Answer : (B)

51. A firm's net income as reported on its income statement is known as _____.

(A) operating cash flow

(B) net cash flow

(C) noncash income

(D) accounting profit

(E) net sales

Answer : (D)

52. How is net cash flow calculated if depreciation is the only noncash item in a firm's income statement?

(A) Net cash flow = Net income + Depreciation and amortization

(B) Net cash flow = Accounting profit - Depreciation and amortization

(C) Net cash flow = Accounting profit - Operating cash flow

(D) Net cash flow = Fixed assets + Depreciation and amortization

(E) Net cash flow = Operating cash flow - Depreciation and amortization

Answer : (A)

53. Which of the following financial statements summarizes the revenue generated and the expenses incurred by a firm during the accounting period?

(A) Balance sheet

(B) Statement of cash flows

(C) Statement of retained earnings

(D) Income statement

(E) Proxy statement

Answer : (D)

54. What is the first item in an income statement used to determine the net income of a firm?

(A) Earnings before tax

(B) Operating costs

(C) Net sales

(D) Gross profit

(E) Retained earnings

Answer : (C)

55. How is net income calculated in an income statement?

(A) Net income = Net operating income + Interest

(B) Net income = Gross profit - Retained earnings

(C) Net income = Net sales - Variable operating costs

(D) Net income = Earnings before taxes - Taxes

(E) Net income = Net cash flow + Depreciation

Answer : (D)

56. Which of the following is considered by analysts when comparing the operations of two firms that are financed differently?

(A) Total assets

(B) Earnings before interest and taxes

(C) Net sales

(D) Gross profit

(E) Retained earnings

Answer : (B)

57. Violet Solutions Ltd. has net sales of $850 million, variable operating costs of $475 million, and fixed operating costs including depreciation of $100 million. What is the net operating income of Violet Solutions?

(A) $1,425 million

(B) $1,325 million

(C) $750 million

(D) $375 million

(E) $275 million

Answer : (E)

58. What is the appropriate measure used to examine whether a management is maximizing the firm's stock price?

(A) Retained earnings

(B) Net income

(C) Cash flows

(D) Earnings per share

(E) Accounting profits

Answer : (C)

59. Which of the following is an example of a noncash item reported in the income statement of a firm?

(A) Taxes

(B) Dividends

(C) Interest

(D) Depreciation

(E) Net sales

Answer : (D)

60. Sapphire Industries Ltd. has a net income of $60 million and the total depreciation on its assets is $20 million. The net cash flow of Sapphire Industries is:

(A) $80 million.

(B) $60 million.

(C) $20 million.

(D) $40 million.

(E) $100 million.

Answer : (A)

61. Determine the increase or decrease in cash for Rinky Supply Company for last year, given the following information. (Assume no other changes occurred during the past year.)

Decrease in marketable securities	$25
Increase in accounts receivables	$50
Increase in notes payable	$30
Decrease in accounts payable	$20
Increase in accrued wages and taxes	$15
Increase in inventories	$35
Retained earnings	$5

(A) -$50

(B) +$40

(C) -$30

(D) +$20

(E) -$10

Answer : (C)

62. Which of the following is considered a use of cash in a cash flow statement?

(A) Increase in accrued wages

(B) Increase in common stock

(C) Decrease in accounts receivable

(D) Decrease in inventory

(E) Increase in fixed assets

Answer : (E)

63. Which of the following is considered a part of cash flow from a financing activity in a statement of cash flow?

(A) Increase in corporate bonds

(B) Decrease in accrued wages

(C) Increase in inventories

(D) Decrease in accounts payable

(E) Increase in fixed assets

Answer : (A)

64. _____ is an example of cash flow from an investing activity in a cash flow statement.

(A) Payment of dividends

(B) Repurchase of stock

(C) Purchase of equipment

(D) Purchase of inventory

(E) Repayment of debt

Answer : (C)

65. Which of the following ratios shows the relationship between a firm's cash and other current assets, and its current liabilities?

(A) Asset management ratios

(B) Liquidity ratios

(C) Debt management ratios

(D) Profitability ratios

(E) Market value ratios

Answer : (B)

66. A firm's current ratio has steadily increased over the past 5 years, from 1.9 to 3.8. What would a financial analyst probably conclude from this information?

(A) The firm's fixed assets turnover has improved.

(B) The firm's liquidity position has improved.

(C) The firm's stock price has increased.

(D) The firm's financial leverage has improved.

(E) The firm's market value has increased.

Answer : (B)

67. Which of the following transactions will not affect the quick ratio of a company?

(A) Inventory sold on credit

(B) Cash purchase of equipment

(C) Payment for accounts payable

(D) Accounts receivable collected

(E) Bank loan repaid

Answer : (D)

68. Other things held constant, which of the following will not affect the current ratio, assuming an initial current ratio greater than 1.0?

(A) Fixed assets are sold for cash.

(B) Long-term debt is issued to pay off current liabilities.

(C) Accounts receivable are collected.

(D) Cash is used to pay off accounts payable.

(E) A bank loan is obtained, and the proceeds are credited to the firm's checking account.

Answer : (C)

69. If a company has a quick ratio of 1.0 and a current ratio of 2.0, then:

(A) the value of current assets is equal to the value of inventory.

(B) the value of current assets is equal to the value of current liabilities.

(C) the value of current liabilities is more than the value of current assets.

(D) the value of current liabilities is equal to the value of inventory.

(E) the value of inventory is more than the value of current assets.

Answer : (D)

70. Bicksler Corporation has a current ratio of 2.0 on 21st July. On 22nd July, Bicksler purchased (and received) raw materials on credit from its supplier. Assuming all other things are equal, how will this transaction affect the current ratio of Bicksler?

(A) The current ratio will increase.

(B) The current ratio will decrease.

(C) The current ratio will become equal to its quick ratio.

(D) The quick ratio will become more than its current ratio.

(E) The current ratio will remain the same.

Answer : (B)

71. The first step in a financial analysis of a company includes:

(A) ratio analysis.

(B) pro forma balance sheet construction.

(C) statement of cash flows construction.

(D) profit and loss analysis.

(E) pro forma income statement construction

Answer : (A)

72. A firm obtains the funds needed to pay its current bills from its:

(A) current liabilities.

(B) long-term assets.

(C) long-term liabilities.

(D) equity.

(E) liquid assets.

Answer : (E)

73. Which of the following ratios is calculated to determine the liquidity of a firm?

(A) Inventory turnover ratio

(B) Quick ratio

(C) Total assets turnover ratio

(D) Debt ratio

(E) Net profit ratio

Answer : (B)

74. The balance sheet of Crimpson Solutions Ltd. has cash of $125 million, accounts receivable of $245 million, inventory of $160 million, and equipment worth $450 million. The company also has accounts payable of $120 million, notes payable of $280 million, and corporate bonds of $365 million. Crimpson's current ratio is:

(A) 2.5 times.

(B) 1.56 times.

(C) 1.325 times.

(D) 0.565 times.

(E) 1.855 times.

Answer : (C)

75. Which of the following ratios measures how effectively a firm is managing its assets?

(A) Quick ratio

(B) Times interest earned ratio

(C) Profit margin ratio

(D) Inventory turnover ratio

(E) Price earnings ratio

Answer : (D)

76. If an analyst's goal is to determine how effectively a firm is managing its assets, which of the following sets of ratios would s/he examine?

(A) profit margin, current ratio, fixed charge coverage ratio

(B) quick ratio, debt ratio, time interest earned

(C) inventory turnover ratio, days sales outstanding, fixed asset turnover ratio

(D) total assets turnover ratio, price earnings ratio, return on total assets

(E) time interest earned, profit margin, fixed asset turnover ratio

Answer : (C)

77. The days sales outstanding (DSO) ratio of a firm identifies:

(A) the average length of time a firm must wait after making a credit sale before receiving cash.

(B) how effectively the firm uses its plant and equipment to help generate sales.

(C) the extent to which a firm's net operating income can safely decline.

(D) the profit (earnings) per dollar of sales.

(E) how much investors are willing to pay for the firm's stock for each dollar of reported profits.

Answer : (A)

78. A low inventory turnover ratio suggests that:

(A) the firm is using the first-in first-out (FIFO) method of inventory valuation.

(B) the cost of inventory of the firm is lower than that of the similar firms.

(C) the firm is holding excess stocks of inventory.

(D) the inventory of the firm is sold and restocked very often.

(E) the firm purchases all its inventory on credit.

Answer : (C)

79. A firm has total assets of $500 million, including its accounts receivable, which is worth $120 million. The annual sales of the firm is $650 million. The days sales outstanding (DSO) ratio of the firm is:

(A) 48 days.

(B) 52 days.

(C) 39 days.

(D) 82 days.

(E) 66 days.

Answer : (E)

80. An inventory turnover ratio of 8.5 times indicates that:

(A) the inventory of the firm turns over after 8.5 days.

(B) the value of the inventory of the firm is 8.5 percent of the total assets of the firm.

(C) the value of sales of the firm is 8.5 times the cost of goods sold.

(D) the firm will restock its inventory every 42 days.

(E) the firm pays for its inventory once in 42 days.

Answer : (D)

81. Which of the following is the formula to calculate a firm's inventory turnover ratio?

(A) Inventory Turnover = Sales ÷ Inventory

(B) Inventory Turnover = Cost of goods sold ÷ Inventory

(C) Inventory Turnover = Inventory ÷ Current assets

(D) Inventory Turnover = Inventory ÷ Accounts receivables

(E) Inventory Turnover = (Sales - Cost of goods sold) ÷ Inventory

Answer : (B)

82. The net fixed assets of Auburn Media Ltd. is $850 million. The sales of the firm is $1,420 million. The firm's fixed assets turnover ratio is:

(A) 1.35 times.

(B) 2.42 times.

(C) 1.67 times.

(D) 2.8 times.

(E) 3.45 times.

Answer : (C)

83. Which of the following statements is true regarding debt ratios?

(A) Firms with relatively low debt ratios have higher expected returns when business is good.

(B) Firms with relatively low debt ratios are exposed to more risk as compared to firms with relatively high debt ratios, when business is poor.

(C) Firms with relatively high debt ratios have higher expected returns when business is bad.

(D) Firms with relatively high debt ratios have higher expected returns when business is good.

(E) Firms with relatively low debt ratios have higher expected returns when business is poor.

Answer : (D)

84. The extent to which the operating income can decline before a firm is unable to meet its annual interest costs can be found in:

(A) the fixed charge coverage ratio.

(B) the debt ratio.

(C) the times-interest-earned ratio.

(D) the return on equity.

(E) the profit margin.

Answer : (C)

85. A firm has total interest charges of $10,000 per year, sales of $1 million, a tax rate of 40 percent, and a net profit margin of 6 percent. The firm's times interest earned ratio is:

(A) 16 times.

(B) 10 times.

(C) 7 times.

(D) 11 times.

(E) 20 times.

Answer : (D)

86. Alumbat Corporation has $800,000 in debt outstanding, and pays an interest rate of 10 percent annually on its bank loan. Alumbat's annual sales are $3,200,000, its average tax rate is 40 percent, and its net profit margin on sales is 6 percent. If the company does not maintain a TIE ratio of at least 4 times, its bank will refuse to renew its loan, and bankruptcy will result. Alumbat's current times interest earned ratio is:

(A) 2.4.

(B) 3.4.

(C) 3.6.

(D) 4.0.

(E) 5.0.

Answer : (E)

87. Which of the following ratios recognizes that many firms lease rather than buying a long-term asset?

(A) Fixed charge coverage ratio

(B) Times interest earned ratio

(C) Debt ratio

(D) Net profit margin

(E) Equity multiplier ratio

Answer : (A)

88. The debt ratio is calculated as:

(A) debt ratio = net operating income ÷ total debt.

(B) debt ratio = long-term liabilities ÷ current liabilities.

(C) debt ratio = sales ÷ total liabilities.

(D) debt ratio = total liabilities ÷ total assets.

(E) debt ratio = interest charges ÷ total liabilities.

Answer : (D)

89. The proportion of a firm's funds that is provided by shareholders is equal to:

(A) the debt ratio minus the times interest earned.

(B) 1 minus the debt ratio.

(C) the times interest earned plus 1.

(D) the debt ratio minus the dividends paid.

(E) the fixed charge coverage ratio minus 1.

Answer : (B)

90. Greenwood Builders Ltd. has a debt ratio of 35 percent and it has total assets of $750,000. What is the value of their total liabilities?

(A) $750,000

(B) $1,000,000

(C) $450,000

(D) $262,500

(E) $153,200

Answer : (D)

91. A firm has a profit margin of 15 percent on sales of $20,000,000. If the firm has a debt of $7,500,000, total assets of $22,500,000, and an after-tax interest cost on a total debt of 5 percent, what is the firm's return on total assets (ROA)?

(A) 8.4%

(B) 10.9%

(C) 12.0%

(D) 13.3%

(E) 15.1%

Answer : (D)

92. Selzer Inc. sells all of its merchandise on credit. It has a profit margin of 4 percent, days sales outstanding equal to 60 days, receivables of $150,000, total assets of $3 million, and a debt ratio of 0.64. The firm's return on equity (ROE) is:

(A) 7.1%.

(B) 33.3%.

(C) 3.3%.

(D) 71.0%.

(E) 8.1%.

Answer : (C)

93. Suppose a firm has a growth rate equal to 8 percent, return on assets (ROA) of 10 percent, a debt ratio of 20 percent, and a current stock price of $36. The firm's return on equity (ROE) is:

(A) 14.0%.

(B) 12.5%.

(C) 15.0%.

(D) 2.5%.

(E) 13.5%.

Answer : (B)

94. Assume that Meyer Corporation is 100 percent equity financed, and has the following information: (1) Earnings before taxes = $1,500;
(2) Sales = $5,000;
(3) Dividend payout ratio = 60%;
(4) Total assets turnover = 2.0;
(5) Applicable tax rate = 30%
The firm's return on equity is:

(A) 25%.

(B) 30%.

(C) 35%.

(D) 42%.

(E) 50%.

Answer : (D)

95. If a firm earns a net profit of $100,000 on sales of $2,000,000, its net profit margin is:

(A) 5%.

(B) 10%.

(C) 15%.

(D) 3.5%.

(E) 1.5%.

Answer : (A)

96. Market value ratios indicate:

(A) the effect of liquidity, asset management, and debt management on operating results.

(B) how much debt the firm has and whether it can take on more debt.

(C) the firm's ability to meet its current obligations.

(D) how effectively a firm is managing its assets.

(E) what investors think of the company's future prospects based on its past performance.

Answer : (E)

97. The Charleston Company is a relatively small, privately owned firm. Last year the company had an after-tax income of $15,000 and 10,000 shares were outstanding. The owners were trying to determine the market value for the stock prior to taking the company public. A similar firm, which is publicly traded, had a price/earnings ratio of 5.0. Using only the information given, the market value of one share of Charleston's stock is estimated as:

(A) $10.00.

(B) $7.50.

(C) $5.00.

(D) $2.50.

(E) $1.50.

Answer : (B)

98. Using the information below for WAM Inc., the market value per share is:Earnings after interest and taxes = $200,000
Earnings per share = $2.00
Stockholders' equity = $2,000,000
Market/Book ratio = 0.20

(A) $20.00.

(B) $8.00.

(C) $4.00.

(D) $2.00.

(E) $1.00.

Answer : (C)

99. Which of the following ratios indicate how much investors are willing to pay for the firm's stock for each dollar of reported profits?

(A) Earnings per share ratio

(B) Market/book ratio

(C) Price/earnings ratio

(D) Return on equity ratio

(E) Net profit margin ratio

Answer : (C)

100. Assuming that other things are constant, the price earnings (P/E) ratio:

(A) is higher for firms with high growth prospects and lower for riskier firms.

(B) is lower for firms with high growth prospects and higher for riskier firms.

(C) is not affected by the growth prospects of the firm.

(D) is equal to the market price of the share of the firm.

(E) is equal to the earnings per share of the firm.

Answer : (A)

101. An analysis of a firm's financial ratios over time used to determine the improvement or deterioration in its financial situation is called _____.

(A) sensitivity analysis

(B) the DuPont chart

(C) ratio analysis

(D) benchmarking analysis

(E) trend analysis

Answer : (E)

102. A comparison of a firm's ratios with those of other firms in the same industry at the same point in time is called:

(A) trend analysis.

(B) benchmarking.

(C) DuPont analysis.

(D) sensitivity analysis.

(E) cash flow analysis.

Answer : (B)

103. Which of the following dissects a single ratio into two or more related ratios?

(A) DuPont analysis

(B) Ratio analysis

(C) Comparative analysis

(D) Trend analysis

(E) Benchmarking

Answer : (A)

104. Emerald Corporation's current ratio is 0.5, while Ruby (Emerald's competitor) Company's current ratio is 1.5. Both firms want to "window dress" their coming end-of-year financial statements. As part of their window dressing strategy, each firm will double its current liabilities by adding short-term debt and placing the funds obtained in the cash account. Which of the statements below best describes the actual results of these transactions?

(A) The transactions will have no effect on the current ratios.

(B) The current ratios of both firms will be increased.

(C) The current ratios of both firms will be decreased.

(D) Only Emerald Corporation's current ratio will be increased.

(E) Only Ruby Company's current ratio will be increased.

Answer : (D)

105. Pearl Automotive Ltd. has a current ratio of 2. The company wants to window dress its financial statements. Which of the following transactions will increase the current ratio of Pearl Automotive, assuming all other variables remain constant?

(A) Selling of inventory on credit

(B) Purchase of inventory on credit

(C) Collecting accounts receivable

(D) Purchase of fixed assets for cash

(E) Repayment of short-term loan

Answer : (E)

106. If a firm's existing quick ratio is 1.0, and all other variables remain unchanged, the quick ratio can be increased by:

(A) repayment of a loan.

(B) purchase of fixed assets using a loan.

(C) receiving interest income.

(D) collecting accounts receivable.

(E) purchase of fixed assets for cash.

Answer : (C)

107. Techniques employed by firms to make their financial statements look better than they actually are, are called:

(A) DuPont techniques.

(B) window-dressing techniques.

(C) trend analysis techniques.

(D) benchmarking.

(E) equity multipliers.

Answer : (B)

108. A limitation of ratio analysis is that:

(A) it is useful only for large, multidivisional firms.

(B) inflation, which distorts the firm's balance sheet, is considered when calculating ratios.

(C) seasonal factors that distort the firm's balance sheet are taken into account when calculating ratios.

(D) window-dressing techniques will change the ratios of a firm.

(E) statistical procedures are considered to analyze the net effects of a set of ratios.

Answer : (D)

109. Which of the following was created to develop and approve a set of common International Financial Reporting Standards (IFRS)?

(A) International Accounting Standards Board (IASB)

(B) Securities and Exchange Commission (SEC)

(C) Generally Accepted Accounting Principles (GAAP)

(D) International Federation of Accountants

(E) International Accounting Standards Committee

Answer : (A)

110. Which of the following accounting principles does the Securities and Exchange Commission (SEC) require U.S. firms to use when filing their financial statements?

(A) International Accounting Standards Board (IASB)

(B) International Financial Reporting Standards (IFRS)

(C) Generally Accepted Accounting Principles (GAAP)

(D) National Advisory Accounting Standards (NAAS)

(E) Financial Accounting Standards Principles (FASP)

Answer : (C)

111. All firms that are publicly traded in the United States will be required to adopt the _____ in the near future.

(A) Generally Accepted Accounting Principles (GAAP)

(B) Financial Accounting Standards Rules (FASR)

(C) Governmental Accounting Standards Principles (GASP)

(D) International Financial Reporting Standards (IFRS)

(E) National Advisory Accounting Standards (NAAS)

Answer : (D)