SS 07 Financial Reporting and Analysis: Income Statements, Balance Sheets, and Cash Flow Statements

Answers

Question #1 of 200

Question ID: 627886

Use the following financial data for Moose Printing Corporation, a U.S. GAAP reporting firm, to calculate the cash flow from operations (CFO) using the indirect method.

- Net income: $225
- Increase in accounts receivable: $55
- Decrease in inventory: $33
- Depreciation: $65
- Decrease in accounts payable: $25
- Increase in wages payable: $15
- Decrease in deferred taxes: $10
- Purchase of new equipment: $65
- Dividends paid: $75

✗ **A)** Increase in cash of $183.

✓ **B)** Increase in cash of $248.

✗ **C)** Increase in cash of $173.

Explanation

CFO for Moose Printing Corporation is calculated as follows:

+Net Income $225 − A/R $55 + Inventory $33 + Depreciation $65 − A/P $25 + Wages Payable $15 − Deferred taxes $10 = $248.

The purchase of new equipment is an investing activity and therefore is not included in CFO. Dividends paid is a financing activity and is not included in CFO.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #2 of 200

Question ID: 414273

An examination of the cash receipts and payments of Xavier Corporation reveals the following:

Cash paid to suppliers for purchase of merchandise	$5,000
Cash received from customers	14,000
Cash paid for purchase of equipment	22,000

Dividends paid	2,000
Cash received from issuance of preferred stock	10,000
Interest received on short-term investments	1,000
Wages paid	4,000
Repayment of loan to the bank	5,000
Cash from sale of land	12,000

Under U.S. GAAP, Xavier's cash flow from financing (CFF) and cash flow from investing (CFI) will be:

	CFF	CFI
✗ **A)**	$3,000	$12,000
✗ **B)**	$10,000	$12,000
✓ **C)**	$3,000	-$10,000

Explanation

Cash flow relating to financing activities includes dividends paid, cash received from preferred stock, and repayment of loan. -2,000 + 10,000 + -5,000 = 3,000.

Cash flow relating to investing activities includes cash paid for equipment and cash from sale of land. -22,000 + 12,000 = -10,000.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #3 of 200

Question ID: 414239

Liquidity-based presentation of a balance sheet is *most likely* to be used by a:

✗ **A)** retailer.

✓ **B)** bank.

✗ **C)** manufacturer.

Explanation

The liquidity-based format of balance sheet presentation is most common in the banking industry.

References

Question From: Session 7 > Reading 25 > LOS c

Related Material:

- Key Concepts by LOS

Question #4 of 200

Question ID: 414241

One of a firm's assets is 270-day commercial paper that the firm intends to hold to maturity. One of its liabilities is a short position in a common stock, which the firm holds for trading purposes. How should this asset and this liability be classified on the firm's balance sheet?

✗ **A)** Both should be classified as non-current.

✗ **B)** One should be classified as current and one should be classified as non-current.

✓ **C)** Both should be classified as current.

Explanation

The commercial paper should be classified as current because it will be converted to cash in less than a year. A liability that is held primarily for trading purposes, such as this short position, should also be classified as current.

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #5 of 200

Question ID: 414423

The traditional DuPont equation shows ROE equal to:

✗ **A)** EBIT/sales × sales/assets × assets/equity × (1 - tax rate).

✓ **B)** net income/sales × sales/assets × assets/equity.

✗ **C)** net income/assets × sales/equity × assets/sales.

Explanation

Profit margin × asset turnover × financial leverage. Although net income/assets × sales/equity × assets/sales also yields ROE, it is not the DuPont equation.

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #6 of 200

Question ID: 414413

Given the following income statement and balance sheet for a company:

Balance Sheet

Assets	*Year 2006*	*Year 2007*
Cash	200	450
Accounts Receivable	600	660
Inventory	500	550
Total CA	1300	1660
Plant, prop. equip	1000	1580
Total Assets	2600	3240
Liabilities		
Accounts Payable	500	550
Long term debt	700	1052
Total liabilities	1200	1602
Equity		
Common Stock	400	538
Retained Earnings	1000	1100
Total Liabilities & Equity	2600	3240

Income Statement

Sales		3000
Cost of Goods Sold		(1000)
Gross Profit		2000
SG&A		500
Interest Expense		151
EBT		1349
Taxes (30%)		405
Net Income		944

Which of the following is *closest* to the company's return on equity (ROE)?

- ✗ **A)** 0.29.
- ✓ **B)** 0.62.
- ✗ **C)** 1.83.

Explanation

There are several ways to approach this question but the easiest way is to recognize that ROE = NI / average equity thus ROE = 944 / 1,519 = 0.622.

If using the traditional DuPont, ROE = (NI / Sales) × (Sales / Assets) × (Assets / Equity):

ROE = (944 / 3,000) × (3,000 / 2,920) × (2,920 / 1,519) = 0.622

The 5-part Dupont formula gives the same result:

ROE = (net income / EBT)(EBT / EBIT)(EBIT / revenue)(revenue / total assets)(total assets / total equity)

Where EBIT = EBT + interest = 1,349 + 151 = 1,500

ROE 2007 = (944 / 1,349)(1,349 / 1,500)(1,500 / 3,000)(3,000 / 2,920)(2,920 / 1,519) = 0.622

References

Question From: Session 7 > Reading 27 > LOS c

Related Material:

- Key Concepts by LOS

Question #7 of 200

Question ID: 414440

In preparing a forecast of future financial performance, which of the following *best* describes sensitivity analysis and scenario analysis, respectively?

Description #1 - A computer generated analysis based on developing probability distributions of key variables that are used to drive the potential outcomes.
Description #2 - The process of analyzing the impact of future events by considering multiple key variables.

Description #3 - A technique whereby key financial variables are changed one at a time and a range of possible outcomes are observed. Also known as "what-if" analysis.

	Sensitivity analysis	Scenario analysis
✗ **A)**	Description #3	Description #1
✗ **B)**	Description #2	Description #3
✓ **C)**	Description #3	Description #2

Explanation

Sensitivity analysis develops a range of possible outcomes as specific inputs are changed one at a time. Sensitivity analysis is also known as "what-if" analysis. *Scenario* analysis is based on a specific set of outcomes for multiple variables. Computer generated analysis, based on developing probability distributions of key variables, is known as *simulation* analysis.

References

Question From: Session 7 > Reading 27 > LOS g

Related Material:

- Key Concepts by LOS

Question #8 of 200

Question ID: 414398

>An analyst has gathered the following data about a company:

- Average receivables collection period of 95 days.
- Average inventory processing period of 183 days.
- A payables payment period of 274 days.

What is their cash conversion cycle?

✓ **A)** 4 days.

✗ **B)** 186 days.

✗ **C)** -4 days.

Explanation

Cash conversion cycle = average receivables collection period + average inventory processing period - payables payment period

> = 95 + 183 - 274 = 4 days

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #9 of 200

Question ID: 414250

Consider the following:

Statement #1 - Copyrights and patents are tangible assets that can be separately identified.
Statement #2 - Purchased copyrights and patents are amortized on a straight line basis over 30 years.
With respect to the statements about copyrights and patents acquired from an independent third party:

✗ **A)** only statement #2 is incorrect.

✓ **B)** both are incorrect.

✗ **C)** only statement #1 is incorrect.

Explanation

Acquired copyrights and patents are *intangible* assets that can be separately identified. Identifiable intangible assets are amortized over their useful lives.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #10 of 200

Question ID: 414249

According to the Financial Accounting Standards Board, what is the appropriate measurement basis for equipment used in the manufacturing process and inventory that is held for sale?

	Equipment	Inventory
✗ **A)**	Fair value	Lower of cost or market
✗ **B)**	Historical cost	Historical cost
✓ **C)**	Historical cost	Lower of cost or market

Explanation

Equipment is reported in the balance sheet at historical cost less accumulated depreciation. Inventory is reported in the balance sheet at the lower of cost or market.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #11 of 200

Question ID: 414425

If a firm has a net profit margin of 0.05, an asset turnover of 1.465, and a leverage ratio of 1.66, what is the firm's ROE?

✓ **A)** 12.16%.

✗ **B)** 5.87%.

✗ **C)** 3.18%.

Explanation

One of the many ways to express ROE = net profit margin × asset turnover × leverage ratio

ROE = (0.05)(1.465)(1.66) = 0.1216

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #12 of 200

Question ID: 414361

As of December 31, 2007, Manhattan Corporation had a quick ratio of 2.0, current assets of $15 million, trade payables of $2.5 million, and receivables of $3 million, and inventory of $6 million. How much were Manhattan's current liabilities?

- ✓ **A)** $4.5 million.
- ✗ **B)** $12.0 million.
- ✗ **C)** $7.5 million.

Explanation

Manhattan's quick assets were equal to $9 million ($15 million current assets - $6 million inventory). Given a quick ratio of 2.0, quick assets were twice the current liabilities. Thus, the current liabilities must have been $4.5 million ($9 million quick assets / 2.0 quick ratio).

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #13 of 200

Question ID: 414417

Assume that Q-Tell Incorporated is in the communications industry, which has an average receivables turnover ratio of 16 times. If the Q-Tell's receivables turnover is less than that of the industry, Q-Tell's average receivables collection period is *most likely*:

- ✗ **A)** 12 days.
- ✗ **B)** 20 days.
- ✓ **C)** 25 days.

Explanation

Average receivables collection period = 365 / receivables turnover, which is 22.81 days for the industry (= 365 / 16). If Q-Tell's receivables turnover is less than 16, its average days collection period must be greater that 22.81 days.

References

Question From: Session 7 > Reading 27 > LOS c

Related Material:

- Key Concepts by LOS

Question #14 of 200

Question ID: 414341

Favor, Inc.'s capital and related transactions during 20X5 were as follows:

- On January 1, $1,000,000 of 5-year 10% annual interest bonds were issued to Cover Industries in exchange for old equipment owned by Cover.
- On June 30, Favor paid $50,000 of interest to Cover.
- On July 1, Cover returned the bonds to Favor in exchange for $1,500,000 par value 6% preferred stock.
- On December 31, Favor paid preferred stock dividends of $45,000 to Cover.

Favor, Inc.'s cash flow from financing (CFF) for 20X5 (assume U.S. GAAP) is:

✓ **A)** −$45,000.

✗ **B)** −$95,000.

✗ **C)** −$1,045,000.

Explanation

Only the preferred stock dividends paid would be considered CFF. Issuing bonds in exchange for equipment and exchanging bonds for stock are both noncash transactions that should be disclosed in a footnote to the Statement of Cash Flows. Interest paid is an operating cash flow under U.S. GAAP.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #15 of 200

Question ID: 414439

Lightfoot Shoe Company reported sales of $100 million for the year ended 20X7. Lightfoot expects sales to increase 10% in 20X8. Cost of goods sold is expected to remain constant at 40% of sales and Lightfoot would like to have an average of 73 days of inventory on hand in 20X8. Forecast Lightfoot's average inventory for 20X8 assuming a 365 day year.

✗ **A)** $8.0 million.

✗ **B)** $22.0 million.

✓ **C)** $8.8 million.

Explanation

20X8 sales are expected to be $110 million [$100 million × 1.1] and COGS is expected to be $44 million [$110 million sales × 40%]. With 73 days of inventory on hand, average inventory is $8.8 million [($44 million COGS / 365) × 73 days].

References

Question From: Session 7 > Reading 27 > LOS g

Related Material:

- Key Concepts by LOS

Question #16 of 200

Question ID: 414416

Selected financial information gathered from the Matador Corporation follows:

	2007	2006	2005
Average debt	$792,000	$800,000	$820,000
Average equity	$215,000	$294,000	$364,000
Return on assets	5.9%	6.6%	7.2%
Quick ratio	0.3	0.5	0.6
Sales	$1,650,000	$1,452,000	$1,304,000
Cost of goods sold	$1,345,000	$1,176,000	$1,043,000

Using only the data presented, which of the following statements is *most correct*?

- ✗ **A)** Gross profit margin has improved.
- ✓ **B)** Return on equity has improved.
- ✗ **C)** Leverage has declined.

Explanation

Leverage *increased* as measured by the debt-to-equity ratio from 2.25 in 2005 to 3.68 in 2007. Gross profit margin declined from 20.0% in 2005 to 18.5% in 2007. Return on equity has improved since 2005. One measure of ROE is ROA × financial leverage. Financial leverage (assets / equity) can be derived by adding 1 to the debt-to-equity ratio. In 2005, ROE was 23.4% [7.2% ROA × (1 + 2.25 debt-to-equity)]. In 2007, ROE was 27.6% [5.9% ROA × (1 + 3.68 debt-to-equity)].

References

Question From: Session 7 > Reading 27 > LOS c

Related Material:

- Key Concepts by LOS

Question #17 of 200

Question ID: 414271

The actual coupon payment on a bond is reported on the statement of cash flow as:

- ✓ **A)** an operating cash outflow.
- ✗ **B)** a financing cash outflow.
- ✗ **C)** an investing cash outflow.

Explanation

The coupon payment is recorded on the statement of cash flows as an operating cash outflow because cash flow from operations includes a deduction for interest expense.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #18 of 200

Question ID: 414276

Which of the following items is NOT found in the financing cash flow part of the statement of cash flows?

✓ **A)** Change in retained earnings.

✗ **B)** Dividends paid.

✗ **C)** Change in long-term debt.

Explanation

Changes in retained earnings are not included in the calculation of financing cash flows.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #19 of 200

Question ID: 414329

Which of the following is CORRECT about the consideration of depreciation in the operations section of a cash flow statement?

	Direct Method	Indirect Method
✓ **A)**	Does not consider	Considers
✗ **B)**	Does not consider	Does not consider
✗ **C)**	Considers	Considers

Explanation

The indirect method must add back depreciation expense because the starting point is net income. Since the direct method does not begin with net income it does not need to consider non-cash expenses such as depreciation.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #20 of 200

Question ID: 414397

Which of the following ratios would NOT be used to evaluate how efficiently management is utilizing the firm's assets?

- ✗ **A)** Payables turnover.
- ✓ **B)** Gross profit margin.
- ✗ **C)** Fixed asset turnover.

Explanation

The gross profit margin is used to measure a firm's operating profitability, not operating efficiency.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #21 of 200

Question ID: 414252

On January 1, 20X7, Omega Corporation paid $45,000 to renew its property insurance for 3 years. What amount of insurance expense should Omega report for the year-ended December 31, 20X7 and what is the balance of Omega's prepaid insurance account on December 31, 20X8?

	Insurance expense	Prepaid insurance
✓ **A)**	$15,000	$15,000
✗ **B)**	$15,000	$30,000
✗ **C)**	$45,000	$15,000

Explanation

At the beginning of 20X7, the prepaid insurance account (asset) will have a balance of $45,000. Insurance expense will be recognized at a rate of $15,000 per year. At the end of 20X8, one year's insurance remains; thus, the balance of the prepaid insurance account will equal $15,000 ($45,000 beginning balance - $15,000 insurance expense for 20X7 - $15,000 insurance expense for 20X8).

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #22 of 200

Question ID: 414245

According to International Financial Reporting Standards, how do cash dividends received from trading securities and available-for-sale securities affect net income?

	Trading securities	Available-for-sale securities
✗ **A)**	Increase	No effect
✓ **B)**	Increase	Increase
✗ **C)**	No effect	Increase

Explanation

Dividends received from trading securities and available-for-sale securities are recognized in the income statement. The difference in trading and available-for-sale classifications relates to the treatment of any unrealized gains and losses.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #23 of 200

Question ID: 414396

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000

Retained Earnings	620
Total Liab. and Stockholder's equity	2750

Income Statement

Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

What is the inventory turnover ratio?

- ✗ **A)** 1.59.
- ✗ **B)** 0.77.
- ✓ **C)** 1.29.

Explanation

Inventory turnover = 1,100(COGS) / 850(inventory) = 1.29

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #24 of 200

Question ID: 414420

What is the net income of a firm that has a return on equity of 12%, a leverage ratio of 1.5, an asset turnover of 2, and revenue of $1 million?

- ✗ **A)** $360,000.
- ✗ **B)** $36,000.
- ✓ **C)** $40,000.

Explanation

The traditional DuPont system is given as:

ROE = (net profit margin)(asset turnover)(leverage ratio)

Solving for the net profit margin yields:

$0.12 = (\text{net profit margin}) \times (2) \times (1.5)$

$0.04 = (\text{net profit margin})$

Recognizing that the net profit margin is equal to net income / revenue we can substitute that relationship into the above equation and solve for net income:

0.04 = net income / revenue = net income / $1,000,000

$40,000 = net income.

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #25 of 200

Question ID: 414295

How would a stock split be reported on the statement of cash flows? A stock split would:

- ✗ **A)** be reported as a use of cash in the cash flows from financing.
- ✗ **B)** be reported as a source of cash in the cash flows from financing.
- ✓ **C)** not be reported on the statement of cash flows because it is a non-cash event.

Explanation

No cash is involved in a stock split--shares are exchanged for shares.

References

Question From: Session 7 > Reading 26 > LOS b

Related Material:

- Key Concepts by LOS

Question #26 of 200

Question ID: 414432

Would an increase in net profit margin or in the firm's dividend payout ratio increase a firm's sustainable growth rate?

Net profit margin	Dividend payout ratio

✓ **A)**	Yes	No
✗ **B)**	Yes	Yes
✗ **C)**	No	No

Explanation

The sustainable growth rate is equal to ROE multiplied by the retention rate. According to the Dupont formula, an increase in net profit margin will result in higher ROE. Thus, an increase in net profit margin will result in a higher growth rate. The retention rate is equal to 1 minus the dividend payout ratio. Thus, an increase in the dividend payout ratio will lower the retention rate and lower the growth rate.

References

Question From: Session 7 > Reading 27 > LOS e

Related Material:

- Key Concepts by LOS

Question #27 of 200

Question ID: 414251

GTO Corporation purchased all of the common stock of Charger Company for $4 million. At the time, Charger reported total assets of $3 million and total liabilities of $1 million. At the acquisition date, the fair value of Charger's assets was $3.5 million and the fair value of Charger's liabilities was $1.3 million. What amount of goodwill should GTO report as a result of the acquisition and is it necessary for GTO to amortize the goodwill?

	Goodwill	Amortization required
✗ **A)**	$1.8 million	Yes
✓ **B)**	$1.8 million	No
✗ **C)**	$2.2 million	No

Explanation

The acquisition goodwill is equal to $1.8 million [$4 million purchase price - $2.2 million fair value of net assets acquired ($3.5 million assets at fair value - $1.3 million liabilities at fair value)]. Under IFRS or U.S. GAAP, goodwill is not amortized but is subject to an annual impairment test.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #28 of 200

Question ID: 414255

Earlier this year, Slayton Corporation repurchased 5% of its total shares outstanding. At the time, the book value of Slayton shares exceeded their market value. The shares are expected to be reissued in the future when the market price of Slayton's stock increases. Do Slayton's repurchased shares continue to have voting rights and to pay cash dividends?

	Voting rights	Cash dividends paid
✗ **A)**	Yes	No
✓ **B)**	No	No
✗ **C)**	No	Yes

Explanation

Repurchased stock that is not cancelled is called treasury stock. Treasury stock does not have voting rights and does not receive cash dividends.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #29 of 200

Question ID: 414356

Ratio analysis is most useful for comparing companies:

- ✗ **A)** in different industries that use the same accounting standards.
- ✓ **B)** of different size in the same industry.
- ✗ **C)** that operate in multiple lines of business.

Explanation

Ratio analysis is a useful way of comparing companies that are similar in operations but different in size. Ratios of companies that operate in different industries are often not directly comparable. For companies that operate in several industries, ratio analysis is limited by the difficulty of determining appropriate industry benchmarks.

References

Question From: Session 7 > Reading 27 > LOS a

Related Material:

- Key Concepts by LOS

Question #30 of 200

Question ID: 414332

An analyst has gathered the following information about a company:

Income Statement for the Year 20X5		
Sales		$1,500
Expenses		
COGS	$1,300	
Depreciation	20	
Goodwill	10	
Int. Expenses	40	
Total expenses		1,370
Income from cont. op.		130
Gain on sale		30
Income before tax		160
Income tax		64
Net Income		$96

Additional Information:	
Dividends paid	30
Common stock sold	20
Equipment purchased	50
Bonds issued	80
Fixed asset sold for (original cost of $100 with accumulated depreciation of $70)	60
Accounts receivable decreased by	30
Inventory decreased by	20
Accounts payable increased by	20
Wages payable decreased by	10

What is the cash flow from investing?

- ✗ **A)** $110.
- ✓ **B)** $10.
- ✗ **C)** $130.

Explanation

Purchase of equipment	-$50
Fixed asset sold	$60
CFI	$10

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #31 of 200

Question ID: 414387

The cash conversion cycle is the:

- ✗ **A)** length of time it takes to sell inventory.
- ✗ **B)** sum of the time it takes to sell inventory and the time it takes to collect accounts receivable.
- ✓ **C)** sum of the time it takes to sell inventory and collect on accounts receivable, less the time it takes to pay for credit purchases.

Explanation

Cash conversion cycle = (average receivables collection period) + (average inventory processing period) − (payables payment period)

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #32 of 200

Question ID: 414288

Which of the following items is *least* appropriately described as a liability arising from an operating activity for a non-financial company?

- ✓ **A)** The current portion of long-term debt.
- ✗ **B)** Cash advances from customers.
- ✗ **C)** Trade payables.

Explanation

The current portion of long-term debt arises from a financing activity. The other items listed arise from operating activities.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #33 of 200

Question ID: 414428

With other variables remaining constant, if profit margin rises, ROE will:

- ✗ **A)** fall.
- ✗ **B)** remain the same.
- ✓ **C)** increase.

Explanation

The DuPont equation shows clearly that ROE will increase as profit margin increases, as long as asset turn and leverage do not fall.

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #34 of 200

Question ID: 414385

Given the following income statement:

Net Sales	200
Cost of Goods Sold	55
Gross Profit	145
Operating Expenses	30
Operating Profit (EBIT)	115
Interest	15
Earnings Before Taxes (EBT)	100
Taxes	40
Earnings After Taxes (EAT)	60

What are the gross profit margin and operating profit margin?

	Gross Profit Margin	Operating Profit Margin
✗ **A)**	0.379	0.725
✗ **B)**	2.630	1.226
✓ **C)**	0.725	0.575

Explanation

Gross profit margin = gross profit / net sales = 145 / 200 = 0.725

Operating profit margin = EBIT / net sales = 115 / 200 = 0.575

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #35 of 200

Question ID: 500859

Companies are required to report segment data under:

- ✗ **A)** U.S. GAAP but not IFRS.
- ✓ **B)** both IFRS and U.S. GAAP.
- ✗ **C)** IFRS but not U.S. GAAP.

Explanation

Both IFRS and U.S. GAAP require companies to report segment data.

References

Question From: Session 7 > Reading 27 > LOS f

Related Material:

- Key Concepts by LOS

Question #36 of 200

Question ID: 496417

Selected balance sheet data for Parker Company are as follows:

Current assets	3,000
Long-lived assets	7,000
Total assets	10,000
Current liabilities	2,000
Long-term liabilities	4,000
Total liabilities	6,000
Shareholders' equity	4,000

On a common-size balance sheet, Parker's current liabilities would be stated as:

- ✗ **A)** 67%.
- ✓ **B)** 20%.
- ✗ **C)** 33%.

Explanation

On a common-size balance sheet, each line item is stated as a percentage of total assets: 2,000 / 10,000 = 20%.

References

Question From: Session 7 > Reading 25 > LOS g

Related Material:

- Key Concepts by LOS

Question #37 of 200

Question ID: 414230

Liabilities are *best* described as:

- ✗ **A)** residual ownership interest.
- ✗ **B)** resources that are expected to provide future benefits.
- ✓ **C)** obligations that are expected to require a future outflow of resources.

Explanation

Liabilities are obligations resulting from past events that are expected to require a future outflow of resources.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #38 of 200

Question ID: 434284

The latest balance sheet for XYZ, Inc. appears below:

	12/31/20X4	12/31/20X3
Assets		
Cash	2,098	410
Accounts receivable	4,570	4,900
Inventory	4,752	4,500
Prepaid SGA	877	908
Total current assets	12,297	10,718
Land	0	4,000
Property, Plant & Equipment	11,000	11,000
Accumulated Depreciation	(5,862)	(5,200)
Total Assets	17,435	20,518

Liabilities and Equity

Accounts Payable	4,651	5,140
Wages Payable	2,984	2,890
Dividends Payable	100	100
Total current liabilities	7,735	8,130
Long term Debt	1,346	7,388
Common Stock	4,000	4,000
Retained Earnings	4,354	1,000
Total Liabilities and Equity	17,435	20,518

At the end of 20X4, what were XYZ's current and quick ratios?

	Current ratio	Quick ratio
✗ **A)**	1.59	1.59
✗ **B)**	1.48	0.86
✓ **C)**	1.59	0.86

Explanation

Current ratio = current assets / current liabilities = 12,297 / 7,735 = 1.59

Quick ratio = (cash + receivables) / current liabilities = 2,098 + 4,570 / 7,735 = 0.86

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #39 of 200

Question ID: 414281

Which of the following is NOT a cash flow from operation?

- ✗ **A)** dividends received.
- ✗ **B)** interest payments.
- ✓ **C)** dividends paid to shareholders.

Explanation

Dividends paid are a financing cash flow. Dividends received and interest paid are both operating cash flows.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #40 of 200

Question ID: 434281

Consider the following:

Argument #1: The indirect method presents a firm's operating cash receipts and payments and is thus more consistent with the objectives of the cash flow statement.

Argument #2: The indirect method provides more information than the direct method and is more useful to analysts in estimating future operating cash flows.

Which of these arguments support the use of the indirect method for presenting cash flow from operating activities in the cash flow statement?

- ✓ **A)** Neither argument.
- ✗ **B)** Argument #2 only.
- ✗ **C)** Argument #1 only.

Explanation

It is the *direct* method, not the indirect method, that presents operating cash receipts and payments and is thus more consistent with the objectives of the cash flow statement. The *direct* method provides more information than the indirect method and is preferred by analysts who are estimating future cash flows.

References

Question From: Session 7 > Reading 26 > LOS d

Related Material:

- Key Concepts by LOS

Question #41 of 200

Question ID: 414287

Which of the following items would *least likely* be included in cash flow from financing?

- ✗ **A)** Dividends paid to shareholders.
- ✗ **B)** Purchase of treasury stock.
- ✓ **C)** Gain on sale of stock of a subsidiary.

Explanation

Gains or losses will be found in cash flow from investments.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #42 of 200

Question ID: 414358

Comparing a company's ratios with those of its competitors is *best* described as:

- ✗ **A)** common-size analysis.
- ✗ **B)** longitudinal analysis.
- ✓ **C)** cross-sectional analysis.

Explanation

Comparing a company's ratios with those of its competitors is known as cross-sectional analysis.

References

Question From: Session 7 > Reading 27 > LOS a

Related Material:

- Key Concepts by LOS

Question #43 of 200

Question ID: 414427

Summit Co. has provided the following information for its most recent reporting period:

	Beginning Figures	*Ending Figures*	*Average Figures*
Sales		$ 5,000,000	
EBIT		$ 800,000	
Interest Expense		$ 160,000	
Taxes		$ 256,000	
Assets	$ 3,500,000	$ 4,000,000	$ 3,750,000
Equity	$ 1,700,000	$ 2,000,000	$ 1,850,000

What is Summit Co.'s total asset turnover and return on equity?

	Total Asset Turnover	Return on Equity
✗ **A)**	1.25	20.8%

✗ **B)** 1.33 15.8%

✓ **C)** 1.33 20.8%

Explanation

Total asset turnover = sales / average assets = 5,000,000 / 3,750,000 = 1.33

Return on equity = net income / average equity
Net income = EBIT − interest − taxes = 800,000 − 160,000 − 256,000 = 384,000
ROE = 384,000 / 1,850,000 = 20.8%

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #44 of 200

Question ID: 414407

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

Income Statement	
Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250

Interest Expense	25
Taxes	75
Net Income	150

What is the receivables turnover ratio?

- ✗ **A)** 0.5.
- ✓ **B)** 2.0.
- ✗ **C)** 1.0.

Explanation

Receivables turnover = 1,500(sales) / 750(receivables) = 2.0

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #45 of 200

Question ID: 414410

An analyst has gathered the following information about a firm:

- Quick ratio of 0.25.
- Cash ratio of 0.20.
- $2 million in marketable securities.
- $10 million in cash.

What is their receivables balance?

- ✓ **A)** 3 million.
- ✗ **B)** 5 million.
- ✗ **C)** 2 million.

Explanation

Cash ratio = (cash + marketable securities) / current liabilities

0.20 = ($10,000,000 + $2,000,000) / current liabilities

current liabilities = $12,000,000 / 0.2 = $60,000,000

Quick ratio = [cash + marketable securities + receivables] / $60,000,000

0.25 = [$10,000,000 + $2,000,000 + receivables] / $60,000,000

($60,000,000)(0.25) = $12,000,000 + receivables

$15,000,000 = $12,000,000 + receivables

$15,000,000 − $12,000,000 = receivables

$3,000,000 = receivables

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #46 of 200

Question ID: 414269

Given the following income statement and balance sheet for a company:

Balance Sheet

Assets	*Year 2003*	*Year 2004*
Cash	500	450
Accounts Receivable	600	660
Inventory	500	550
Total CA	1600	1660
Plant, prop. equip	1000	1250
Total Assets	2600	2910
Liabilities		
Accounts Payable	500	550
Long term debt	700	1002
Total liabilities	1200	1552
Equity		
Common Stock	400	538
Retained Earnings	1000	820
Total Liabilities & Equity	2600	2910

Income Statement

Sales	3000
Cost of Goods Sold	(1000)
Gross Profit	2000
SG&A	(500)
Interest Expense	(151)
EBT	1349
Taxes (30%)	(405)
Net Income	944

What is the current ratio for 2004?

- ✗ **A)** 2.018.
- ✗ **B)** 0.331.
- ✓ **C)** 3.018.

Explanation

Current ratio = (CA / CL) = (1,660 / 550) = 3.018

References

Question From: Session 7 > Reading 25 > LOS h

Related Material:

- Key Concepts by LOS

Question #47 of 200

Question ID: 414352

The RR Corporation had cash flow from operations of $20 million. RR purchased $5 million in equipment and sold $3 million of equipment during the period. What is RR's free cash flow to equity for the period?

- ✓ **A)** $18 million.
- ✗ **B)** $22 million.
- ✗ **C)** $15 million.

Explanation

Free cash flow to equity (FCFE) is generally defined as cash flow from operations (CFO) less net fixed capital expenditures plus net borrowing. No information on borrowing is given here, so FCFE = 20 − (5 − 3) = $18 million.

References

Question From: Session 7 > Reading 26 > LOS i

Related Material:

- Key Concepts by LOS

Question #48 of 200

Question ID: 414284

Which of the following is *least likely* a cash flow in the calculation of cash flow from operations under U.S. GAAP?

- ✗ **A)** Interest paid.
- ✓ **B)** Dividends paid.
- ✗ **C)** Dividends received.

Explanation

According to SFAS 95, dividends paid are treated as cash flow from financing.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #49 of 200

Question ID: 414323

Galaxy, Inc.'s U.S. GAAP balance sheet as of December 31, 20X4 included the following information (in $):

	12-31-X3	*12-31-X4*
Accounts Payable	300,000	500,000
Dividends Payable	200,000	300,000
Common Stock	1,000,000	1,000,000
Retained Earnings	700,000	1,000,000

Galaxy's net income in 20X4 was $800,000. What was Galaxy's cash flow from financing (CFF) in 20X4?

- ✗ **A)** −$300,000.
- ✗ **B)** −$500,000.
- ✓ **C)** −$400,000.

Explanation

Dividends declared are net income less the increase in retained earnings ($800,000 - $300,000 = $500,000). Dividends declared less the increase in dividends payable is dividends paid ($500,000 - ($300,000 - $200,000) = $400,000). This is a cash outflow so it is a negative number. Dividends paid are always cash flow from financing under U.S. GAAP. Note that accounts payable changes are included in cash flow from operations (CFO).

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #50 of 200

Question ID: 498756

A common-size cash flow statement is *least likely* to provide payments to employees as a percentage of:

✗ **A)** revenues for the period.

✗ **B)** total cash outflows for the period.

✓ **C)** operating cash flow for the period.

Explanation

There are two formats for a common-size cash flow statement, expressing each type of outflow as a percentage of total cash outflows or as a percentage of total revenue for the period. Operating cash flow for the period mixes inflows and outflows and is not used to calculate percentage flows for payment made.

References

Question From: Session 7 > Reading 26 > LOS h

Related Material:

- Key Concepts by LOS

Question #51 of 200

Question ID: 414422

Using the following data, find the return on equity (ROE).

Net Income	*Total Assets*	*Sales*	*Equity*
$2	$10	$10	$8

✗ **A)** 20%.

✓ **B)** 25%.

✗ **C)** 100%.

Explanation

Net Income / Equity = ROE

2 / 8 = 25%

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #52 of 200

Question ID: 414339

Financial information for Jefferson Corp. for the year ended December 31st, was as follows:

Sales	$3,000,000
Purchases	1,800,000
Inventory at Beginning	500,000
Inventory at Ending	800,000
Accounts Receivable at Beginning	300,000
Accounts Receivable at Ending	200,000
Accounts Payable at Beginning	100,000
Accounts Payable at Ending	100,000
Other Operating Expenses Paid	400,000

Based upon this data and using the direct method, what was Jefferson Corp.'s cash flow from operations (CFO) for the year ended December 31st?

- ✓ **A)** $900,000.
- ✗ **B)** $1,200,000.
- ✗ **C)** $800,000.

Explanation

CFO = sales $3,000,000 - change in accounts receivable ($200,000 - $300,000) - purchases $1,800,000 - other cash operating expenses $400,000 = $900,000.

Note that no adjustment for inventories is necessary because purchases are given. From the inventory equation, P = COGS + EI - BI.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #53 of 200

Question ID: 485774

An analyst is examining the operating performance ratios for a company. A summary of the company's data for the three most recent fiscal years along with the industry averages are shown below:

	Industry	20X5	20X4	20X3
Return on total capital (ROTC)	24.0%	26.6%	27.3%	28.4%
Return on common equity	10.0%	12.6%	15.5%	20.2%
Return on equity (ROE)	8.0%	12.1%	14.7%	18.9%

Based on the above data, the analyst's *most appropriate* conclusion is that the trend in ROE:

- ✗ **A)** relative to return on common equity implies declining leverage and financial risk.
- ✓ **B)** relative to ROTC implies increasing leverage and financial risk.

✗ **C)** relative to the industry average reflects underperformance due to weak management.

Explanation

Return on equity (net income / average total equity) includes both common equity and preferred equity in the denominator, but not debt. Return on total capital (EBIT / average total debt + average total equity) includes both equity and debt. An increasing spread between ROE and ROTC implies increasing debt in the capital structure, which reflects increasing leverage and financial risk.

References

Question From: Session 7 > Reading 27 > LOS e

Related Material:

- Key Concepts by LOS

Question #54 of 200

Question ID: 414372

A company has a receivables turnover of 10, an inventory turnover of 5, and a payables turnover of 12. The company's cash conversion cycle is *closest to*:

✗ **A)** 30 days.

✗ **B)** 37 days.

✓ **C)** 79 days.

Explanation

Cash conversion cycle = receivables days + inventory processing days - payables payment period.
Receivables days = 365 / receivables turnover = 365 / 10 = 36.5 days.
Inventory processing days = 365 / inventory turnover = 365 / 5 = 73.0 days.
Payables payment period = 365 / payables turnover = 365 / 12 = 30.4 days.
Cash collection cycle = 36.5 + 73.0 - 30.4 = 79.1 days.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #55 of 200

Question ID: 414277

Which of the following should be classified as cash flows from investing (CFI) by Elegant, Inc., which reports under U.S. GAAP?

✗ **A)** Interest received by Elegant, Inc. on a bond Elegant, Inc. purchased from an outside investor.

✓ **B)** Elegant's payment to purchase equipment to be used in its business.

✗ **C)** Dividends received by Elegant, Inc. from an investment in another firm.

Explanation

Purchases of equipment are considered to be cash flows from investing. Interest paid or received and dividends received are considered to be cash flows from operations under U.S. GAAP.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #56 of 200

Question ID: 414320

A company has the following changes in its balance sheet accounts:

Net Sales	$500
An increase in accounts receivable	20
A decrease in accounts payable	40
An increase in inventory	30
Sale of common stock	100
Repayment of debt	10
Depreciation	2
Net Income	100
Interest expense on debt	5

The company's cash flow from financing is:

✓ **A)** $90.

✗ **B)** $100.

✗ **C)** -$10.

Explanation

Sale of common stock	$100
Repayment of debt	(10)
Financing cash flows	$ 90

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #57 of 200

Question ID: 414322

The net income for Miller Bat Company was $3 million for the year ended December 31, 20X4. Additional information is as follows:

- Depreciation on fixed assets: $1,500,000
- Gain from cash sales of land: 200,000
- Increase in accounts payable: 300,000
- Dividends paid on preferred stock: 400,000

Under U.S. GAAP, the net cash provided by operating activities in the statement of cash flows for the year ended December 31, 20X4 is:

✓ **A)** $4,600,000.

✗ **B)** $4,500,000.

✗ **C)** $4,200,000.

Explanation

$3,000,000 + $1,500,000 − $200,000 + $300,000 = $4,600,000.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #58 of 200

Question ID: 414388

Given the following income statement:

Net Sales	200
Cost of Goods Sold	55
Gross Profit	145
Operating Expenses	30
Operating Profit (EBIT)	115
Interest	15
Earnings Before Taxes (EBT)	100

Taxes	40
Earnings After Taxes (EAT)	60

What are the interest coverage ratio and the net profit margin?

	Interest Coverage Ratio	Net Profit Margin
✗ **A)**	2.63	0.30
✓ **B)**	7.67	0.30
✗ **C)**	0.57	0.56

Explanation

Interest coverage ratio = (EBIT / interest expense) = (115 / 15) = 7.67

Net profit margin = (net income / net sales) = (60 / 200) = 0.30

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #59 of 200

Question ID: 414401

An analyst has collected the following data about a firm:

- Receivables turnover = 10 times.
- Inventory turnover = 8 times.
- Payables turnover = 12 times.

What is the average receivables collection period, the average inventory processing period, and the average payables payment period? (assume 360 days in a year)

	Receivables Collection Period	Inventory Processing Period	Payables Payment Period
✓ **A)**	36 days	45 days	30 days
✗ **B)**	30 days	30 days	60 days
✗ **C)**	45 days	36 days	30 days

Explanation

Receivables collection period = 360 / 10 = 36 days

Inventory processing period = 360 / 8 = 45 days

Payables payment period = 360 / 12 = 30 days

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #60 of 200

Question ID: 414405

Given the following information about a company:

- Receivables turnover = 10 times.
- Payables turnover = 12 times.
- Inventory turnover = 8 times.

What are the average receivables collection period, the average payables payment period, and the average inventory processing period respectively?

	Average Receivables Collection Period	Average Payables Payment Period	Average Inventory Processing Period
✓ **A)**	37	30	46
✗ **B)**	37	30	52
✗ **C)**	37	45	46

Explanation

Average receivables collection period = (365 / 10) = 36.5 or 37

Average payables payment period = (365 / 12) = 30.4 or 30

Average inventory processing period = (365 / 8) = 45.6 or 46

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #61 of 200

Question ID: 414366

An analyst gathered the following data about a company:

- Current liabilities are $300.

- Total debt is $900.
- Working capital is $200.
- Capital expenditures are $250.
- Total assets are $2,000.
- Cash flow from operations is $400.

If the company would like a current ratio of 2, they could:

- ✗ **A)** decrease current assets by 100 or increase current liabilities by 50.
- ✓ **B)** increase current assets by 100 or decrease current liabilities by 50.
- ✗ **C)** increase current assets by 100 or increase current liabilities by 50.

Explanation

For the current ratio to equal 2.0, current assets would need to move to $600 (or up by $100) or current liabilities would need to decrease to $250 (or down by $50). Remember that CA − CL = working capital (500 − 300 = 200).

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #62 of 200

Question ID: 414301

For the year ended December 31, 2007, Challenger Company reported the following financial information:

Revenue	$100,000
Cost of goods sold	(40,000)
Cash operating expenses	(20,000)
Depreciation expense	(5,000)
Tax expense	(3,000)
Net income	$32,000
Increase in accounts receivable	$7,500
Decrease in inventory	$2,500
Increase in short-term notes payable	$3,000
Decrease in accounts payable	$1,000

Calculate cash flow from operating activities using the direct method and the indirect method.

	Direct method	Indirect method
✓ **A)**	$31,000	$31,000
✗ **B)**	$31,000	$34,000
✗ **C)**	$34,000	$34,000

Explanation

CFO is the same under both methods, the only difference is presentation. Direct method: $92,500 cash collections ($100,000 revenue - $7,500 increase in receivables) - $38,500 cash paid to suppliers (- $40,000 COGS + $2,500 decrease in inventory - $1,000 decrease in payables) - $20,000 cash operating expenses - $3,000 tax expense = $31,000. Indirect method: $32,000 net income + $5,000 depreciation expense - $7,500 increase in receivables + $2,500 decrease in inventory - $1,000 decrease in payables = $31,000. The increase in short-term notes payable is a financing activity.

References

Question From: Session 7 > Reading 26 > LOS d

Related Material:

- Key Concepts by LOS

Question #63 of 200

Question ID: 414335

Determine the cash flow from operations given the following table.

Item	*Amount*
Cash payment of dividends	$30
Sale of equipment	$25
Net income	$25
Purchase of land	$15
Increase in accounts payable	$20
Sale of preferred stock	$25
Increase in deferred taxes	$5
Profit on sale of equipment	$15

✗ **A)** $20.

✓ **B)** $35.

✗ **C)** $45.

Explanation

Using the indirect method, CFO = Net income 25 + increase in accounts payable 20 + increase in deferred taxes 5 − profit on sale of equipment 15 = $35.

Increases in accounts payable and deferred taxes are sources of operating cash that are not included in net income and must be added. Profit on sale of equipment is a CFI item that must be removed from net income.

No adjustment needs to be made for cash payment of dividends (CFF), sale of preferred stock (CFF), or purchase of land (CFI) because they are not included in net income. Only the profit on sale of equipment, not the full proceeds from sale, is included in net income.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #64 of 200

Question ID: 414404

An analyst has gathered the following information about a company:

- Cost of goods sold = 65% of sales.
- Inventory of $450,000.
- Sales of $1 million.

What is the value of this firm's average inventory processing period using a 365-day year?

✗ **A)** 1.4 days.

✗ **B)** 0.7 days.

✓ **C)** 252.7 days.

Explanation

COGS = (0.65)($1,000,000) = $650,000

Inventory turnover = CGS / Inventory = $650,000 / $450,000 = 1.4444

Average Inventory Processing Period = 365 / 1.4444 = 252.7 days

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #65 of 200

Question ID: 414430

When the return on equity equation (ROE) is decomposed using the original DuPont system, what three ratios comprise the components of ROE?

✗ **A)** Gross profit margin, asset turnover, equity multiplier.

✓ **B)** Net profit margin, asset turnover, equity multiplier.

✗ **C)** Net profit margin, asset turnover, asset multiplier.

Explanation

The three ratios can be further decomposed as follows:

Net profit margin = net income/sales

Asset turnover = sales/assets

Equity multiplier = assets/equity

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #66 of 200

Question ID: 414314

Impala Corporation reported the following financial information:

	2006	2007
Balance sheet values as of December 31:		
Prepaid insurance	$650,000	$475,000
Interest payable	250,000	300,000
Cash flows for the year ended December 31:		
Insurance premiums paid	$845,000	$750,000
Interest paid	900,000	900,000

Calculate Impala's insurance expense and interest expense for the year ended December 31, 2007.

	Insurance expense	Interest expense
✗ **A)**	$925,000	$850,000
✗ **B)**	$1,020,000	$950,000
✓ **C)**	$925,000	$950,000

Explanation

Cash paid for insurance = insurance expense + change in prepaid insurance, so insurance expense = cash paid for insurance -

change in prepaid insurance. Insurance expense for 2007 is equal to $925,000 [($750,000 cash paid for insurance - (-$175,000)]. Interest expense for 2007 is equal to $950,000 ($900,000 cash interest paid + $50,000 increase in interest payable).

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #67 of 200

Question ID: 414294

Which of the following transactions would *least likely* be reported in the cash flow statement as investing cash flows?

✓ **A)** Purchase of plant and equipment used in the manufacturing process with financing provided by the seller.

✗ **B)** Principal payments received from loans made to others.

✗ **C)** Sale of held-to-maturity securities for cash.

Explanation

The purchase of plant and equipment with financing provided by the seller is a non-cash transaction. Non-cash transactions are disclosed separately in a note or supplementary schedule to the cash flow statement.

References

Question From: Session 7 > Reading 26 > LOS b

Related Material:

- Key Concepts by LOS

Question #68 of 200

Question ID: 414436

A firm's financial statements reflect the following:

EBIT	$2,000,000
Sales	$16,000,000
Interest expense	$900,000
Total assets	$12,300,000
Equity	$7,000,000
Effective tax rate	35%
Dividend payout rate	28%

Based on this information, what is the firm's sustainable growth rate?

- ✓ **A)** 7.35%.
- ✗ **B)** 10.63%.
- ✗ **C)** 8.82%.

Explanation

ROE = tax burden × interest burden × EBIT margin × asset turnover × financial leverage

tax burden = net income/EBT
EBT = EBIT - I = 2,000,000 - 900,000 = 1,100,000
net income = (EBT)(1-t) = (1,100,000)(1 - 0.35) = 715,000
tax burden = 715,000/1,100,000 = 0.65
interest burden = EBT/EBIT = 1,100,000/2,000,000 = 0.55

EBIT margin = EBIT/revenue = 2,000,000/16,000,000 = 0.125

asset turnover = revenue/total assets = 16,000,000/12,300,000 = 1.301

financial leverage = total assets/total equity = 12,300,000/7,000,000 = 1.757

ROE = 0.65 × 0.55 × 0.125 × 1.301 × 1.757 = 0.1021

Alternatively, ROE = [(EBIT - I)(1-t)]/equity = [(2,000,000 - 900,000)(1 - 0.35)]/7,000,000 = 0.1021

Sustainable growth = ROE (1 - dividend payout rate) = 0.1021 × 0.72 = 7.35%.

References

Question From: Session 7 > Reading 27 > LOS e

Related Material:

- Key Concepts by LOS

Question #69 of 200

Question ID: 414408

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750

Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

Income Statement

Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

Determine the current ratio and the cash ratio.

	Current Ratio	Cash Ratio
✗ **A)**	2.67	1.07
✗ **B)**	1.98	1.86
✓ **C)**	4.65	0.93

Explanation

Current ratio = [100(cash) + 750(accounts receivable)+ 300(marketable securities) + 850(inventory)] / [300(AP) + 130(short term debt)] = (2000 / 430) = 4.65

Cash ratio = [100(cash) + 300(marketable securities)] / [300(AP) + 130(short term debt)] = (400 / 430) = 0.93

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #70 of 200

Question ID: 414306

Use the following information to calculate cash flows from operations using the indirect method.

- Net Income: $12,000
- Depreciation Expense: $1,000

- Loss on sale of machinery: $500
- Increase in Accounts Receivable: $2,000
- Decrease in Accounts Payable: $1,500
- Increase in Income taxes payable: $500
- Repayment of Bonds: $3,000

✓ **A)** Increase in cash of $10,500.
✗ **B)** Increase in cash of $9,500.
✗ **C)** Increase in cash of $7,500.

Explanation

Cash flow from operations would be calculated as +Net Income $12,000 + Depreciation $1,000 + Loss on sale of machinery $500 − A/R $2,000 − A/P $1,500 + Income taxes payable $500 = $10,500.

Repayment of Bonds is a financing activity and would not be included with operating activities. Depreciation is not a cash flow activity and is therefore always added back to net income to calculate CFO. The loss on the sale of machinery is not a cash outflow so it is also added back to calculate CFO. Accounts receivable is subtracted when there is an increase as this increases net income but does not affect cash.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #71 of 200

Question ID: 414391

Which ratio is used to measure a company's internal liquidity?

✓ **A)** Current ratio.
✗ **B)** Interest coverage.
✗ **C)** Total asset turnover.

Explanation

Total asset turnover measures operating efficiency and interest coverage measures a company's financial risk.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #72 of 200

Question ID: 414308

Darth Corporation's most recent income statement shows net sales of $6,000, and Darth's marginal tax rate is 40%. The total expenses reported were $3,200, all of which were paid in cash. In addition, depreciation expense was reported at $800. A further examination of the most recent balance sheets reveals that accounts receivable during that period increased by $1,000. The cash flow from operating activities reported by Darth should be:

- ✓ **A)** $1,000.
- ✗ **B)** $1,200.
- ✗ **C)** $2,200.

Explanation

Net income is ($6,000 - 3,200 - 800)(1 - 0.4) = $1,200. Adjustments to reconcile net income to cash flow from operating activities will require that depreciation ($800) be added back, and increase in accounts receivable ($1,000) be subtracted: $1,200 + 800 - 1,000 = $1,000.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #73 of 200

Question ID: 498754

A firm's balance sheet prepared under IFRS is *least likely* to include:

- ✗ **A)** fair value of firm PPE.
- ✓ **B)** market value of the firm's equity.
- ✗ **C)** market value of inventory.

Explanation

The market value of the firm's common equity (common stock) is not included on the balance sheet. IFRS allows some PP&E assets to be carried at fair value and some types of inventory to be carried at their market values.

References

Question From: Session 7 > Reading 25 > LOS b

Related Material:

- Key Concepts by LOS

Question #74 of 200

Question ID: 414238

A liquidity-based balance sheet, on which assets and liabilities are not classified as current or non-current, is permitted under:

- ✓ **A)** IFRS only.
- ✗ **B)** Both IFRS and U.S. GAAP.
- ✗ **C)** U.S. GAAP only.

Explanation

Liquidity-based balance sheet presentation is an exception, under IFRS only, to the requirement (under both IFRS and U.S. GAAP) for assets and liabilities to be classified as current or non-current. Under IFRS, a firm may present a liquidity-based balance sheet if this format is more reliable and relevant than a classified balance sheet.

References

Question From: Session 7 > Reading 25 > LOS c

Related Material:

- Key Concepts by LOS

Question #75 of 200

Question ID: 414244

Do the following characteristics have to be met in order to classify a liability as current on the balance sheet?

Characteristic #1 - Settlement is expected within one year or operating cycle, whichever is less.
Characteristic #2 - Settlement will require the use of cash within one year or operating cycle, whichever is greater.

	Characteristic #1	Characteristic #2
✓ **A)**	No	No
✗ **B)**	No	Yes
✗ **C)**	Yes	No

Explanation

A current liability is expected to be settled within one year or operating cycle, whichever is *greater*. It is not necessary to settle a current liability with cash. There are a number of ways to settle a current liability. For example, unearned revenue is a liability that is settled by providing goods or services.

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #76 of 200

Question ID: 414304

Which balance sheet accounts are *most* closely related to the operating activities on a firm's cash flow statement?

- ✓ **A)** Working capital.
- ✗ **B)** Non-current assets.
- ✗ **C)** Equity and non-current liabilities.

Explanation

Typically, operating activities on the cash flow statement are most closely related to the working capital accounts (current assets and current liabilities) on the balance sheet. Investing activities are typically related to non-current assets. Financing activities are typically related to non-current liabilities for transactions with creditors, or equity for transactions with shareholders.

References

Question From: Session 7 > Reading 26 > LOS e

Related Material:

- Key Concepts by LOS

Question #77 of 200

Question ID: 414395

Are the quick ratio and the debt-to-capital ratio used primarily to assess a company's ability to meet short-term obligations?

	Quick ratio	Debt-to-capital ratio
✗ **A)**	No	Yes
✓ **B)**	Yes	No
✗ **C)**	Yes	Yes

Explanation

The quick ratio is a liquidity ratio. Liquidity ratios are used to measure a firm's ability to meet its short-term obligations. The debt-to-capital ratio is a solvency ratio. Solvency ratios are used to measure a firm's ability to meet its longer-term obligations.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #78 of 200

Question ID: 414296

What is the difference between the direct and the indirect method of calculating cash flow from operations?

- ✗ **A)** Balance sheet items are not included in the cash flow from operations for the direct method, while they are included for the indirect method.
- ✗ **B)** The indirect method starts with gross income and adjusts to cash flow from operations, while the direct method starts with gross profit and flows through the income statement to calculate cash flows from operations.
- ✓ **C)** The direct method starts with sales and follows cash as it flows through the income statement, while the indirect method starts with net income and adjusts for non-cash charges and other items.

Explanation

The main difference between the direct and indirect methods of calculating cash flows is the way that cash flow from operations is calculated. The direct method starts with sales and follows cash as it flows through the income statement, while the indirect method starts with income after taxes and adjusts backwards for non-cash and other items. Both methods will have the same result for operating cash flows. The direct and indirect method calculates the financing and investing cash flows the same way and both methods will result in the same cash flow figure.

References

Question From: Session 7 > Reading 26 > LOS c

Related Material:

- Key Concepts by LOS

Question #79 of 200

Question ID: 414257

Carpenter Corporation reported the following statement of shareholders' equity as of December 31, 2006:

Common stock at par	$600,000
Additional paid-in-capital	900,000
Treasury stock	(200,000)
Retained earnings	10,500,000
Accumulated other comprehensive income	450,000
	$12,250,000

During 2007, Carpenter:

- earned net income of $1,700,000.
- declared dividends of $300,000. $75,000 of the dividends remain unpaid.
- purchased held-to-maturity securities for $100,000. The securities have a fair value of $110,000 at year-end.
- purchased available-for-sale securities for $250,000. The securities have a fair value of $225,000 at year-end.
- translated the financial statements of a foreign subsidiary and calculated a $90,000 unrealized gain.

- purchased treasury stock for $75,000. The stock was valued at $60,000 when issued.

Calculate Carpenter's retained earnings and accumulated other comprehensive income as of December 31, 2007.

	Retained earnings	Accumulated other comprehensive income
✓ **A)**	$11,900,000	$515,000
✗ **B)**	$11,900,000	$65,000
✗ **C)**	$12,125,000	$515,000

Explanation

As of December 31, 2007, Carpenter's retained earnings is $11,900,000 [$10,500,000 beginning balance + $1,700,000 net income - $300,000 dividends declared]. Accumulated other comprehensive income is $515,000 [$450,000 beginning balance - $25,000 unrealized loss from available for sale securities ($225,000 fair value - $250,000 cost) + $90,000 unrealized translation gain]. There is no impact on retained earnings or accumulated other comprehensive income from unrealized gains and losses on held-to-maturity securities since the securities are not reported at fair value on the balance sheet. The purchase of treasury stock does not affect comprehensive income because it is a transaction with shareholders.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #80 of 200

Question ID: 414280

Holden Company's fixed asset footnote included the following:

- During 20X7, Holden sold machinery for a gain of $100,000. The machinery had an original cost of $500,000 and its accumulated depreciation was $240,000.
- At the end of 20X7, Holden purchased machinery at a cost of $1,000,000. Holden paid $400,000 cash. The balance was financed by the seller at 8% interest.
- Depreciation expense was $2,080,000 for the year ended 20X7.

Calculate Holden's cash flow from investing activities for the year ended 20X7.

✓ **A)** $40,000 outflow.

✗ **B)** $300,000 outflow.

✗ **C)** $360,000 inflow.

Explanation

Given the gain of $100,000 and book value of the machinery sold of $260,000 ($500,000 original cost - $240,000 accumulated depreciation), the proceeds from the sale of the machinery were $360,000 ($100,000 gain + $260,000 book value). For 20X7, CFI was an outflow of $40,000 ($360,000 sale proceeds - $400,000 machinery purchase). The $600,000 financed by the seller is a non-cash transaction and is reported in the notes to the cash flow statement.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #81 of 200

Question ID: 414437

A company must report separate financial information for any segment of their business which:

- ✓ **A)** accounts for more than 10% of the firm's assets and has risk and return characteristics distinguishable from the company's other lines of business.
- ✗ **B)** is located in a country other than the firm's home country.
- ✗ **C)** is more than 20% of a firm's revenues.

Explanation

Financial statement items must be reported separately for any segment of a firm's business that is greater than 10% of revenue or assets *and* has risk and return characteristics that are distinguishable from those of the company's other lines of business. Requirements for reporting of geographic segments have the same size threshold and the segment must operate in a business environment that is different from that of the firm's other segments.

References

Question From: Session 7 > Reading 27 > LOS f

Related Material:

- Key Concepts by LOS

Question #82 of 200

Question ID: 414345

To convert an indirect statement of cash flows to a direct basis, the analyst would:

- ✓ **A)** add decreases in accounts receivables to net sales.
- ✗ **B)** add increases in accounts payable to cost of goods sold.
- ✗ **C)** subtract increases in inventory from cost of goods sold.

Explanation

A decrease in accounts receivable represents an increase in cash so this should be added to sales. Increases in accounts payable represent an increase in cash so these should be subtracted from cost of goods sold. Increases in inventory represent a use of cash so these would be added to cost of goods sold.

References

Question From: Session 7 > Reading 26 > LOS g

Related Material:

- Key Concepts by LOS

Question #83 of 200

Question ID: 414406

Given the following income statement and balance sheet for a company:

Balance Sheet

Assets	*Year 2003*	*Year 2004*
Cash	500	450
Accounts Receivable	600	660
Inventory	500	550
Total CA	1300	1660
Plant, prop. equip	1000	1250
Total Assets	2600	2,910
Liabilities		
Accounts Payable	500	550
Long term debt	700	1102
Total liabilities	1200	1652
Equity		
Common Stock	400	538
Retained Earnings	1000	720
Total Liabilities & Equity	2600	2,910

Income Statement

Sales	3000
Cost of Goods Sold	(1000)
Gross Profit	2000
SG&A	500
Interest Expense	151
EBT	1349
Taxes (30%)	405
Net Income	944

What is the average receivables collection period?

✓ **A)** 76.7 days.

✗ **B)** 80.3 days.

✗ **C)** 60.6 days.

Explanation

Average collection period = 365 / receivables turnover
Receivables turnover = sales / average receivables = 3,000 / 630 = 4.76
Average receivables collection period = 365 / 4.76 = 76.65

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #84 of 200

Question ID: 414248

At the beginning of the year, Alpha Corporation purchased 10,000 shares of Beta Corporation for $20 per share. During the year, Beta paid a $2,000 cash dividend to Alpha. At the end of the year, Beta's stock was selling for $22 per share. What amount should Alpha recognize in its year-end income statement if the investment is treated as an available-for-sale security and what amount should be recognized in the income statement if the investment is treated as a trading security?

	Available-for-sale	Trading security
✓ **A)**	$2,000	$22,000
✗ **B)**	$0	$22,000
✗ **C)**	$2,000	$20,000

Explanation

Unrealized gains and losses from trading securities are recognized in the income statement while unrealized gains and losses from available-for-sale securities bypass the income statement and are reported as other comprehensive income, a component of stockholders' equity. Cash dividends are recognized in the income statement for both trading and available-for-sale securities. Thus, Alpha will recognize only the $2,000 dividend if the shares are considered available-for-sale and will recognize $22,000 ($2,000 dividend + $20,000 unrealized gain) if the shares are considered trading securities.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #85 of 200

Question ID: 414348

How does decreasing accounts payable turnover affect a company's cash flow from financing activities and is this source of cash sustainable?

	Financing cash flow	Sustainable source
✗ **A)**	No impact	Yes
✗ **B)**	Increase	No
✓ **C)**	No impact	No

Explanation

Decreasing accounts payable turnover saves cash by delaying payments to suppliers. The result is an *operating* source of cash, not a financing source. Decreasing accounts payable turnover is not a sustainable source of cash flow because suppliers will refuse to extend credit, at some point, if payment is slower and slower.

References

Question From: Session 7 > Reading 26 > LOS h

Related Material:

- Key Concepts by LOS

Question #86 of 200

Question ID: 414362

Which of the following ratios would *least likely* measure liquidity?

- ✗ **A)** Current ratio.
- ✓ **B)** Return on assets (ROA).
- ✗ **C)** Quick ratio.

Explanation

ROA = (EBIT / average total assets) which measures management's ability and efficiency in using the firm's assets to generate operating profits. Other ratios that measure liquidity (if a company can pay its current bills) besides the quick, cash, and current ratios are the: receivables turnover, inventory turnover, and payables turnover ratios.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #87 of 200

Question ID: 414303

The difference between cash flow from operations (CFO) under the direct method and CFO under the indirect method is:

- ✗ **A)** disclosed as a reserve in the footnotes to the cash flow statement.
- ✗ **B)** balanced by an opposite difference in cash flow from investing.
- ✓ **C)** always equal to zero.

Explanation

The direct and indirect methods are two ways of presenting the same total for cash from operations.

References

Question From: Session 7 > Reading 26 > LOS d

Related Material:

- Key Concepts by LOS

Question #88 of 200

Question ID: 414421

What is a company's equity if their return on equity (ROE) is 12%, and their net income is $10 million?

- ✗ **A)** $1,200,000.
- ✓ **B)** $83,333,333.
- ✗ **C)** $120,000,000.

Explanation

One of the many ways ROE can be expressed is: ROE = net income / equity

0.12 = $10,000,000 / equity

Equity = $10,000,000 / 0.12 = $83,333,333

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #89 of 200

Question ID: 414370

Johnson Corp. had the following financial results for the fiscal 2004 year:

Current ratio	2.00
Quick ratio	1.25

Current liabilities	$100,000
Inventory turnover	12
Gross profit %	25

The only current assets are cash, accounts receivable, and inventory. The balance in these accounts has remained constant throughout the year. Johnson's net sales for 2004 were:

- ✓ **A)** $1,200,000.
- ✗ **B)** $300,000.
- ✗ **C)** $900,000.

Explanation

The 25% GP indicates that the cost of goods sold is 75% of sales. The inventory is derived from the difference between current ratio and the quick ratio. The current ratio indicates that the current assets are $200,000 and the quick assets are $125,000. The difference represents the inventory of $75,000. The inventory turnover is used to obtain cost of goods sold of $900,000. The cost of goods sold is 75% of sales, indicating that sales are $1,200,000.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #90 of 200

Question ID: 414232

Two of the elements of a balance sheet are:

- ✗ **A)** equity and cash flows.
- ✗ **B)** income and liabilities.
- ✓ **C)** assets and equity.

Explanation

The three elements of a balance sheet are assets, liabilities, and equity.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #91 of 200

Question ID: 460645

Regarding the use of financial ratios in the analysis of a firm's financial statements, it is *most accurate* to say that:

✓ **A)** a range of target values for a ratio may be more appropriate than a single target value.

✗ **B)** variations in accounting treatments have little effect on financial ratios.

✗ **C)** many financial ratios are useful in isolation.

Explanation

Determining a target value for a ratio is difficult, so a range of values may be more appropriate. Financial ratios are not useful when viewed in isolation and are only valid when compared to historical figures or peers. Comparing ratios between firms can be complicated by variations in accounting treatments used at each firm.

References

Question From: Session 7 > Reading 27 > LOS a

Related Material:

- Key Concepts by LOS

Question #92 of 200

Question ID: 434280

Dart Corporation engaged in the following transactions earlier this year:

Transaction #1: Retired long-term debenture bonds with a face amount of $10 million by issuing 500,000 shares of common stock to the bondholders.

Transaction #2: Borrowed $5 million from a bank and used the proceeds to purchase equipment used in the manufacturing process.

With respect to these transactions, should Dart report transaction #1 as a financing cash flow and/or transaction #2 as an investing cash flow?

✗ **A)** Both should be reported as such.

✓ **B)** Only one should be reported as such.

✗ **C)** Neither should be reported as such.

Explanation

Retiring bonds by issuing common stock to the bondholders is a non-cash transaction and is disclosed separately in a note or supplementary schedule to the cash flow statement, rather than as a financing cash flow. The cash borrowed for the equipment purchase is a financing inflow and the cash cost of the equipment is reported as an investing cash flow in the cash flow statement. Had a bond been issued to the seller of the equipment, it would be treated as a non-cash transaction and reported only in the notes to the cash flow statement.

References

Question From: Session 7 > Reading 26 > LOS b

Related Material:

- Key Concepts by LOS

Question #93 of 200

Question ID: 414336

Determine the cash flow from financing given the following table.

Item	*Amount*
Cash payment of dividends	$30
Sale of equipment	$10
Net income	$25
Purchase of land	$15
Increase in accounts payable	$20
Sale of preferred stock	$25
Increase in deferred taxes	$5
Profit on sale of equipment	$15

✓ **A)** -$5.

✗ **B)** $20.

✗ **C)** $15.

Explanation

CFF = 25(Sale of Stock) − 30(Div Paid) = -$5

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #94 of 200

Question ID: 414253

At the beginning of 20X7, Bryan's Bakery Company purchased a secret cookie recipe for $25,000. In addition, Bryan developed a new cake recipe at a cost of $5,000. Bryan expects to use both recipes indefinitely; however, the useful (economic) life of similar recipes has been 10 years. Assuming straight-line amortization, what amount of recipe expense should Bryan report for the year ended 20X7 and what amount should Bryan report as assets related to these recipes on its balance sheet at the end of 20X7?

	Recipe expense	Balance sheet
✗ **A)**	$5,000	$25,000

✗ **B)**	$3,000	$30,000
✓ **C)**	$7,500	$22,500

Explanation

The recipes are intangible assets. The purchased cookie recipe is capitalized and amortized over 10 years at $2,500 per year ($25,000 cost / 10 years). Since the cake recipe was developed internally, it is expensed immediately. Thus, total expense for 20X7 is $7,500 ($2,500 amortization expense + $5,000 cake recipe expense). The balance sheet value of the purchased recipe at the end of 20X7 is $25,000 - $2,500 = $22,500.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #95 of 200

Question ID: 414247

Earlier this year, Ponca Corporation purchased non-dividend paying equity securities which it classified as trading securities. Information related to the securities follows:

Security	Cost	Fair value at year-end
X	$400,000	$435,000
Y	$550,000	$545,000

What amounts should Ponca report in its year-end income statement and balance sheet as a result of its investment in securities X and Y?

	Income Statement	Balance Sheet
✓ **A)**	$30,000 unrealized gain	$980,000
✗ **B)**	No gain or loss	$980,000
✗ **C)**	$30,000 unrealized gain	$950,000

Explanation

Trading securities are reported in the balance sheet at fair value. At the end of the year, the fair value of the securities was $980,000 ($435,000 + $545,000). The unrealized gains and losses from trading securities are recognized in the income statement. Thus, Ponca would recognize an unrealized gain of $30,000 ($980,000 fair value - $950,000 cost).

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #96 of 200

Question ID: 414338

An analyst has gathered the following information about a company that reports under U.S. GAAP:

Income Statement for the Year		
Sales		$1,500
Expenses		
COGS	$1,300	
Depreciation	20	
Goodwill	10	
Int. Expenses	40	
Total expenses		1,370
Income from cont. op.		130
Gain on sale		30
Income before tax		160
Income tax		64
Net Income		$96

Additional Information:	
Dividends paid	$30
Common stock issued	20
Equipment purchased	50
Bonds issued	80
Fixed asset sold for (original cost of $100 with accumulated depreciation of $70)	60
Accounts receivable decreased by	30
Inventory decreased by	20
Accounts payable increased by	20
Wages payable decreased by	10

What is the cash flow from financing?

✓ **A)** $70.

✗ **B)** $110.

✗ **C)** $130.

Explanation

Dividends paid	-$30
Stock issued	20

Bonds issued	80
CFF	$70

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #97 of 200

Question ID: 434279

Consider the following statements.

Statement #1: Par value is a nominal dollar value assigned to shares of stock in a corporation's charter.

Statement #2: The par value of common stock represents the amount the corporation received when the stock was issued.

With respect to these statements:

- ✗ **A)** both statements are correct.
- ✗ **B)** only statement #2 is correct.
- ✓ **C)** only statement #1 is correct.

Explanation

The par value of common stock is the stated or nominal value assigned to the stock. Par value has no relationship to market value. The amount the corporation receives from the issuance of common stock is equal to the par value plus the additional paid-in-capital (proceeds in excess of par).

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #98 of 200

Question ID: 414326

Juniper Corp. has the following transactions in 20X5.

- Juniper's equipment with a book value of $55,000 was sold for $85,000 cash.
- A parcel of land was purchased for $100,000 worth of Juniper common stock.
- ABC company paid Juniper preferred dividends of $40,000.
- Juniper declared and paid a $100,000 cash dividend.

Under U.S. GAAP, what is cash flow from financing (CFF) for Juniper for 20X5?

- ✗ **A)** −$115,000.
- ✗ **B)** −$60,000.
- ✓ **C)** −$100,000.

Explanation

The only item involving cash flow from financing (CFF) was the payment of a cash dividend by Juniper. The sale of equipment affects cash flow from investing (CFI), the purchase of land has no effect on cash, and the preferred dividends received are cash flow from operations under U.S. GAAP.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #99 of 200

Question ID: 414316

Murray Company reported the following revenues and expenses for the year ended 2007:

Sales revenue	$200,000
Wage expense	89,000
Insurance expense	17,000
Interest expense	10,400
Depreciation expense	50,000

Following are the related balance sheet accounts:

	2007	2006
Unearned revenue	$15,600	$13,200
Wages payable	5,400	6,600
Prepaid insurance	1,200	0
Interest payable	500	1,600
Accumulated depreciation	95,000	45,000

Calculate cash collections and cash expenses.

Cash collections Cash expenses

✗ **A)**	$202,400	$58,100
✓ **B)**	$202,400	$119,900
✗ **C)**	$197,600	$119,900

Explanation

Cash collections are $202,400 ($200,000 sales + $2,400 increase in unearned revenue). Cash expenses are $119,900 (-$89,000 wages expense - $1,200 decrease in wages payable - $17,000 insurance expense - $1,200 increase in prepaid insurance - $10,400 interest expense - $1,100 decrease in interest payable). Depreciation expense is a non-cash expense.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #100 of 200

Question ID: 414266

Balance sheet data for two comparable firms are presented below:

	Amplus, Inc.	**Brevis, Inc.**
Cash and equivalents	**3,800**	**500**
Accounts receivable	**2,400**	**700**
Inventories	**5,800**	**1,100**
Current assets	**12,000**	**2,300**
Land	**400**	**100**
Property, plant and equipment	**24,600**	**6,400**
Noncurrent assets	**25,000**	**6,500**
Total assets	**37,000**	**8,800**
Accounts payable	**1,800**	**400**
Unearned revenue	**600**	**100**
Current liabilities	**2,400**	**500**
Long-term borrowing	**9,600**	**3,300**
Total liabilities	**12,000**	**3,800**
Common stock	**1,500**	**300**
Retained earnings	**23,500**	**4,700**
Total equity	**25,000**	**5,000**

Total liabilities and equity	**37,000**	**8,800**

Based on common-size analysis of the two firms' balance sheets, Amplus Company:

- ✓ **A)** has a greater investment in working capital than Brevis Company.
- ✗ **B)** uses relatively more fixed assets then Brevis Company.
- ✗ **C)** is more financially leveraged than Brevis Company.

Explanation

Common-size balance sheets for the two firms are as follows:

	Amplus, Inc.	**Brevis, Inc.**
Cash and equivalents	**10.3%**	**5.7%**
Accounts receivable	**6.5%**	**8.0%**
Inventories	**15.7%**	**12.5%**
Current assets	**32.4%**	**26.1%**
Land	**1.1%**	**1.1%**
Property, plant and equipment	**66.5%**	**72.7%**
Noncurrent assets	**67.6%**	**73.9%**
Total assets	**100.0%**	**100.0%**
Accounts payable	**4.9%**	**4.5%**
Unearned revenue	**1.6%**	**1.1%**
Current liabilities	**6.5%**	**5.7%**
Long-term borrowing	**25.9%**	**37.5%**
Total liabilities	**32.4%**	**43.2%**
Common stock	**4.1%**	**3.4%**
Retained earnings	**63.5%**	**53.4%**
Total equity	**67.6%**	**56.8%**
Total liabilities and equity	**100.0%**	**100.0%**

Working capital (current assets minus current liabilities) is 32.4% - 6.5% = 25.9% of assets for Amplus and 26.1% - 5.7% = 20.4% of assets for Brevis. Fixed assets (property, plant, and equipment) are relatively larger for Brevis than for Amplus. Based on long-term borrowing and total liabilities, Brevis is significantly more leveraged than Amplus.

References

Question From: Session 7 > Reading 25 > LOS g

Related Material:

- Key Concepts by LOS

Question #101 of 200

Question ID: 414364

Given the following income statement and balance sheet for a company:

Balance Sheet

Assets	*Year 2003*	*Year 2004*
Cash	500	450
Accounts Receivable	600	660
Inventory	500	550
Total CA	1300	1660
Plant, prop. equip	1000	1250
Total Assets	2600	2910
Liabilities		
Accounts Payable	500	550
Long term debt	700	1102
Total liabilities	1200	1652
Equity		
Common Stock	400	538
Retained Earnings	1000	720
Total Liabilities & Equity	2600	2,910

Income Statement

Sales	3000
Cost of Goods Sold	(1000)
Gross Profit	2000
SG&A	500
Interest Expense	151
EBT	1349
Taxes (30%)	405
Net Income	944

What is the gross profit margin?

✓ **A)** 0.666.

✗ **B)** 0.472.

✗ **C)** 0.333.

Explanation

Gross profit margin = (gross profit / net sales) = (2,000 / 3,000) = 0.666

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #102 of 200

Question ID: 414237

A key limitation of balance sheets in financial analysis is that:

- ✗ **A)** some items are recognized when they are unlikely to reflect a flow of economic benefits.
- ✓ **B)** different balance sheet items may be measured differently.
- ✗ **C)** liquidity and solvency ratios require information from other financial statements.

Explanation

Balance sheet values may use a mixture of measurement bases (historical cost, fair value, etc.). As a result, balance sheet values of assets, liabilities, and equity may not reflect their intrinsic values. Balance sheets provide the information necessary to calculate the firm's solvency and liquidity ratios. Items are recognized on the balance sheet only if a flow of future economic benefits to or from the firm is probable.

References

Question From: Session 7 > Reading 25 > LOS b

Related Material:

- Key Concepts by LOS

Question #103 of 200

Question ID: 414386

Adams Co.'s common sized balance sheet shows that:

- Current Liabilities = 20%
- Equity = 45%
- Current Assets = 45%
- Total Assets = $2,000

What are Adams' long-term debt to equity ratio and working capital?

		Debt to Equity	Working Capital
✗	**A)**	1.22	$500
✓	**B)**	0.78	$500
✗	**C)**	0.78	$250

Explanation

If equity equals 45% of assets, and current liabilities equals 20%, then long-term debt must be 35%.

Long-Term Debt / Equity = 0.35 / 0.45 = 0.78

Working capital = CA − CL = 45% - 20% = 25% of assets

WC = 2,000(0.25) = $500

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #104 of 200

Question ID: 414379

A firm's financial statements reflect the following:

Current liabilities	$4,000,000
Cash	$400,000
Inventory	$1,200,000
Accounts receivable	$800,000
Short-term investments	$2,000,000
Long-term investments	$800,000
Accounts payable	$2,500,000

What are the firm's current ratio, quick ratio, and cash ratio?

	Current Ratio	Quick Ratio	Cash Ratio
✗ **A)**	0.8	0.6	1.1
✓ **B)**	1.1	0.8	0.6
✗ **C)**	1.1	0.6	0.8

Explanation

Current ratio = (0.4 + 2.0 + 0.8 + 1.2) / 4.0 = 1.1.

Quick ratio = (0.4 + 2.0 + 0.8) / 4.0 = 0.8.
Cash ratio = (0.4 + 2.0) / 4.0 = 0.6.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #105 of 200

Question ID: 414384

Goldstar Manufacturing has an accounts receivable turnover of 10.5 times, an inventory turnover of 4 times, and payables turnover of 8 times. What is Goldstar's cash conversion cycle?

✗ **A)** 171.64 days.
✓ **B)** 80.38 days.
✗ **C)** 6.50 days.

Explanation

The cash conversion cycle = average receivables collection period + average inventory processing period - payables payment period. The average receivables collection period = 365 / average receivables turnover or 365 / 10.5 = 34.76. The average inventory processing period = 365 / inventory turnover or 365 / 4 = 91.25. The payables payment period = 365 / payables turnover ratio = 365 / 8 = 45.63. Putting it all together: cash conversion cycle = 34.76 + 91.25 - 45.63 = 80.38.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #106 of 200

Question ID: 414283

Which of the following does NOT represent a cash flow relating to operating activity?

✗ **A)** Cash received from customers.
✗ **B)** Interest paid to bondholders.
✓ **C)** Dividends paid to stockholders.

Explanation

Dividends paid to stockholders are considered cash flow relating to financing activity. However, U.S. GAAP requires interest paid to bondholders to be considered an operating activity.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #107 of 200

Question ID: 414292

For the year ended December 31, 2007, Gremlin Corporation reported the following transactions:

- Issued 5,000 shares of preferred stock for land with a fair value of $4.8 million.
- Purchased a patent for $3.3 million cash.
- Acquired 40% of the common stock of an affiliate for $2.7 million cash which was borrowed from a bank.
- Exchanged equipment with a book value of $1.7 million for equipment valued at $2.1 million. The exchange was an even trade.
- Converted bonds payable with a book value of $5 million to 50,000 shares of common stock with a fair value of $6 million.

Calculate Gremlin's cash flow from investing activities and cash flow from financing activities for the year ended December 31, 2007.

		Cash flow from investing activities	Cash flow from financing activities
✗	**A)**	$2.7 million outflow	$6.0 million inflow
✗	**B)**	$1.7 million inflow	$1.3 million outflow
✓	**C)**	$6.0 million outflow	$2.7 million inflow

Explanation

Only the acquisition of common stock of the affiliate for $2.7 million and the purchase of the patent for $3.3 million are included in cash flow from investing activities. Since the acquisition of the stock purchase was financed with a bank loan, $2.7 million will be reported as a financing inflow. Both remaining transactions are non-cash transactions and are disclosed in the notes to or in a supplementarty schedule to the cash flow statement.

References

Question From: Session 7 > Reading 26 > LOS b

Related Material:

- Key Concepts by LOS

Question #108 of 200

Question ID: 414402

The following footnote appeared in Crabtree Company's 20X7 annual report:

> *"On December 31, 20X7, Crabtree recognized a restructuring charge of $20 million, of which $5 million was for severance pay for employees who will be terminated in 20X8 and $15 million was for land that became permanently impaired in 20X7."*

Based only on these changes, Crabtree's net profit margin and fixed asset turnover ratio (using year-end financial statement values) in 20X8 as compared to 20X7 will be:

Net profit margin	Fixed asset turnover

✗ **A)** Higher Higher

✗ **B)** Lower Higher

✓ **C)** Higher Unchanged

Explanation

The restructuring charge and asset write-down are non-recurring transactions; thus, net income will be higher in 20X8, all else equal. In 20X8, fixed asset turnover will be the same as 20X7, all else equal. The asset impairment charge is a one-time charge, so fixed assets will not be reduced further in 20X8.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #109 of 200

Question ID: 414337

A firm has net sales of $3,500, earnings after taxes (EAT) of $1,000, depreciation expense of $500, cost of goods sold (COGS) of $1,500, and cash taxes of $500. Also, inventory decreased by $100, and accounts receivable increased by $300. What is the firm's cash flow from operations?

✓ **A)** $1,300.

✗ **B)** $1,800.

✗ **C)** $1,200.

Explanation

Indirect Method	
EAT	+1,000
Depreciation	+500
Change in Inv.	+ 100 a source
Change in Accts. Rec.	(300) a use
CFO	**1,300**
Direct Method	
Net Sales	+3,500
Change in Accts. Rec.	(300) a use
COGS	(1,500)
Cash Taxes	(500)
Change in Inv.	+100 a source
CFO	**1,300**

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #110 of 200

Question ID: 414346

To convert an indirect statement of cash flows to a direct basis, the analyst would:

- ✗ **A)** reduce cost of goods sold by any decreases in accounts payable.
- ✓ **B)** reduce cost of goods sold by any decreases in inventory.
- ✗ **C)** increase cost of goods sold by any depreciation that was included.

Explanation

Decreases in inventory represent a source of cash so these would be subtracted from cost of goods sold. Any depreciation and/or amortization included in the cost of goods sold does not represent an actual use of cash, so this amount should be subtracted from cost of goods sold. Decreases in accounts payable represent a use of cash so these should be added to cost of goods sold.

References

Question From: Session 7 > Reading 26 > LOS g

Related Material:

- Key Concepts by LOS

Question #111 of 200

Question ID: 414376

Paragon Company's operating profits are $100,000, interest expense is $25,000, and earnings before taxes are $75,000. What is Paragon's interest coverage ratio?

- ✗ **A)** 3 times.
- ✓ **B)** 4 times.
- ✗ **C)** 1 time.

Explanation

ICR = operating profit ÷ I = EBIT ÷ I
= 100,000 ÷ 25000 = 4

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #112 of 200

Question ID: 434282

Consider the following:

Statement #1: One approach to presenting a common-size cash flow statement is to express each inflow of cash as a percentage of total cash inflows and each outflow of cash as a percentage of total cash outflows.

Statement #2: Expressing each line item of the cash flow statement as a percentage of revenue is useful in forecasting future cash flows.

Which of these statements regarding a common-size cash flow statement is (are) CORRECT?

- ✗ **A)** Only statement #2 is correct.
- ✓ **B)** Both statements are correct.
- ✗ **C)** Only statement #1 is correct.

Explanation

A cash flow statement can be presented in common-size format by expressing each line item as a percentage of total revenue or by expressing each inflow of cash as a percentage of total cash inflows and each outflow as a percentage of total cash outflows. Expressing each line item of the cash flow statement as a percentage of revenue is useful in forecasting future cash flows since revenue usually drives the forecast.

References

Question From: Session 7 > Reading 26 > LOS h

Related Material:

- Key Concepts by LOS

Question #113 of 200

Question ID: 457613

Given the following information about a firm:

- Net Sales = $1,000.
- Cost of Goods Sold = $600.
- Operating Expenses = $200.
- Interest Expenses = $50.
- Tax Rate = 34%.

What are the gross and operating profit margins?

	Gross Profit Margin	Operating Profit Margin

✗ **A)**	20%	15%
✗ **B)**	40%	10%
✓ **C)**	40%	20%

Explanation

Gross profit margin = ($1,000 net sales − $600 COGS) / $1,000 net sales = 400 / 1,000 = 0.4

Operating profit margin = ($1,000 net sales − $600 COGS − $200 operating expenses) / $1,000 net sales = $200 / $1000 = 0.2

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #114 of 200

Question ID: 414282

Interest payments, either as part of a coupon payment or to creditors, are considered which type of cash flow under U.S. GAAP?

✗ **A)** Financing.

✗ **B)** Investing.

✓ **C)** Operating.

Explanation

Under U.S. GAAP, interest paid is an operating cash flow.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #115 of 200

Question ID: 414291

If Jackson Ski Company issues common stock, and uses the proceeds to purchase fixed assets such as equipment:

✓ **A)** cash flow from financing would increase and cash flow from investing would decrease.

✗ **B)** cash flow from financing would decrease and cash flow from investing would increase.

✗ **C)** both cash flow from operations and cash flow from financing would increase.

Explanation

Cash flow from financing increases when stock is issued, while cash flow from investing decreases when spending for purchases of fixed assets.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #116 of 200

Question ID: 414375

A firm has a cash conversion cycle of 80 days. The firm's payables turnover goes from 11 to 12, what happens to the firm's cash conversion cycle? It:

- ✗ **A)** shortens.
- ✗ **B)** may shorten or lengthen.
- ✓ **C)** lengthens.

Explanation

CCC = collection period + Inv Period - Payment period.

Payment period = (365 / payables turnover) = (365 / 11) = 33; (365 / 12) = 30. This means the CCC actually increased to 83.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #117 of 200

Question ID: 414236

The balance sheet is *most likely* to provide an analyst with information about a firm's:

- ✗ **A)** internal controls.
- ✗ **B)** operating profitability.
- ✓ **C)** solvency.

Explanation

An analyst can use the balance sheet to assess a firm's solvency and liquidity. Operating profitability can be assessed by examining the income statement. Information on a firm's internal controls appears in management's commentary and the auditor's report.

References

Question From: Session 7 > Reading 25 > LOS b

Related Material:

- Key Concepts by LOS

Question #118 of 200

Question ID: 414325

Which of the following statements regarding depreciation expense in the cash flow statements is CORRECT? Depreciation is added back to net income when determining CFO using:

- ✗ **A)** the direct method.
- ✓ **B)** the indirect method.
- ✗ **C)** either the direct or indirect methods.

Explanation

Depreciation is a non-cash expense. Only in the indirect method is depreciation added back to net income when determining CFO because net income is only used in the indirect method and not the direct method. The direct method instead starts with cash sales and works down the income statement.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #119 of 200

Question ID: 641297

An analyst compiled the following information for Universe, Inc. for the year ended December 31, 20X4:

- Net income was $850,000.
- Depreciation expense was $200,000.
- Common stock was sold for $100,000.
- Preferred stock (eight percent annual dividend) was sold at par value of $125,000.
- Common stock dividends of $25,000 were paid.
- Preferred stock dividends of $10,000 were paid.
- Equipment with a book value of $50,000 was sold for $100,000.

Using the indirect method and assuming U.S. GAAP, what was Universe Inc.'s cash flow from operations (CFO) for the year ended December 31, 20X4?

✗ **A)** $1,015,000.
✓ **B)** $1,000,000.
✗ **C)** $1,050,000.

Explanation

Cash flow from operations (CFO) using the indirect method is computed by taking net income plus non-cash expenses (i.e. depreciation) less gains from the equipment sale. Note that cash flow from operations must be adjusted downward for the amount of the gain on the sale of the equipment. Cash flow from operations is ($850,000 + $200,000 - ($100,000 − $50,000)) = $1,000,000. The other information relates to financing cash flows.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #120 of 200

Question ID: 414334

An analyst contemplates using the indirect methods to create the projected statement of cash flows. She decides to research the differences between the direct and indirect methods. Which of the following statements is *most* accurate? Under the:

✗ **A)** indirect method, changes in accounts receivable are already included in the net income figure.
✓ **B)** indirect method, depreciation must be added to net income, because it is a non-cash expense.
✗ **C)** direct method, depreciation must be added to cash collections because it is a non-cash expense.

Explanation

The indirect method begins with net income, which has already included all cash and non-cash expenses. Therefore, under the indirect method, depreciation must be added to net income, because it is a non-cash expense.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #121 of 200

Question ID: 414343

Maverick Company reported the following financial information for 2007:

	in millions
Beginning accounts receivable	$180

Ending accounts receivable	225
Sales	11,000
Beginning inventory	2,000
Ending inventory	2,300
Purchases	8,100
Beginning accounts payable	1,600
Ending accounts payable	1,200

Calculate Maverick's cost of goods sold and cash paid to suppliers for 2007.

	Cost of goods sold	Cash paid to suppliers
✗ **A)**	$3,800 million	$8,500 million
✓ **B)**	$7,800 million	$8,500 million
✗ **C)**	$7,800 million	$7,100 million

Explanation

Cost of goods sold is equal to $7,800 million ($2,000 million beginning inventory + $8,100 million purchases - $2,300 million ending inventory). Cash paid to suppliers is equal to $8,500 million (-$7,800 COGS - $300 million increase in inventory - $400 million decrease in accounts payable). Alternate solution: Cash paid to suppliers is equal to $8,500 million (-$8,100 million purchases - $400 decrease in accounts payable).

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #122 of 200

Question ID: 414344

In converting a statement of cash flows from the indirect to the direct method, which of the following adjustments should be made for a decrease in unearned revenue when calculating cash collected from customers, and for an inventory writedown (when market value is less than cost) when calculating cash payments to suppliers?

	Cash collections from customers:	Cash payments to suppliers:
✗ **A)**	Subtract decrease in unearned revenue	Add an inventory writedown
✗ **B)**	Add decrease in unearned revenue	Subtract an inventory writedown

✓ **C)** Subtract decrease in unearned revenue	Subtract an inventory writedown

Explanation

Beginning with net sales, calculating cash collected from customers requires the addition (subtraction) of any increase (decrease) in unearned revenue. Cash advances from customers represent unearned revenue and are not included in net sales, so any advances must be added to net sales in order to calculate cash collected.

An inventory writedown, as a result of applying the lower of cost or market rule, will reduce ending inventory and increase COGS for the period. However, no cash flow is associated with the writedown, so COGS is reduced by the amount of the writedown in calculating cash paid to suppliers.

References

Question From: Session 7 > Reading 26 > LOS g

Related Material:

- Key Concepts by LOS

Question #123 of 200

Question ID: 652913

Statement #1 - As compared to the price-to-earnings ratio, the price-to-cash flow ratio is easier to manipulate because management can easily control the timing of the cash flows.

Statement #2 - A firm with earnings per share of $2 is more profitable than a firm with earnings per share of $1.
With respect to these statements:

- ✓ **A)** both are incorrect.
- ✗ **B)** both are correct.
- ✗ **C)** only one is correct.

Explanation

Although manipulation of cash flow can occur, the P/E ratio is easier to manipulate because earnings are based on the numerous estimates and judgments of accrual accounting. EPS does not facilitate direct comparisons of profitability. Two firms may have the same amount of earnings but their number of shares outstanding may differ significantly.

References

Question From: Session 7 > Reading 27 > LOS e

Related Material:

- Key Concepts by LOS

Question #124 of 200

Question ID: 414438

McQueen Corporation prepared the following common-size income statement for the year ended December 31, 20X7:

Sales	100%
Cost of goods sold	60%
Gross profit	40%

For 20X7, McQueen sold 250 million units at a sales price of $1 each. For 20X8, McQueen has decided to reduce its sales price by 10%. McQueen believes the price cut will double unit sales. The cost of each unit sold is expected to remain the same. Calculate the change in McQueen's expected gross profit for 20X8 assuming the price cut doubles sales.

- ✗ **A)** $80 million increase.
- ✓ **B)** $50 million increase.
- ✗ **C)** $150 million increase.

Explanation

20X7 gross profit is equal to $100 million ($1 × 250 million units sold × 40% gross profit margin). The 10% price cut to $0.90 will increase cost of goods sold to 67% of sales [COGS=0.6($1) = $0.60; $0.60 / $0.90 = 67%.]. As a result, gross profit will decrease to 33% of sales. If unit sales double in 20X8, gross profit will equal $150 million ($0.90 × 500 million units × 33% gross profit margin). Therefore, gross profit will increase $50 million ($150 million 20X8 gross profit - $100 million 20X7 gross profit).

References

Question From: Session 7 > Reading 27 > LOS g

Related Material:

- Key Concepts by LOS

Question #125 of 200

Question ID: 414383

Using a 365-day year, if a firm has net annual sales of $250,000 and average receivables of $150,000, what is its *average* collection period?

- ✓ **A)** 219.0 days.
- ✗ **B)** 1.7 days.
- ✗ **C)** 46.5 days.

Explanation

Receivables turnover = $250,000 / $150,000 = 1.66667

Collection period = 365 / 1.66667 = 219 days

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #126 of 200

Question ID: 414274

An examination of the cash receipts and payments of Xavier Corporation reveals the following:

Cash paid to suppliers for purchase of merchandise	$5,000
Cash received from customers	14,000
Cash paid for purchase of equipment	22,000
Dividends paid	2,000
Cash received from issuance of preferred stock	10,000
Interest received on short-term investments	1,000
Wages paid	4,000
Repayment of loan to the bank	5,000
Cash from sale of land	12,000

Under U.S. GAAP, Xavier's reported cash flow from operations will be:

✗ **A)** $5,000.

✗ **B)** -$5,000.

✓ **C)** $6,000.

Explanation

Cash flow relating to operating activities includes cash paid to suppliers, cash received from customers, interest received, and wages paid. -5,000 + 14,000 + 1,000 + -4,000 = 6,000.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #127 of 200

Question ID: 414243

Firebird Company reported the following financial information at the end of 2007:

	in millions
Merchandise inventory	$240
Minority interest	70

Cash and equivalents	275
Accounts receivable	1,150
Accounts payable	225
Property & equipment	2,160
Accrued expenses	830
Current portion of long-term debt	120
Long-term debt	1,570
Retained earnings	4,230

Calculate Firebird's current assets and working capital.

	Current assets	Working capital
✗ **A)**	$1,735 million	$490 million
✓ **B)**	$1,665 million	$490 million
✗ **C)**	$1,665 million	$420 million

Explanation

Current assets are equal to $1,665 ($275 cash and equivalents + $1,150 accounts receivable + $240 inventory). Working capital (current assets minus current liabilities) is equal to $490 ($1,665 current assets - $225 accounts payable - $830 accrued expenses - $120 current portion of long-term debt).

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #128 of 200

Question ID: 414310

The following information is from the balance sheet of Silverstone Company:

Net Income for 5/1/20X5 to 5/31/20X5: $8,000

Balance 5/01/20X5	Account	Balance 5/31/20X5
$2,000	Inventory	$1,750
$1,200	Prepaid exp.	$1,700
$800	Accum. Depr.	$975
$425	Accounts payable	$625
$650	Bonds payable	$550

Using the indirect method, calculate the cash flow from operations for Silverstone Company as of 5/31/20X5:

- ✗ **A)** Increase in cash of $7,725.
- ✗ **B)** Increase in cash of $8,025.
- ✓ **C)** Increase in cash of $8,125.

Explanation

Silverstone Company's cash flow from operations would be calculated as +Net Income $8,000 + Inventory $250 - Prepaid exp. $500 + Depreciation $175 + A/P $200 = $8,125.

Bonds payable is a financing activity and would not be included in the cash flow from operations. The indirect method takes the change in the non-cash accounts and decreases or increases net income to get to the change in cash flow.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #129 of 200

Question ID: 414242

Peterson Painting Company is a commercial painting contractor. At the beginning of 20X7, Peterson's net working capital was $350,000. The following transactions occurred during 20X7:

Performed services on credit	$150,000
Purchased office equipment for cash	10,000
Recognized salaries expense	54,000
Purchased paint supplies on on credit	25,000
Consumed paint supplies	20,000
Paid salaries	50,000
Collected accounts receivable	157,000

Recognized straight-line depreciation expense	2,000
Paid accounts payable	15,000

Calculate Peterson's working capital at the end of 20X7 and the change in cash for the year 20X7.

	Working capital	Change in cash
✓ **A)**	$416,000	$82,000
✗ **B)**	$414,000	$82,000
✗ **C)**	$416,000	$80,000

Explanation

Transaction	Amount	Working capital	Cash
Performed services on credit	$150,000	Increase A/R	
Purchased PP&E for cash	10,000	Decrease cash	-$10,000
Recognized salaries expense	54,000	Increase A/P	
Purchased paint supplies on on credit	25,000	Increase inventories, increase A/P	
Consumed paint supplies	20,000	Decrease inventories	
Paid salaries	50,000	Decrease cash, decrease A/P	-$50,000
Collected accounts receivable	157,000	Increase cash, decrease A/R	+$157,000
Recognized straight-line depreciation expense	2,000		
Paid accounts payable	15,000	Decrease cash, decrease A/P	-$15,000

The change in cash was $82,000 ($157,000 collections - $10,000 from equipment purchase - $50,000 salaries paid - $15,000 for payables).

Working capital at the end of 20X7 is $416,000 ($350,000 beginning working capital + $150,000 increase in accounts receivable from services - $10,000 office equipment purchase - $54,000 salaries expense accrual - $20,000 consumed supplies).

- Purchasing $25,000 of paint supplies on credit has no net effect on working capital (current assets and current liabilities increase). Consuming $20,000 of these supplies reduces working capital (current assets decrease).
- Salary expense reduces working capital by $54,000 when recognized (current liabilities increase). Paying $50,000 of these salaries has no net effect on working capital (current assets and current liabilities decrease).
- Collecting accounts receivable has no net effect on working capital (one current asset increases and another decreases).
- Recognizing depreciation does not affect working capital.
- Paying accounts payable has no net effect on working capital (current assets and current liabilities decrease).

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #130 of 200

Question ID: 414331

The Beeline Company has the following balance sheet and income statement.

Beeline Company Balance Sheet

As of December 31, 20X4

	2003	*2004*		*2003*	*2004*
Cash	$50	$60	Accounts payable	$100	$150
Accounts receivable	100	110	Long-term debt	400	300
Inventory	200	180	Common stock	50	50
			Retained earnings	400	500
Fixed assets (gross)	800	900	Total liabilities and equity	$950	$1,000
Less: Accumulated depreciation	200	250			
Fixed assets (net)	600	650			
Total assets	$950	$1,000			

Beeline Company Income Statement

For year ended December 31, 20X4

Sales	$1,000
Less:	
COGS	600
Depreciation	50
Selling, general, and administrative expenses	160
Interest expense	23
Income before taxes	$167
Less tax	67
Net income	$100

The cash flow from operations for 2004 is:

✓ **A)** $210.

✗ **B)** $150.

✗ **C)** $260.

Explanation

Cash flow from operations (CFO) calculated using the indirect method is: net income (100) + depreciation (50) - increase in accounts receivable (10) + decrease in inventory (20) + increase in accounts payable (50) = $210.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #131 of 200

Question ID: 498755

To calculate cash received from customers, an analyst would *most appropriately*:

✗ **A)** add the change in accounts receivable to credit sales.

✓ **B)** subtract the change in accounts receivable from net sales.

✗ **C)** subtract accounts receivable from gross sales.

Explanation

Cash received from customers is most appropriately calculated by subtracting the change in accounts receivable from net sales.

References

Question From: Session 7 > Reading 26 > LOS e

Related Material:

- Key Concepts by LOS

Question #132 of 200

Question ID: 414299

The CORRECT set of cash flow treatments as they relate to interest and dividends received according to U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) is:

	U.S. GAAP	IFRS
✗ **A)**	CFI or CFO	CFI
✗ **B)**	CFI	CFO
✓ **C)**	CFO	CFI or CFO

Explanation

U.S. GAAP treats interest and dividends received as CFO whereas under IFRS interest and dividends received may be treated as either CFO or CFI.

References

Question From: Session 7 > Reading 26 > LOS c

Related Material:

- Key Concepts by LOS

Question #133 of 200

Question ID: 414412

How would the collection of accounts receivable *most likely* affect the current and cash ratios?

	Current ratio	Cash ratio
✗ **A)**	Increase	Increase
✓ **B)**	No effect	Increase
✗ **C)**	No effect	No effect

Explanation

Collecting receivables increases cash and decreases accounts receivable. Thus, current assets do not change and the current ratio is unaffected. Because the numerator of the cash ratio only includes cash and marketable securities, collecting accounts receivable increases the cash ratio.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #134 of 200

Question ID: 414392

The *main difference* between the current ratio and the quick ratio is that the quick ratio excludes:

✓ **A)** inventory.

✗ **B)** cost of goods sold.

✗ **C)** assets.

Explanation

Current ratio = (current assets / current liabilities) = [cash + marketable securities + receivables + inventory] / current liabilities

Quick ratio = [cash + marketable securities + receivables] / current liabilities

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #135 of 200

Question ID: 414350

Which of the following *best* describes a ratio that measures a firm's ability to acquire long-term assets with cash flows from operations, and a performance ratio, respectively?

	Acquire assets with CFO	Performance ratio
✗ **A)**	Reinvestment ratio	Debt payment ratio
✓ **B)**	Reinvestment ratio	Cash-to-income ratio
✗ **C)**	Investing and financing ratio	Cash-to-income ratio

Explanation

The reinvestment ratio measures a firm's ability to acquire long-term assets with cash flows from operations. In contrast, the investing and financing ratio, which is more comprehensive, measures the firm's ability to purchase assets, satisfy debts, and pay dividends.

The cash-to-income ratio measures the ability to generate cash from a firm's operations and is a performance ratio for cash flow analysis purposes. The debt payment ratio measures the firm's ability to satisfy long-term debt with cash flow from operations but it is more of a coverage ratio than a performance ratio.

References

Question From: Session 7 > Reading 26 > LOS i

Related Material:

- Key Concepts by LOS

Question #136 of 200

Question ID: 414409

Eagle Manufacturing Company reported the following selected financial information for 2007:

Accounts payable turnover	5.0
Cost of goods sold	$30 million
Average inventory	$3 million
Average receivables	$8 million

Total liabilities	$35 million
Interest expense	$2 million
Cash conversion cycle	13.5 days

Assuming 365 days in the calendar year, calculate Eagle's sales for the year.

- ✗ **A)** $52.3 million.
- ✓ **B)** $58.4 million.
- ✗ **C)** $57.8 million.

Explanation

Set up the cash conversion cycle formula and solve for the missing variable, sales. Days in payables is equal to 73 [365 / 5 accounts payable turnover]. Days in inventory is equal to 36.5 [365 / ($30 million COGS / $3 million average inventory)]. Given the cash conversion cycle, days in inventory, and days in payables, calculate days in receivables of 50 [13.5 days cash conversion cycle + 73 days in payables - 36.5 days in inventory]. Given days in receivables of 50 and average receivables of $8 million, sales are $58.4 million [($8 million average receivables / 50 days) × 365].

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #137 of 200

Question ID: 414382

If the inventory turnover ratio is 7, what is the average number of days the inventory is in stock?

- ✗ **A)** 25 days.
- ✓ **B)** 52 days.
- ✗ **C)** 70 days.

Explanation

Average Inventory Processing Period = 365 / inventory turnover = 365 / 7 = 52 days.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #138 of 200

Question ID: 414318

Eagle Company's financial statements for the year ended December 31, 20X5 were as follows (in $ millions):

Income Statement	
Sales	150
Cost of Goods Sold	(48)
Wages Expense	(56)
Interest Expense	(12)
Depreciation	(22)
Gain on Sale of Equipment	6
Income Tax Expense	(8)
Net Income	10

Balance Sheet	*12-31-X4*	*12-31-X5*
Cash	32	52
Accounts Receivable	18	22
Inventory	46	44
Property, Plant & Equip. (net)	182	160
Total Assets	278	278
Accounts Payable	28	33
Long-term Debt	145	135
Common Stock	70	70
Retained Earnings	35	40
Total Liabilities & Equity	278	278

Cash flow from operations (CFO) for Eagle Company for the year ended December 31, 20X5 was (in $ millions).

- ✗ **A)** $37.
- ✓ **B)** $29.
- ✗ **C)** $41.

Explanation

Using the indirect method:

Add: Net Income	$10
Add: Depreciation Expense	22

Less: Gain from Sale of Equip.	(6)
Less: Increase in Accounts Receivable	(4)
Add: Decrease in Inventory	2
Add: Increase in Accounts Payable	5
Cash flow from operations (CFO)	29

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #139 of 200

Question ID: 414285

Which of the following items would NOT be included in cash flow from investing?

✓ **A)** Selling stock of the company.

✗ **B)** Proceeds related to acquisitions.

✗ **C)** Buying or selling a building.

Explanation

Selling stock of the company would be a financing cash flow.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #140 of 200

Question ID: 414394

The following data applies to the XTC Company:

- Sales = $1,000,000.
- Receivables = $260,000.
- Payables = $600,000.
- Purchases = $800,000.
- COGS = $800,000.
- Inventory = $400,000.
- Net Income = $50,000.

- Total Assets = $800,000.
- Debt/Equity = 200%.

What is the average collection period, the average inventory processing period, and the payables payment period for XTC Company?

	Average Collection Period	Average Inventory Processing Period	Payables Payments Period
✗ **A)**	45 days	45 days	132 days
✓ **B)**	95 days	183 days	274 days
✗ **C)**	55 days	195 days	231 days

Explanation

Receivables turnover = $1,000,000 / $260,000 = 3.840
Average collection period = 365 / 3.840 = 95.05 or 95 days

Inventory turnover = $800,000 / $400,000 = 2
Average inventory processing period = 365 / 2 = 183 days

Payables turnover ratio = $800,000 / $600,000 = 1.333
Payables payment period = 365 / 1.333 = 273.82 or 274 days

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #141 of 200

Question ID: 414259

Which of the following transactions is *most likely* to be recognized on a firm's statement of changes in equity?

✓ **A)** Declaring a dividend on common shares.
✗ **B)** Buying a machine from an equipment dealer.
✗ **C)** Investing cash in an exchange-traded fund.

Explanation

Declaring a dividend decreases shareholders' equity and is reflected on the statement of changes in shareholders' equity. Buying a machine is unlikely to change shareholders' equity at the time of purchase. Investing cash in a security is an exchange of one asset for another and is also unlikely to change shareholders' equity at the time of the investment.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #142 of 200

Question ID: 414319

When calculating cash flow from operations (CFO) using the indirect method which of the following is *most* accurate?

✗ **A)** The indirect method requires an additional schedule to reconcile net income to cash flow.

✗ **B)** In using the indirect method, each item on the income statement is converted to its cash equivalent.

✓ **C)** When recognizing a gain on the sale of fixed assets, the amount is a deduction to operating cash flows.

Explanation

When recognizing a gain on the sale of fixed assets, the amount is a deduction to operating cash flows. This is because the gain would be double counted in the investing section and in net income. Therefore, the gain must be removed from net income. The direct method of cash flow calculation converts the income statement items to their cash equivalents, not the indirect method. Also, depreciation is added to net income in order to calculate CFO using the indirect method.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #143 of 200

Question ID: 414256

Ascot Corporation has 4 million shares of common stock authorized, 2.4 million shares of common stock issued, and 1.8 million shares of common stock outstanding. How many shares of treasury stock does Ascot own and is the treasury stock reported as an asset in Ascot's balance sheet?

		Treasury shares	Reported as an asset
✗	**A)**	1.6 million	No
✗	**B)**	600,000	Yes
✓	**C)**	600,000	No

Explanation

Shares that were issued previously but are not outstanding are treasury shares (owned by the firm). Thus, there are 600,000 treasury shares (2.4 million issued - 1.8 million outstanding). Treasury shares are reported as a reduction in shareholders' equity on the balance sheet. Treasury stock is not an asset.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #144 of 200

Question ID: 414434

An analysis of the industry reveals that firms have been paying out 45% of their earnings in dividends, asset turnover = 1.2; asset-to-equity (A/E) = 1.1 and profit margins are 8%. What is the industry's projected growth rate?

✓ **A)** 5.81%.

✗ **B)** 4.55%.

✗ **C)** 4.95%.

Explanation

ROE = profit margin × asset turnover × A/E = 0.08 × 1.2 × 1.1 = 0.1056
RR = (1 - 0.45) = 0.55
g = ROE × RR = 0.1056 × 0.55 = 0.0581

References

Question From: Session 7 > Reading 27 > LOS e

Related Material:

- Key Concepts by LOS

Question #145 of 200

Question ID: 414286

Which of the following is NOT a category on the statement of cash flows? Cash flow from:

✓ **A)** sales.

✗ **B)** financing.

✗ **C)** operations.

Explanation

There are only three types of cash flows: financing, investing, and operating.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #146 of 200

Question ID: 414354

Are the following statements about common-size financial statements correct or incorrect?

Statement #1 - Expressing financial information in a common-size format enables the analyst to make better comparisons between two firms of similar size that operate in different industries.

Statement #2 - Common-size financial statements can be used to highlight the structural changes in the firm's operating results and financial condition that have occurred over time.

With respect to these statements:

✓ **A)** only one is correct:

✗ **B)** both are incorrect.

✗ **C)** both are correct.

Explanation

Vertical common-size statements enable the analyst to make better comparisons of two firms of *different* sizes that operate in the *same* industry. Horizontal common-size financial statements express each line as a percentage of the base year figure; thus, horizontal common-size statements can be used to identify structural changes in a firm's operating results and financial condition over time.

References

Question From: Session 7 > Reading 27 > LOS a

Related Material:

- Key Concepts by LOS

Question #147 of 200

Question ID: 414313

Given the following information, what is the adjustment to net income when calculating cash flow from operations using the indirect method?

- Increase in accounts payable of $25.
- Sold one share of stock for $15.
- Paid dividends of $10 to shareholders.
- Depreciation expense of $100.
- Increase in inventory of $20.

✗ **A)** -$95.

✓ **B)** +$105.

✗ **C)** -$50.

Explanation

Using the indirect method, the increase in accounts payable is a source of cash from operations (+25), depreciation expense is a non-cash expense added back in computing cash from operations (+100), and increase in inventory is a use of cash from operations (-20) = 25 + 100 - 20 = 105. The sale of stock and the dividends paid are financing cash flows that are not included in net income, so they do not require adjustment when calculating CFO.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #148 of 200

Question ID: 414279

Which of the following would NOT be a component of cash flow from investing?

✓ **A)** Dividends paid.
✗ **B)** Purchase of equipment.
✗ **C)** Sale of land.

Explanation

Dividends paid is not a component of cash flow from investing, it is a component of cash flow from financing. The other items are all components of cash flow from investing.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #149 of 200

Question ID: 414374

Use the following data from Delta's common size financial statement to answer the question:

Earnings after taxes	=	18%
Equity	=	40%
Current assets	=	60%
Current liabilities	=	30%
Sales	=	$300
Total assets	=	$1,400

What is Delta's after-tax return on equity?

✗ **A)** 5.0%.

✗ **B)** 18.0%.

✓ **C)** 9.6%.

Explanation

Net income after taxes = 300 × 0.18 = 54
Equity = 1400 × 0.40 = 560
ROE = Net Income / Equity = 54 / 560 = 0.0964 = 9.6%

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #150 of 200

Question ID: 414260

The statement of changes in equity is *least likely* to provide information on the firm's:

✓ **A)** repayment of bond principal.

✗ **B)** comprehensive income.

✗ **C)** payment of dividends.

Explanation

The statement of changes in equity shows a firm's comprehensive income (net income and other comprehensive income) and transactions with shareholders, such as dividends paid and issuance or repurchases of stock. Repayment of bond principal is not a change in equity: assets (cash) decrease and liabilities (long-term debt) decrease.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #151 of 200

Question ID: 414327

Selected information from Rockway, Inc.'s U.S. GAAP financial statements for the year ended December 31, included the following (in $):

	2004	*2005*
Sales	17,000,000	21,000,000

Cost of Goods Sold	11,000,000	15,000,000
Interest Paid	800,000	1,000,000
Current Income Taxes Paid	700,000	1,000,000
Accounts Receivable	3,000,000	2,500,000
Inventory	2,400,000	3,000,000
Property, Plant & Equip.	2,000,000	16,000,000
Accounts Payable	1,000,000	1,400,000
Long-term Debt	8,000,000	9,000,000
Common Stock	4,000,000	5,000,000

Using the direct method, cash provided or used by operating activities(CFO) in the year 2005 was:

- ✗ **A)** $5,300,000.
- ✓ **B)** $4,300,000.
- ✗ **C)** $6,300,000.

Explanation

Cash provided or used by operating activities under the direct method is computed by adding cash inflows and subtracting cash inputs and cash outflows. Operating Cash inflows for Rockway Inc. for 2005 came from sales ($21,000,000) and decrease in accounts receivable ($3,000,000 − $2,500,000 = $500,000) for net cash inflows of ($21,000,000 + $500,000 =) $21,500,000. Operating cash inputs were cost of goods sold ($15,000,000), plus the increase in inventory ($3,000,000 − $2,400,000 = $600,000) less the increase in accounts payable, (which is a source of funds) ($1,000,000 − $1,400,000 = -$400,000) for net cash inputs of ($15,000,000 + $600,000 - $400,000 =) $15,200,000. Other operating cash outflows were interest paid ($1,000,000) and current income taxes paid ($1,000,000) totaling ($2,000,000). Cash provided by operations was ($21,500,000 − $15,200,000 − $2,000,000 =) $4,300,000. Changes in property, plant and equipment, long-term debt and common stock do *not* affect cash from operations.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #152 of 200

Question ID: 414321

Which of the following statements about accounting procedures and their impact on the statement of cash flows is *least valid*? All else equal:

- ✗ **A)** Cash flow from financing (CFF) is higher over the life of a bond if a firm issues the bond at a premium, compared to issuing the bond at par.

✓ **B)** A nonprofitable company that uses LIFO to account for inventory will have higher total cash flow than a nonprofitable company that uses FIFO during a period of rising prices.

✗ **C)** A company that finances through common stock issues may have the same cash flow from financing (CFF) as a firm that issues debt.

Explanation

Because of the impact of income taxes, a *profitable* company that accounts for inventory using LIFO will have higher total cash flow than a *profitable* company that uses FIFO. The company that uses LIFO will have higher cost of goods sold, resulting in lower net income and thus lower taxes.

The other statements are accurate:

- A company that issues common stock is *not* required to pay dividends (which would reduce cash flow from financing). Thus, it may have the same CFF as a firm that issues debt since interest paid on debt is a component of CFO.
- When a company issues bonds at a premium, the proceeds raised at issuance (CFF inflow) are greater than the par value repaid at maturity (CFF outflow). For bonds issued at par, the CFF inflow at issuance is equal to the CFF outflow at maturity.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #153 of 200

Question ID: 414309

Convenience Travel Corp.'s financial information for the year ended December 31, 20X4 included the following:

Property Plant & Equipment	$15,000,000
Accumulated Depreciation	9,000,000

The only asset owned by Convenience Travel in 20X5 was a corporate jet airplane. The airplane was being depreciated over a 15-year period on a straight-line basis at a rate of $1,000,000 per year. On December 31, 20X5 Convenience Travel sold the airplane for $10,000,000 cash. Net income for the year ended December 31, 20X5 was $12,000,000. Based on the above information, and ignoring taxes, what is cash flow from operations (CFO) for Convenience Travel for the year ended December 31, 20X5?

✗ **A)** $13,000,000.

✓ **B)** $8,000,000.

✗ **C)** $11,000,000.

Explanation

Using the indirect method, CFO is net income increased by 20X5 depreciation ($1,000,000) and decreased by the gain recognized on the sale of the plane [$10,000,000 sale price − ($15,000,000 original cost − $10,000,000 accumulated depreciation including 20X5) = $5,000,000]. $12,000,000 + $1,000,000 − $5,000,000 = $8,000,000.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #154 of 200

Question ID: 414381

Which of the following items is NOT in the numerator of the quick ratio?

✗ **A)** Cash.

✗ **B)** Receivables.

✓ **C)** Inventory.

Explanation

Quick ratio = (cash + marketable securities + receivables) / current liabilities

Current ratio = (cash + marketable securities + receivables + inventory) / current liabilities

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #155 of 200

Question ID: 492016

Pastel Company operates in the following lines of business which management believes have distinguishable return and risk characteristics:

	Revenues	Assets
Food	500	2,000
Beverages	1,300	6,000
Entertainment	2,500	10,000
Lodging	5,000	20,000
Services	22,000	28,000
International	700	3,000
Totals	32,000	69,000

For which of these lines is Pastel required to report segment data?

✓ **A)** Entertainment, Lodging, and Services.

✗ **B)** Services and International.

✗ **C)** International only.

Explanation

For portions of a company that are distinguishable by their risk and return characteristics, IFRS and U.S. GAAP require segment reporting if a portion accounts for more than 10% of the company's revenues or assets. Services and Lodging each account for more than 10% of Pastel's total revenues and assets, and Entertainment accounts for more than 10% of Pastel's total assets.

References

Question From: Session 7 > Reading 27 > LOS f

Related Material:

- Key Concepts by LOS

Question #156 of 200

Question ID: 414373

An analyst has gathered the following information about a firm:

- Net sales of $500,000.
- Cost of goods sold = $250,000.
- EBIT of $150,000.
- EAT of $90,000.

What is this firm's operating profit margin?

✓ **A)** 30%.

✗ **B)** 50%.

✗ **C)** 18%.

Explanation

Operating profit margin = (EBIT / net sales) = ($150,000 / $500,000) = 30%

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #157 of 200

Question ID: 414268

An analyst has gathered the following information about a company:

Balance Sheet

Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

Income Statement

Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

What is the quick ratio?

- ✗ **A)** 0.62.
- ✗ **B)** 1.53.
- ✓ **C)** 2.67.

Explanation

Quick ratio = [100(cash) + 750(AR) + 300(marketable securities)] / [300(AP) + 130(short-term debt)] = (1,150 / 430) = 2.67

References

Question From: Session 7 > Reading 25 > LOS h

Related Material:

- Key Concepts by LOS

Question #158 of 200

Question ID: 434285

In the year 20X4, a company had a net profit margin of 18%, total asset turnover of 1.75, and a financial leverage multiplier of 1.5. If the company's net profit margin declines to 10% in 20X5, what total asset turnover would be needed in order to maintain the same return on equity as in 20X4, assuming there is no change in the financial leverage multiplier?

- ✓ **A)** 3.15.
- ✗ **B)** 2.50.
- ✗ **C)** 1.85.

Explanation

ROE in 20X4 was 0.18 × 1.75 × 1.5 = 0.4725.

If ROE for 20X5 is unchanged from 20X4, then:
0.10 × asset turnover × 1.5 = 0.4725
Asset turnover = 3.15.

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #159 of 200

Question ID: 414231

Resources controlled as a result of past transactions that are expected to provide future benefits are referred to as:

- ✗ **A)** equity.
- ✓ **B)** assets.
- ✗ **C)** liabilities.

Explanation

Assets are resources that are expected to provide future benefits and are controlled as a result of past transactions. Liabilities are obligations resulting from past events that are expected to require a future outflow of resources. Equity is a residual interest in assets after deducting liabilities.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #160 of 200

Question ID: 414342

Mark Industries' income statement and related notes for the year ended December 31 are as follows (in $):

Sales	42,000,000
Cost of Goods Sold	(32,000,000)
Wages Expense	(1,500,000)
Depreciation Expense	(2,500,000)
Interest Expense	(1,000,000)
Income Tax Expense	(2,000,000)
Net Income	3,000,000

During the year:

- Wages Payable increased $100,000.
- Accumulated Depreciation increased $2,500,000.
- Interest Payable decreased $200,000.
- Income Taxes Payable increased $500,000.
- Dividends of $100,000 were declared and paid.

Under U.S. GAAP, Mark Industries' cash flow from operations (CFO) for the year ended December 31 was:

✗ **A)** $4,400,000.
✓ **B)** $5,900,000.
✗ **C)** $4,800,000.

Explanation

Using the indirect method, net income is adjusted by adding back depreciation (a non-cash expense) and changes in working capital: the increase in wages payable and the increase in income taxes payable are sources of cash, and the decrease in interest payable is a use of cash. Dividends paid are financing cash flows under U.S. GAAP.

CFO = $3,000,000 + $2,500,000 + $100,000 + $500,000 - $200,000 = $5,900,000.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #161 of 200

Question ID: 414389

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

Income Statement	
Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

What is the receivables collection period?

- ✗ **A)** 243.
- ✓ **B)** 183.
- ✗ **C)** 365.

Explanation

Receivables turnover = 1,500(sales) / 750(receivables) = 2.0

Average receivables collection period = 365 / 2 = 182.5 or 183

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #162 of 200

Question ID: 414418

Comparative income statements for E Company and G Company for the year ended December 31 show the following (in $ millions):

	E Company	*G Company*
Sales	70	90
Cost of Goods Sold	(30)	(40)
Gross Profit	40	50
Sales and Administration	(5)	(15)
Depreciation	(5)	(10)
Operating Profit	30	25
Interest Expense	(20)	(5)
Earnings Before Taxes	10	20
Income Taxes	(4)	(8)
Earnings after Taxes	6	12

The financial risk of E Company, as measured by the interest coverage ratio, is:

- ✓ **A)** higher than G Company's because its interest coverage ratio is less than one-third of G Company's.
- ✗ **B)** lower than G Company's because its interest coverage ratio is at least three times G Company's.
- ✗ **C)** higher than G Company's because its interest coverage ratio is less than G Company's, but at least one-third of G Company's.

Explanation

E Company's interest coverage ratio (EBIT / interest expense) is (30 / 20) = 1.5.

G Company's interest coverage ratio is (25 / 5) = 5.0. Higher interest coverage means greater ability to cover required interest and lease payments. Note that 1.5 / 5.0 = 0.30, which means the interest coverage for E Company is less than 1/3 that of G Company.

References

Question From: Session 7 > Reading 27 > LOS c

Related Material:

- Key Concepts by LOS

Question #163 of 200

Question ID: 414435

A firm's financial statements reflect the following:

Net profit margin	15%
Sales	$10,000,000
Interest payments	$1,200,000
Avg. assets	$15,000,000
Equity	$11,000,000
Avg. working capital	$800,000
Dividend payout rate	35%

Which of the following is the *closest* estimate of the firm's sustainable growth rate?

✓ **A)** 9%.

✗ **B)** 10%.

✗ **C)** 8%.

Explanation

Return on equity (ROE) = net profit margin × asset turnover × leverage = (0.15)(0.67)(1.364) = 0.137.

The sustainable growth = (1 - dividend rate)(ROE) = (0.65)(0.137) = 8.9%.

References

Question From: Session 7 > Reading 27 > LOS e

Related Material:

- Key Concepts by LOS

Question #164 of 200

Question ID: 414426

Given the following information about a firm what is its return on equity (ROE)?

- An asset turnover of 1.2.
- An after tax profit margin of 10%.
- A financial leverage multiplier of 1.5.

✗ **A)** 0.09.

✗ **B)** 0.12.

✓ **C)** 0.18.

Explanation

ROE = (EAT / S)(S / A)(A / EQ)

ROE = (0.1)(1.2)(1.5) = 0.18

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #165 of 200

Question ID: 414367

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

Income Statement	
Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

What is the current ratio?

✗ **A)** 2.67.

✓ **B)** 4.65.

✗ **C)** 0.22.

Explanation

Current ratio = [100(cash) + 750(AR) + 300(marketable securities) + 850(inventory)] / [300(AP) + 130(short-term debt)] = (2,000 / 430) = 4.65

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #166 of 200

Question ID: 414275

Jodi Lein, small business consultant, is currently working with RJ Landscaping, a sole proprietorship. She is trying to educate the owner on the importance of monitoring cash flows. Operating information as of the end of the most recent month appears below:

- Cash from sale of truck of $7,000.
- Cash salaries paid of $17,000.
- Cash from customers of $45,000.
- Depreciation expense of $5,500.
- Interest on bank line of credit of $1,000.
- Cash paid to suppliers of $22,000.
- Other cash expenses, including rent, of $6,300.
- No taxes due.

Using this information and U.S. GAAP, what is the cash flow from operations for the month?

✓ **A)** -$1,300.

✗ **B)** $11,200.

✗ **C)** -$300.

Explanation

The format of the question information suggests the use of the *direct* cash flow method. In this method, depreciation is *not* a component of cash flow from operations. Cash flow from operations = (all numbers in thousands of dollars) 45 - 17 - 22 - 6.3 - 1.0 = -1.3, or -$1,300.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #167 of 200

Question ID: 414347

The only section of the statement of cash flows that must be adjusted to convert a statement of cash flows from the indirect to the direct method is:

✓ **A)** cash flows from operations.

✗ **B)** cash flows from financing.

✗ **C)** cash flows from investing.

Explanation

The cash flows from investing activities and cash flows from financing activities sections of the statement of cash flows are the same for both the indirect and direct methods. Only the cash flows from operations section must be adjusted to convert the statement of cash flows from the indirect to the direct method.

References

Question From: Session 7 > Reading 26 > LOS g

Related Material:

- Key Concepts by LOS

Question #168 of 200

Question ID: 414414

Income Statements for Royal, Inc. for the years ended December 31, 20X0 and December 31, 20X1 were as follows (in $ millions):

	20X0	*20X1*
Sales	78	82
Cost of Goods Sold	(47)	(48)
Gross Profit	31	34
Sales and Administration	(13)	(14)
Operating Profit (EBIT)	18	20
Interest Expense	(6)	(10)
Earnings Before Taxes	12	10
Income Taxes	(5)	(4)
Earnings after Taxes	7	6

Analysis of these statements for trends in operating profitability reveals that, with respect to Royal's gross profit margin and net profit margin:

✗ **A)** gross profit margin decreased but net profit margin increased in 20X1.

✗ **B)** both gross profit margin and net profit margin increased in 20X1.

✓ **C)** gross profit margin increased in 20X1 but net profit margin decreased.

Explanation

Royal's gross profit margin (gross profit / sales) was higher in 20X1 (34 / 82 = 41.5%) than in 20X0 (31 / 78 = 39.7%), but net profit margin (earnings after taxes / sales) declined from 7 / 78 = 9.0% in 20X0 to 6 / 82 = 7.3% in 20X1.

References

Question From: Session 7 > Reading 27 > LOS c

Related Material:

- Key Concepts by LOS

Question #169 of 200

Question ID: 414298

According to U.S. Generally Accepted Accounting Principles (GAAP) and International Accounting Standards (IAS) GAAP, should dividends paid be treated as a cash flow from financing (CFF) or as a cash flow from operations (CFO)?

	U.S. GAAP	IAS GAAP
✓ **A)**	CFF	CFF or CFO
✗ **B)**	CFF or CFO	CFO
✗ **C)**	CFO	CFF

Explanation

U.S. GAAP treats dividends paid as CFF whereas IAS GAAP treats dividends paid as either CFO or CFF.

References

Question From: Session 7 > Reading 26 > LOS c

Related Material:

- Key Concepts by LOS

Question #170 of 200

Question ID: 414380

An analyst has collected the following data about a firm:

- Receivables turnover = 20 times.
- Inventory turnover = 16 times.
- Payables turnover = 24 times.

What is the cash conversion cycle?

- ✗ **A)** 56 days.
- ✗ **B)** Not enough information is given.
- ✓ **C)** 26 days.

Explanation

Cash conversion cycle = receivables collection period + inventory processing period - payables payment period.

Receivables collection period = (365 / 20) = 18
Inventory processing period = (365 / 16) = 23
Payables payment period = (365 / 24) = 15
Cash conversion cycle = 18 + 23 - 15 = 26

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #171 of 200

Question ID: 414233

Which of the following characteristics are required for recognition of a balance sheet asset?

Characteristic #1: Future economic benefits to the firm are probable.

Characteristic #2: The asset is tangible and is obtained at a cost.

	Characteristic #1	Characteristic #2
✓ **A)**	Yes	No
✗ **B)**	No	No
✗ **C)**	Yes	Yes

Explanation

An asset is recognized on the balance sheet only if it is probable that it will provide future economic benefits. Assets can be tangible or intangible. In some cases, assets are acquired without cost, but will be reported to the extent that they will provide future economic benefit, and thus have value.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #172 of 200

Question ID: 414415

Kellen Harris is a credit analyst with the First National Bank. Harris has been asked to evaluate Longhorn Supply Company's cash needs. Harris began by calculating Longhorn's turnover ratios for 2007. After a discussion with Longhorn's management, Harris decides to adjust the turnover ratios for 2008 as follows:

	2007 Actual Turnover	Expected Increase / (Decrease)
Accounts receivable	5.0	10%
Fixed asset	3.0	7%
Accounts payable	6.0	(20%)
Inventory	4.0	(5%)
Equity	5.5	-
Total asset	2.3	8%

Longhorn's expected cash conversion cycle for 2008, based on the expected changes in turnover and assuming a 365 day year, is *closest* to:

- ✓ **A)** 86 days.
- ✗ **B)** 46 days.
- ✗ **C)** 82 days.

Explanation

2008 expected days of sales outstanding is 66 [365 / (5.0 × 1.1)], 2008 days of inventory on hand is 96 [365 / (4.0 × 0.95)], and 2008 days of payables is 76 [365 / (6.0 × 0.8)]. Expected cash conversion cycle is 86 days [66 days of sales outstanding + 96 days of inventory on hand - 76 days of payables].

References

Question From: Session 7 > Reading 27 > LOS c

Related Material:

- Key Concepts by LOS

Question #173 of 200

Question ID: 414272

In preparing its cash flow statement for the year ended December 31, 20x4, Giant Corporation collected the following data:

Gain on sale of equipment	$6,000
Proceeds from sale of equipment	10,000

Purchase of Zip Co. bonds for	180,000 (maturity value $200,000)
Amortization of bond discount	2,000
Dividends paid	(75,000)
Proceeds from sale of Treasury stock	38,000

In its December 31, 20x4, statement of cash flows, under U.S. GAAP, what amounts should Giant report as net cash used in investing activities and net cash used in financing activities?

	Investing Activities	Financing Activities
✓ **A)**	$170,000	$37,000
✗ **B)**	$178,000	-$37,000
✗ **C)**	$170,000	-$38,000

Explanation

Investing Activities:
$10,000 - $180,000 = -$170,000 cash flow from investing or $170,000 used

Financing Activities:
$38,000 − $75,000 = -$37,000 cash flow from financing or $37,000 used

Note that the question asked for net cash used therefore this is a positive cash outflow.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #174 of 200

Question ID: 454995

If a company has a net profit margin of 5%, an asset turnover ratio of 2.5 and a ROE of 18%, what is the equity multiplier?

✗ **A)** 2.25.

✓ **B)** 1.44.

✗ **C)** 0.69.

Explanation

There are many different ways to illustrate ROE one of which is:

ROE = (net profit margin)(asset turnover)(equity multiplier)

0.18 = (0.05)(2.5)(equity multiplier)

0.18 ÷ [(0.05)(2.5)] = equity multiplier

0.18 ÷ 0.125 = equity multiplier

0.18 ÷ 0.125 = 1.44

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #175 of 200

Question ID: 414424

An analyst has gathered the following information about a company.

- The total asset turnover is 1.2.
- The after-tax profit margin is 10%.
- The financial leverage multiplier is 1.5.

Given this information, the company's return on equity is:

✓ **A)** 18%.
✗ **B)** 12%.
✗ **C)** 9%.

Explanation

ROE = profit margin × total asset turnover × financial leverage
ROE = (0.1)(1.2)(1.5) = 0.18 or 18.0%

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #176 of 200

Question ID: 414240

Which of the following statements about a classified balance sheet is *least likely* accurate? A classified balance sheet:

✗ **A)** groups accounts by subcategories.
✓ **B)** presents the net equity of each asset by subtracting its related liability.

✗ **C)** distinguishes between current and noncurrent assets.

Explanation

A classified balance sheet groups assets and liabilities by subcategories. It distinguishes between current and noncurrent assets and current and noncurrent liabilities. The assets and related liabilities are reported separately, they are not netted.

References

Question From: Session 7 > Reading 25 > LOS c

Related Material:

- Key Concepts by LOS

Question #177 of 200

Question ID: 414403

During 2007, Brownfield Incorporated purchased $140 million of inventory. For the year just ended, Brownfield reported cost of goods sold of $130 million. Inventory at year-end was $45 million. Calculate inventory turnover for the year.

✗ **A)** 2.89.

✗ **B)** 3.71.

✓ **C)** 3.25.

Explanation

First, calculate beginning inventory given COGS, purchases, and ending inventory. Beginning inventory was $35 million [$130 million COGS + $45 million ending inventory - $140 million purchases]. Next, calculate average inventory of $40 million [($35 million beginning inventory + $45 million ending inventory) / 2]. Finally, calculate inventory turnover of 3.25 [$130 million COGS / $40 million average inventory].

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #178 of 200

Question ID: 414290

When a U.S. company pays dividends to its stockholders, which type of cash flow does this represent?

✗ **A)** Operating.

✓ **B)** Financing.

✗ **C)** Investing.

Explanation

Dividends paid to stockholders are considered cash outlays from financing according to U.S. GAAP.

References

Question From: Session 7 > Reading 26 > LOS a

Related Material:

- Key Concepts by LOS

Question #179 of 200

Question ID: 414371

Earnings before interest and taxes (EBIT) is also known as:

- ✗ **A)** earnings before income taxes.
- ✗ **B)** gross profit.
- ✓ **C)** operating profit.

Explanation

Operating profit = earnings before interest and taxes (EBIT)

Gross profit = net sales - COGS

Net income = earnings after taxes = EAT

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #180 of 200

Question ID: 414300

Independence, Inc. reports interest received and dividends paid as part of its cash flow from operations. This treatment is acceptable under:

- ✗ **A)** U.S. GAAP but not under IFRS.
- ✓ **B)** IFRS but not under U.S. GAAP.
- ✗ **C)** either IFRS or U.S. GAAP.

Explanation

IFRS permits interest received to be reported as either cash flow from operations or cash flow from investing, and permits dividends paid to be reported as either cash flow from operations or cash flow from financing. U.S. GAAP requires interest received to be reported as cash flow from operations, but requires dividends paid to be reported as cash flow from financing.

References

Question From: Session 7 > Reading 26 > LOS c

Related Material:

- Key Concepts by LOS

Question #181 of 200

Question ID: 414378

Given the following income statement and balance sheet for a company:

Balance Sheet

Assets	*Year 2003*	*Year 2004*
Cash	500	450
Accounts Receivable	600	660
Inventory	500	550
Total CA	1300	1660
Plant, prop. equip	1000	1250
Total Assets	2600	2910
Liabilities		
Accounts Payable	500	550
Long term debt	700	700
Total liabilities	1200	1652
Equity		
Common Stock	400	400
Retained Earnings	1260	1260
Total Liabilities & Equity	2600	2910

Income Statement

Sales	3000
Cost of Goods Sold	(1000)
Gross Profit	2000
SG&A	500
Interest Expense	151
EBT	1349
Taxes (30%)	405
Net Income	944

What is the operating profit margin?

✗ **A)** 0.45.

✗ **B)** 0.67.

✓ **C)** 0.50.

Explanation

Operating profit margin = (EBIT / sales) = (1,500 / 3,000) = 0.5

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #182 of 200

Question ID: 414368

Wells Incorporated reported the following common size data for the year ended December 31, 20X7:

Income Statement	%
Sales	100.0
Cost of goods sold	58.2
Operating expenses	30.2
Interest expense	0.7
Income tax	5.7
Net income	5.2

Balance sheet	%		%
Cash	4.8	Accounts payable	15.0
Accounts receivable	14.9	Accrued liabilities	13.8
Inventory	49.4	Long-term debt	23.2
Net fixed assets	30.9	Common equity	48.0
Total assets	100.00	Total liabilities & equity	100.0

For 20X6, Wells reported sales of $183,100,000 and for 20X7, sales of $215,600,000. At the end of 20X6, Wells' total assets were $75,900,000 and common equity was $37,800,000. At the end of 20X7, total assets were $95,300,000. Calculate Wells' current ratio and return on equity ratio for 20X7.

	Current ratio	Return on equity
✓ **A)**	2.4	26.8%
✗ **B)**	4.6	25.2%
✗ **C)**	2.4	26.4%

Explanation

The current ratio is equal to 2.4 [(4.8% cash + 14.9% accounts receivable + 49.4% inventory) / (15.0% accounts payable + 13.8% accrued liabilities)]. This ratio can be calculated from the common size balance sheet because the percentages are all on the same base amount (total).

Return on equity is equal to net income divided by average total equity. Since this ratio mixes an income statement item and a balance sheet item, it is necessary to convert the common-size inputs to dollars. Net income is $11,211,200 ($215,600,000 × 5.2%) and average equity is $41,772,000 [($95,300,000 × 48.0%) + $37,800,000] / 2. Thus, 2007 ROE is 26.8% ($11,211,200 net income / $41,772,000 average equity).

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #183 of 200

Question ID: 414297

The correct set of cash flow treatments as they relate to interest paid according to U.S. generally accepted accounting principles (GAAP) and International Accounting Standards (IAS) GAAP is:

	U.S. GAAP	IAS GAAP
✓ **A)**	CFO	CFO or CFF
✗ **B)**	CFF	CFF
✗ **C)**	CFO or CFF	CFO

Explanation

U.S. GAAP treats interest paid as CFO whereas IAS GAAP treats interest paid as either CFO or CFF.

References

Question From: Session 7 > Reading 26 > LOS c

Related Material:

- Key Concepts by LOS

Question #184 of 200

Question ID: 414357

Common size income statements express all income statement items as a percentage of:

✓ **A)** sales.

✗ **B)** net income.

✗ **C)** assets.

Explanation

Common size income statements express all income statement items as a percentage of sales. Note that common size balance sheets express all balance sheet accounts as a percentage of total assets.

References

Question From: Session 7 > Reading 27 > LOS a

Related Material:

- Key Concepts by LOS

Question #185 of 200

Question ID: 414369

To calculate the cash ratio, the total of cash and marketable securities is divided by:

✗ **A)** total assets.

✗ **B)** total liabilities.

✓ **C)** current liabilities.

Explanation

Current liabilities are used in the denominator for the: current, quick, and cash ratios.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #186 of 200

Question ID: 414390

Which of the following is a measure of a firm's liquidity?

✗ **A)** Net Profit Margin.

✗ **B)** Equity Turnover.

✓ **C)** Cash Ratio.

Explanation

Equity turnover and net profit margin are each measures of a company's operating performance.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #187 of 200

Question ID: 414400

What type of ratio is revenue divided by average working capital and what type of ratio is average total assets divided by average total equity?

	Revenue / Average working capital	Average total assets / Average total equity
✗ **A)**	Activity ratio	Liquidity ratio
✗ **B)**	Profitability ratio	Solvency ratio
✓ **C)**	Activity ratio	Solvency ratio

Explanation

Revenue divided by average working capital, also known as the working capital turnover ratio, is an activity ratio. Average total assets divided by average total equity, also known as the financial leverage ratio, is a solvency ratio.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #188 of 200

Question ID: 414351

Selected information from the most recent cash flow statement of Thibault Company appears below:

Cash collections	€8,900
Cash paid to suppliers	(€3,700)
Cash operating expenses	(€1,500)
Cash taxes paid	(€2,400)
Cash from operating activities	**€1,300**
Cash paid for plant and equipment	(€2,600)
Cash interest received	€700
Cash dividends received	€600
Cash from investing activities	**(€1,300)**

Cash received from debt issuance	€2,000
Cash interest paid	(€400)
Cash dividends paid	(€600)
Cash from financing activities	**€1,000**
Total change in cash	**€1,000**

Thibault's reinvestment ratio for this period is *closest* to:

- ✗ **A)** 1.00.
- ✗ **B)** 0.75.
- ✓ **C)** 0.50.

Explanation

The reinvestment ratio is CFO divided by cash paid for long-term assets: 1,300 / 2,600 = 0.5. (Note that on this cash flow statement, CFI includes interest and dividends received and CFF includes interest paid, which is acceptable under IFRS.)

References

Question From: Session 7 > Reading 26 > LOS i

Related Material:

- Key Concepts by LOS

Question #189 of 200

Question ID: 414340

Capital Corp.'s activities in the year 20X5 included the following:

- At the beginning of the year, Capital purchased a cargo plane from Aviation Partners for $10 million in exchange for $2 million cash, $3 million in Capital Corp. bonds and $5 million in Capital Corp. preferred stock.
- Interest of $150,000 was paid on the bonds, and dividends of $250,000 were paid on the preferred stock.
- At the end of the year, the cargo plane was sold for $12,000,000 cash to Standard Company. Proceeds from the sale were used to pay off the $3 million in bonds held by Aviation Partners.

On Capital Corp.'s U.S. GAAP statement of cash flows for the year ended December 31, 20X5, cash flow from investments (CFI) related to the above activities is:

- ✓ **A)** $10,000,000.
- ✗ **B)** $9,750,000.
- ✗ **C)** $6,750,000.

Explanation

Investing cash of $2 million was used to purchase the cargo plane. Proceeds from the sale of the plane were a source of $12 million of investing cash. Net CFI is $12 million − $2 million = $10 million. Under U.S. GAAP, the interest payment is included in cash from operations (CFO) and the dividend payment in cash from financing (CFF). Redemption of the bonds is a use of cash from financing (CFF).

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #190 of 200

Question ID: 414393

An analyst has gathered the following data about a company:

- Average receivables collection period of 37 days.
- Average payables payment period of 30 days.
- Average inventory processing period of 46 days.

What is their cash conversion cycle?

- ✗ **A)** 113 days.
- ✓ **B)** 53 days.
- ✗ **C)** 45 days.

Explanation

Cash conversion cycle = average receivables collection period + average inventory processing period - payables payment period = 37 + 46 - 30 = 53 days.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #191 of 200

Question ID: 414431

Which of the following ratios is NOT part of the original DuPont system?

- ✗ **A)** Equity multiplier.
- ✗ **B)** Asset turnover.
- ✓ **C)** Debt to total capital.

Explanation

The debt to total capital ratio is not part of the original DuPont system. The firm's leverage is accounted for through the equity multiplier.

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #192 of 200

Question ID: 414246

When the market value of an investment in a debt security is less than its carrying value, how should the investor report the investment on the balance sheet if the security is classified as held-to-maturity and what amount should be reported if the security is classified as available-for-sale?

	Held-to-maturity	Available-for-sale
✗ **A)**	Amortized cost	Amortized cost
✗ **B)**	Fair value	Fair value
✓ **C)**	Amortized cost	Fair value

Explanation

Held-to-maturity securities are reported on the balance sheet at amortized cost while available-for-sale securities are reported at fair value. Amortized cost includes the amortization of a premium or discount that was created when the security was purchased.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #193 of 200

Question ID: 414333

An analyst contemplates using the indirect method to create the projected statement of cash flows. She decides to research the differences between the direct and indirect methods. Which of the following is *least likely* a component of the statement of cash flows under the direct method?

✗ **A)** Property, Plant, & Equipment.

✗ **B)** Payment of dividends.

✓ **C)** Net income.

Explanation

Property, Plant, & Equipment and payment of dividends are components of the statement of cash flows under both the direct and indirect methods. Net income is the first figure under the indirect method, but it is not a part of the statement of cash flows under the direct method. The correct response is net income.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #194 of 200

Question ID: 414324

Determine the cash flow from investing given the following table:

Item	*Amount*
Cash payment of dividends	$30
Sale of equipment	$25
Net income	$25
Purchase of land	$15
Increase in accounts payable	$20
Sale of preferred stock	$25
Increase in deferred taxes	$5

✓ **A)** $10.

✗ **B)** -$10.

✗ **C)** -$5.

Explanation

Item		*Amount*
Cash payment of dividends	CFF	-$30
Sale of equipment	CFI	+$25
Net income	CFO	+$25
Purchase of land	CFI	-$15
Increase in accounts payable	CFO	+$20
Sale of preferred stock	CFF	+$25
Increase in deferred taxes	CFO	+$5

CFI = Sale of Equipment (+25) + Purchase of Land (-15) = $10.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #195 of 200

Question ID: 414270

The following data is from Delta's common size financial statement:

Earnings after taxes	18%
Equity	40%
Current assets	60%
Current liabilities	30%
Sales	$300
Total assets	$1,400

What is Delta's total-liabilities-to-equity ratio?

✗ **A)** 1.0.

✓ **B)** 1.5.

✗ **C)** 2.0.

Explanation

If equity = 40% of assets, total liabilities = 60% of assets, thus 60 / 40 = 1.5.

References

Question From: Session 7 > Reading 25 > LOS h

Related Material:

- Key Concepts by LOS

Question #196 of 200

Question ID: 414317

Pacific, Inc.'s financial information includes the following, with "change" referring to the difference from the prior year (in $ millions):

Net Income	27
Change in Accounts Receivable	+4
Change in Accounts Payable	+1
Change in Inventory	+5
Loss on sale of equipment	-8

Gain on sale of real estate	+4
Change in Retained Earnings	+21
Dividends declared and paid	+4

Pacific, Inc.'s cash flow from operations (CFO) in millions was:

- ✗ **A)** $15.
- ✗ **B)** $27.
- ✓ **C)** $23.

Explanation

Using the indirect method, cash flow from operations is net income less increase in accounts receivable, plus increase in accounts payable, less increase in inventory, plus loss on sale of equipment, less gain on sale of real estate. 27 - 4 + 1 - 5 + 8 - 4 = $23 million.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS

Question #197 of 200

Question ID: 414419

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Equity	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

Income Statement	
Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

What is the ROE?

✓ **A)** 9.3%.

✗ **B)** 10.7%.

✗ **C)** 9.9%.

Explanation

ROE = 150(NI) / [1000(common) + 620(RE)] = 150 / 1620 = 0.0926 or 9.3%

References

Question From: Session 7 > Reading 27 > LOS d

Related Material:

- Key Concepts by LOS

Question #198 of 200

Question ID: 414411

What would be the impact on a firm's return on assets ratio (ROA) of the following independent transactions, assuming ROA is less than one?

Transaction #1 - A firm owned investment securities that were classified as available-for-sale and there was a recent decrease in the fair value of these securities.

Transaction #2 - A firm owned investment securities that were classified as trading securities and there was recent increase in the fair value of the securities.

	Transaction #1	Transaction #2
✗ **A)**	Lower	Higher
✗ **B)**	Higher	Lower
✓ **C)**	Higher	Higher

Explanation

Available-for-sale securities are reported on the balance sheet at fair value and any unrealized gains and losses bypass the income statement and are reported as an adjustment to equity. Thus, a decrease in fair value will result in a higher ROA ratio (lower assets). Trading securities are also reported on the balance sheet at fair value; however, the unrealized gains and losses are recognized in the income statement. Therefore, an increase in fair value will result in higher ROA. In this case, both the numerator and denominator are higher; however, since the ratio is less than one, the percentage change of the numerator is greater than the percentage change of the denominator, so the ratio will increase.

References

Question From: Session 7 > Reading 27 > LOS b

Related Material:

- Key Concepts by LOS

Question #199 of 200

Question ID: 414305

Noncurrent assets on the balance sheet are *most* closely linked to which part of the cash flow statement?

- ✗ **A)** Financing cash flows.
- ✗ **B)** Operating cash flows.
- ✓ **C)** Investing cash flows.

Explanation

Investing cash flows are most closely linked with a firm's noncurrent assets. For example, purchases and sales of property, plant, and equipment are classified as investing cash flows.

References

Question From: Session 7 > Reading 26 > LOS e

Related Material:

- Key Concepts by LOS

Question #200 of 200

Question ID: 414315

What is the impact on accounts receivable if sales exceed cash collections and what is the impact on accounts payable if cash paid to suppliers exceeds purchases?

- ✓ **A)** Only accounts receivable will increase.
- ✗ **B)** Only accounts payable will increase.
- ✗ **C)** Both accounts payable and accounts receivable will increase.

Explanation

If a firm sells more than it collects, accounts receivable will increase. If a firm pays suppliers more than it purchases, accounts payable will decrease.

References

Question From: Session 7 > Reading 26 > LOS f

Related Material:

- Key Concepts by LOS