Exam

Name___________________________________

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) A public company has a book value of $128 million. They have 20 million shares outstanding, with a market price of $4 per share. Which of the following statements is true regarding this company? 1) ________

A) The value of the firm's assets are greater than their liquidation value.
B) The firm's market value is more than its book value.
C) Investors believe the company's assets are not likely to be profitable as its market value is worth less than its book value.
D) Investors may consider this firm to be a growth company.

Answer: C

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

2) Refer to the balance sheet above. Luther's quick ratio for 2011 is closest to: 2) _______

A) 1.09 B) 1.31 C) 0.92 D) 0.77

Answer: D

Explanation: A)

B)

C)

D) quick ratio = (current assets - inventory) / current liabilities

quick ratio = (144.0 - 42.9) / 132 = 0.77

3) Which of the following firms would be expected to have a high ROE based on that firm's high operating efficiency? 3) ________

A) a brokerage firm that has high levels of leverage
B) a medical supply company that provides very precise instruments at a high price to large medical establishments such as hospitals
C) a high-end fashion retailer that has a very high markup on all items it sells
D) a grocery store chain that has very high turnover, selling many multiples of their assets per year

Answer: D
Explanation: A)
B)
C)
D)

4) A firm whose primary business is in a line of regional grocery stores would be most likely to have to include which of the following facts, if true, in the firm's management discussion and analysis (MD&A)? 4) ________

A) that the company has lost a class action suit brought against the firm by its employees and is expected to have to pay a large amount of damages
B) that a large number of funds were allocated to advertising to increase awareness of the firm's brand in new areas it had expanded into this year
C) that some senior members of the management team have retired in this financial year
D) that the firm has plans to expand into the organic food business in the next financial year by purchasing several small organic food retailers

Answer: A
Explanation: A)
B)
C)
D)

5) The International Financial Reporting Standards set out by the International Accounting Standards Board are NOT accepted by the exchanges in which of the following countries or regions? 5) ________

A) Germany
B) France
C) United Kingdom
D) United States

Answer: D
Explanation: A)
B)
C)
D)

6) A manufacturer of plastic bottles for the medical trade purchases a new compression blow moulder for its bottle production plant. How will the cost to the company of this piece of equipment be recorded? 6) ________

A) It will be depreciated over time on the income statement and subtracted as Inventory on the statement of cash flows.
B) It will be depreciated over time on the income statement and subtracted as a capital expenditure on the statement of cash flows.
C) It will be depreciated over time on the income statement and therefore not be recorded separately on the statement of cash flows.
D) It will be subtracted from Gross Profit on the income statement and therefore not be recorded separately on the statement of cash flows.

Answer: B
Explanation: A)
B)
C)
D)

7) A small company has current assets of $112,000 and current liabilities of $117,000. Which of the following statements about that company are most likely to be true? 7) ________

A) Since net working capital is high, the company will likely have little difficulty meeting its obligations.
B) Since net working capital is nearly zero, the company is well run and will have little difficulty attracting investors.
C) Since net working capital is negative, the company will not have enough funds to meet its obligations.
D) Since net working capital is very high, the company will have ample money to invest after it meets its obligations.

Answer: C
Explanation: A)
B)
C)
D)

8) Which of the following is likely to have contributed to the failure of HIH Insurance? 8) ________

A) unsupervised delegated authority
B) rapid expansion
C) fraudulent reporting
D) All of the above contributed to the failure of HIH.

Answer: D
Explanation: A)
B)
C)
D)

9) What is the main reason that it is necessary for public companies to follow the rules and format set out in the Generally Accepted Accounting Principles (GAAP) when creating financial statements? 9) _______

A) It ensures that important information is not omitted and superfluous information is not included.
B) It ensures that information on the performance of private companies is readily available to the public.
C) It makes it easier to compare the financial results of different firms.
D) It is easier to find specific information in such a report if it is laid out in a clear and consistent manner.

Answer: C
Explanation: A)
B)
C)
D)

10) Which of the following firms would be expected to have a high ROE based on that firm's high profitability? 10) _______

A) a medical supply company that provides very precise instruments at a high price to large medical establishments such as hospitals
B) a grocery store chain that has very high turnover, selling many multiples of their assets per year
C) a brokerage firm that has high levels of leverage
D) a low-end retailer that has a low markup on all items it sells

Answer: A
Explanation: A)
B)
C)
D)

11) Which ratio would you use to measure the financial health of a firm by assessing that firm's leverage? 11) _______

A) market debt-equity ratio
B) current or quick ratio
C) debt-equity or equity multiplier ratio
D) market-to-book ratio

Answer: C
Explanation: A)
B)
C)
D)

12) Which of the following statements regarding the income statement is INCORRECT? 12) _______

A) The last or "bottom" line of the income statement shows the firm's net income.
B) The income statement shows the flow of earnings and expenses generated by the firm between two dates.
C) The income statement shows the earnings and expenses at a given point in time.
D) The first line of an income statement lists the revenues from the sales of products or services.

Answer: C
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Balance Sheet

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	50	Accounts payable	42
Accounts receivable	22	Notes payable/short-term debt	7
Inventories	17		
Total current assets	89	Total current liabilities	49
Long-Term Assets		Long-Term Liabilities	
Net property, plant, and equipment	121	Long-term debt	128
Total long-term assets	121	Total long-term liabilities	128
		Total Liabilities	177
		Shareholders' Equity	33
Total Assets	210	Total Liabilities and Shareholders' Equity	210

13) The above diagram shows a balance sheet for a certain company. All quantities shown are in millions of dollars. If the company has 4 million shares outstanding, and these shares are trading at a price of $8.24 per share, what does this tell you about how investors view this firm's book value? 13) _______

A) Investors consider that the firm's market value is worth more than its book value.
B) Investors consider that the firm's market value is worth less than its book value.
C) Investors consider that the firm's market value and its book value are roughly equivalent.
D) Investors consider that the firm's market value is worth very much less than its book value.

Answer: C
Explanation: A)
B)
C)
D)

14) Allen Company bought a new copy machine to be depreciated straight line for three years. Where would this purchase be reflected on the Statement of Cash Flows? 14) _______

A) It would be an addition to property, plant and equipment, so it would be an investing activity.
B) It would be an expense on the income statement, so it would be reflected in operating cash flows.
C) It would be an addition to cash, so would be reflected in the change in cash.
D) None of the above answers is correct.

Answer: A
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Income Statement for CharmCorp:

	2011	2012
Total sales	600	540
Cost of sales	-532	-488
Gross Profit	68	52
Selling, general, and administrative expenses	-36	-21
Research and development	-4	-5
Depreciation and amortisation	-5	-5
Operating Income	23	21
Other income	1	5
Earnings before interest and taxes (EBIT)	24	26
Interest income (expense)	-7	-7
Pretax income	14	19
Taxes	-4	-5
Net Income	10	14

15) Consider the above Income Statement for CharmCorp. All values are in millions of dollars. If CharmCorp has 6 million shares outstanding, and its managers and employees have stock options for 1 million shares, what is its diluted EPS in 2012? 15) ______

A) \$2.33 B) \$1.42 C) \$1.67 D) \$2.00

Answer: D

Explanation: A)
B)
C)
D)

16) A company that produces drugs is preparing a balance sheet. Which of the following would be most likely to be considered a long-term asset on this balance sheet? 16) ______

A) the inventory of chemicals used to produce the drugs made by the company
B) a patent for a drug held by the company
C) the cash reserves of the company
D) commercial paper held by the company

Answer: B

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Balance Sheet

Assets		Liabilities	
<u>Current Assets</u>		<u>Current Liabilities</u>	
Cash	50	Accounts payable	42
Accounts receivable	22	Notes payable/short-term debt	7
Inventories	17		
Total current assets	89	Total current liabilities	49
<u>Long-Term Assets</u>		<u>Long-Term Liabilities</u>	
Net property, plant, and equipment	121	Long-term debt	128
Total long-term assets	121	Total long-term liabilities	128
		Total Liabilities	177
		Shareholders' Equity	33
Total Assets	210	Total Liabilities and Shareholders' Equity	210

17) The above diagram shows a balance sheet for a certain company. All quantities shown are in millions of dollars. What is the company's net working capital? 17) _______

A) \$33 million B) \$7 million C) \$32 million D) \$40 million

Answer: D

Explanation:
A)
B)
C)
D) Net working capital = total current assets - total current liabilities, which = 89 - 49 = \$40 million as all quantities are expressed in millions of dollars on the table.

18) A 30-year mortgage loan is a 18) _______

A) Current Liability. B) Long-Term Asset.
C) Long-Term Liability. D) Current Asset.

Answer: C

Explanation:
A)
B)
C)
D)

19) The notes to the financial statements would be LEAST likely to be used for which of the following purposes? 19) _______

A) to explain the method of accounting that was used in the preparation of the financial statements
B) to show how the value of assets listed in the financial statements were arrived at
C) to disclose the financial implications of any off balance sheet transactions
D) to provide information regarding the context in which these financial numbers were generated

Answer: C

Explanation:
A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Income Statement
Year ended June 30 (in $ millions)

	2012	2011
Total sales	610.1	578.3
Cost of sales	(500.2)	(481.9)
Gross profit	109.9	96.4
Selling, general, and administrative expenses	(40.5)	(39.0)
Research and development	(24.6)	(22.8)
Depreciation and amortisation	(3.6)	(3.3)
Operating income	41.2	31.3
Other income	---	---
Earnings before interest and taxes (EBIT)	41.2	31.3
Interest income (expense)	(25.1)	(15.8)
Pretax income	16.1	15.5
Taxes	(5.5)	(5.3)
Net income	10.6	10.2
Price per share	$16	$15
Shares outstanding (millions)	10.2	8.0
Share options outstanding (millions)	0.3	0.2
Shareholders' Equity	126.6	63.6
Total Liabilities and Shareholders' Equity	533.1	386.7

20) Refer to the income statement above. For the year ending 30 June 2012, Luther's earnings per share are closest to: 20) ______

A) $1.58 B) $4.04 C) $1.01 D) $1.04

Answer: D

Explanation:
A)
B)
C)
D) EPS = Net income / Shares outstanding = $10.6 / 10.2 = $1.04

Use the table for the question(s) below.

AOS Industries Statement of Cash Flows for 2012

Operating activities	
Net Income	3.2
Depreciation and amortisation	1.4
Cash effect of changes in	
Accounts receivable	2.1
Accounts payable	1.1
Inventory	0.8
Cash from operating activities	2.8
Investment activities	
Capital expenditures	2.2
Acquisitions and other investing activity	-0.4
Cash from investing activities	2.6
Financing activities	
Dividends paid	-1.5
Sale or purchase of stock	2.1
Increase in short-term borrowing	1.4
Increase in long-term borrowing	3.2
Cash from financing activities	5.2
Change in Cash and Cash Equivalents	5.4

21) Consider the above statement of cash flows. If all amounts shown above are in millions of dollars, what were AOS Industries' retained earnings for 2012? 21) _______

A) $1.7 million B) $2.1 million C) $5.4 million D) $1.3 million

Answer: A

Explanation: A) 3.2 - 1.5 = $1.7million
B)
C)
D)

22) Company A has current assets of $42 billion and current liabilities of $31 billion. Company B has current assets of $2.7 billion and current liabilities of $1.8 billion. Which of the following statements is correct, based on this information? 22) _______

A) Company A and Company B have roughly equivalent enterprise values.
B) Company A has greater leverage than Company B.
C) Company A has less leverage than Company B.
D) Company A is less likely than Company B to have sufficient working capital to meet its short-term needs.

Answer: D

Explanation: A)
B)
C)
D)

23) Which of the following is the main lesson that analysts and investors should take from the cases of Enron and HIH? 23) ______

A) The information in financial statements should be viewed extremely critically.
B) It is not possible to effectively evaluate a company unless all the financial statements are fully and correctly prepared.
C) Readers of even fraudulent financial statements can spot signs of a firm's financial health if those statements are read fully and with care.
D) The usefulness of financial statements to investors is entirely dependent on the ethics of those constructing them.

Answer: C
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

AOS Industries Statement of Cash Flows for 2012

Operating activities	
Net Income	3.2
Depreciation and amortisation	1.4
Cash effect of changes in	
Accounts receivable	2.1
Accounts payable	1.1
Inventory	0.8
Cash from operating activities	2.8
Investment activities	
Capital expenditures	2.2
Acquisitions and other investing activity	-0.4
Cash from investing activities	2.6
Financing activities	
Dividends paid	-1.5
Sale or purchase of stock	2.1
Increase in short-term borrowing	1.4
Increase in long-term borrowing	3.2
Cash from financing activities	5.2
Change in Cash and Cash Equivalents	5.4

24) Consider the above statement of cash flows. What were AOS Industries' major means of raising money in 2012? 24) ______

A) by sale of stock
B) from its operations
C) by issuing debt
D) from investment activities

Answer: C
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Income Statement for Xenon Manufacturing:

	2011	2012
Total sales	202	212
Cost of sales	-148	-172
Gross Profit	54	40
Selling, general, and administrative expenses	-22	-20
Research and development	-8	-7
Depreciation and amortisation	-4	-3
Other income	4	6
Earnings before interest and taxes (EBIT)	24	16
Interest income (expense)	-7	-4
Pretax income	14	12
Taxes	-4	-3
Net Income	10	9

25) Consider the above Income Statement for Xenon Manufacturing. All values are in millions of dollars. Calculate the gross margin for 2011 and 2012. What does the change in the gross margin between these two years imply about the company? 25) ______

A) The efficiency of Xenon Manufacturing has significantly risen between 2011 and 2012.
B) The ability of Xenon Manufacturing to sell its goods and services for more than the costs of producing them rose between 2011 and 2012.
C) The leverage of Xenon Manufacturing fell slightly between 2011 and 2012.
D) The ability of Xenon Manufacturing to sell its goods and services for more than the costs of producing them fell between 2011 and 2012.

Answer: D

Explanation:
A)
B)
C)
D)

Use the table for the question(s) below.

Balance Sheet

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	50	Accounts payable	42
Accounts receivable	22	Notes payable/short-term debt	7
Inventories	17		
Total current assets	89	Total current liabilities	49
Long-Term Assets		Long-Term Liabilities	
Net property, plant, and equipment	121	Long-term debt	128
Total long-term assets	121	Total long-term liabilities	128
		Total Liabilities	177
		Shareholders' Equity	33
Total Assets	210	Total Liabilities and Shareholders' Equity	210

26) The above diagram shows a balance sheet for a certain company. If the company pays back all of its accounts payable today using cash, what will its net working capital be? 26) _______

A) $7 million B) $33 million C) $32 million D) $40 million

Answer: D

Explanation:
A)
B)
C)
D) Both cash and accounts payable would fall by the same amount, leaving net working capital the same: $47-$7=$40

Use the table for the question(s) below.

Luther Corporation Consolidated Income Statement Year ended June 30 (in $ millions)	2012	2011
Total sales	610.1	578.3
Cost of sales	(500.2)	(481.9)
Gross profit	109.9	96.4
Selling, general, and administrative expenses	(40.5)	(39.0)
Research and development	(24.6)	(22.8)
Depreciation and amortisation	(3.6)	(3.3)
Operating income	41.2	31.3
Other income	---	---
Earnings before interest and taxes (EBIT)	41.2	31.3
Interest income (expense)	(25.1)	(15.8)
Pretax income	16.1	15.5
Taxes	(5.5)	(5.3)
Net income	10.6	10.2
Price per share	$16	$15
Shares outstanding (millions)	10.2	8.0
Share options outstanding (millions)	0.3	0.2
Shareholders' Equity	126.6	63.6
Total Liabilities and Shareholders' Equity	533.1	386.7

27) Refer to the income statement above. Assuming that Luther has no convertible bonds outstanding, then for the year ending 30 June 2012, Luther's diluted earnings per share are closest to: 27) _______

A) $1.53 B) $1.04 C) $1.01 D) $3.92

Answer: C

Explanation: A)

B)

C) Diluted EPS = Net income / (Shares outstanding + Options contracts outstanding + Shares possible from convertible bonds outstanding) = 10.6 / (10.2 + 0.3 + 0.0) = $1.01

D)

28) A delivery company is creating a balance sheet. Which of the following would most likely be considered a short-term liability on this balance sheet? 28) _______

A) prepaid rent on the offices occupied by the company
B) the depreciation over the last year in the value of the vehicles owned by the company
C) a loan which must be paid back in two years' time
D) revenue received for the delivery of items that have not yet been delivered

Answer: D

Explanation: A)

B)

C)

D)

29) One way Enron manipulated its financial statements was to sell assets at inflated prices to other firms, while promising to buy back those assets at a later date. The incoming cash was recorded as revenue, but the promise to buy back the assets was not disclosed. Which of the following is one of the ways that such a transaction is deceptive? 29) ______

A) The assets should have been listed on the balance sheet as long-term assets.
B) Cash raised by selling assets should not be recorded as revenue.
C) The off balance sheet promises to repurchase assets should have been disclosed in management discussion and analysis (MD&A) or notes to the financial statement.
D) The cash raised should have been recorded as short-term loans.

Answer: C
Explanation: A)
B)
C)
D)

30) Which of the following is NOT one of the financial statements that must be produced by a public company? 30) ______

A) the statement of activities
B) the statement of cash flows
C) the income statement
D) the balance sheet

Answer: A
Explanation: A)
B)
C)
D)

31) Which of the following is a way that the Operating Activity section of the statement of cash flows adjusts Net Income from the balance sheet? 31) ______

A) It adds the cash that flows from investors to the firm.
B) It subtracts all expenses and costs related to the firm's operating activities.
C) It adds all non-cash entries related to the firm's operating activities.
D) It removes the cash used for investment purposes.

Answer: C
Explanation: A)
B)
C)
D)

32) A software company acquires a smaller company in order to acquire the patents that it holds. Where will the cost of this acquisition be recorded on the statement of cash flows? 32) ______

A) as an outflow under Financial Activities
B) as an outflow under Operating Activities
C) as an outflow under Investment Activities
D) The acquisition would not be recorded on the statement of cash flows.

Answer: C
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Balance Sheet

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	50	Accounts payable	42
Accounts receivable	22	Notes payable/short-term debt	7
Inventories	17		
Total current assets	89	Total current liabilities	49
Long-Term Assets		Long-Term Liabilities	
Net property, plant, and equipment	121	Long-term debt	128
Total long-term assets	121	Total long-term liabilities	128
		Total Liabilities	177
		Shareholders' Equity	33
Total Assets	210	Total Liabilities and Shareholders' Equity	210

33) The above diagram shows a balance sheet for a certain company. All quantities shown are in millions of dollars. How would the balance sheet change if the company's long-term assets were judged to depreciate at an extra $5 million per year? 33) ______

A) Long-Term Liabilities would rise to $182 million, and Total Liabilities and Shareholders' Equity would be adjusted accordingly.
B) Net property, plant, and equipment would rise to $126 million, and Total Assets and Shareholders' Equity would be adjusted accordingly.
C) Net property, plant, and equipment would fall to $116 million, and Total Assets and Shareholders' Equity would be adjusted accordingly.
D) Long-Term Liabilities would fall to $172 million, and Total Liabilities and Shareholders' Equity would be adjusted accordingly.

Answer: C

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Income Statement for Xenon Manufacturing:

	2011	2012
Total sales	202	212
Cost of sales	-148	-172
Gross Profit	54	40
Selling, general, and administrative expenses	-22	-20
Research and development	-8	-7
Depreciation and amortisation	-4	-3
Other income	4	6
Earnings before interest and taxes (EBIT)	24	16
Interest income (expense)	-7	-4
Pretax income	14	12
Taxes	-4	-3
Net Income	10	9

34) Consider the above Income Statement for Xenon Manufacturing. All values are in millions of dollars. Calculate the operating margin for 2011 and 2012. What does the change in the operating margin between these two years imply about the company? 34) _______

A) The efficiency of Xenon Manufacturing has significantly fallen between 2011 and 2012.
B) The efficiency of Xenon Manufacturing has significantly risen between 2011 and 2012.
C) The ability of Xenon Manufacturing to sell its goods and services for more than the costs of producing them rose between 2011 and 2012.
D) The leverage of Xenon Manufacturing fell slightly between 2011 and 2012.

Answer: A

Explanation: A) 24 / 202 = 0.12; 16 / 212 = 0.08
B)
C)
D)

35) 35) _______

	Firm A	Firm B	Firm C	Firm D
Net Income	$34.1 million	$5.7 million	$31.1 million	$13.2 million
Market Capitalisation	$310 million	$53 million	$280 million	$112 million
Earnings per share	$4.10	$4.05	$6.75	$12.70

The above data is for four regional trucking firms. Based on price-earnings ratios, which firm's stock is the best value?

A) Firm A B) Firm B C) Firm C D) Firm D

Answer: B

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

36) Refer to the balance sheet above. Luther's current ratio for 2012 is closest to: 36) ______

A) 0.84 B) 1.19 C) 1.15 D) 0.87

Answer: B

Explanation: A)

B) current ratio = current assets / current liabilities = 171 / 144 = 1.19

C)

D)

Use the table for the question(s) below.

Balance Sheet

Assets	20011	2012	Liabilities	2011	2012
Current Assets			Current Liabilities		
Cash	50	46	Accounts payable	42	48
Accounts receivable	22	12	Notes payable/short-term debt	7	5
Inventories	17	38			
Total current assets	89	96	Total current liabilities	49	53
Long-Term Assets			Long-Term Liabilities		
Net property, plant, and equipment	121	116	Long-term debt	128	136
Total long-term assets	121	116	Total long-term liabilities	128	136
			Total Liabilities	177	189
			Shareholders' Equity	33	23
Total Assets	210	212	Total Liabilities and Shareholders' Equity	210	212

37) If the above balance sheet is for a retail company, how has the company's leverage changed between 2011 and 2012? 37) _______

A) The company has experienced a significant decrease in its leverage.
B) The company has experienced a very significant decrease in its leverage.
C) The company has experienced a significant increase in its leverage.
D) The company has experienced no significant change in its leverage.

Answer: C
Explanation: A)
B)
C)
D)

38) Which of the following is NOT a financial statement that every public company is required to produce? 38) _______

A) income statement
B) balance sheet
C) statement of sources and uses of cash
D) statement of changes in equity

Answer: C
Explanation: A)
B)
C)
D)

39) Which of the following is NOT considered to be an operating expense on the income statement? 39) _______

A) depreciation and amortisation
B) salaries
C) administrative expenses and overhead
D) corporate taxes

Answer: D
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

40) Refer to the balance sheet above. If in 2012 Luther has 10.2 million shares outstanding and these shares are trading at $16 per share, then Luther's market-to-book ratio would be closest to: 40) ______

A) 2.57 B) 0.39 C) 1.29 D) 0.76

Answer: A

Explanation: A)
B)
C)
D)

41) A company has a share price of $24.50 and $118 million shares outstanding. Its market-to-book ratio is 4.2, its book debt-equity ratio is 3.2, and it has cash of $800 million. How much would it cost to take over this business assuming you pay its enterprise value? 41) ______

A) $4.2 billion B) $3.6 billion C) $1.5 D) $2.8 billion

Answer: A

Explanation: A) Market cap = 24.5 × 118 = $2.891 billion; Book value = 2.891 / 4.2 = 0.688; Debt = 0.688 × 3.2 = 2.203; Enterprise value = 2.891 + 2.203 - 0.800 = 4.2 billion
B)
C)
D)

42) Cash is a 42) _______

A) Long-Term Asset.
B) Long-Term Liability.
C) Current Liability.
D) Current Asset.

Answer: D

Explanation: A)
B)
C)
D)

43) In 2009, an agricultural company introduced a new cropping process which reduced the cost of growing some of its crops. If sales in 2008 and 2009 were steady at $25 million, but the gross margin increased from 2.3% to 3.4% between those years, by what amount was the cost of sales reduced? 43) _______

A) $275,000
B) $425,000
C) $575,000
D) $325,000

Answer: A

Explanation: A) (25 × 0.034 - 25 × 0.023) × 1,000,000 = $275,000
B)
C)
D)

44) Which of the following statements regarding the balance sheet is INCORRECT? 44) _______

A) The balance sheet lists the firm's assets and liabilities.
B) The balance sheet provides a snapshot of the firm's financial position at a given point in time.
C) The balance sheet reports shareholders' equity on the right-hand side.
D) The balance sheet reports liabilities on the left-hand side.

Answer: D

Explanation: A)
B)
C)
D)

45) Which of the following best describes why the left and right sides of a balance sheet are equal? 45) _______

A) By definition, the assets plus the liabilities will be the same as the shareholders' equity.
B) The assets must equal liabilities plus shareholders' equity, because shareholders' equity is the difference between the assets and the liabilities.
C) By accounting convention, the assets of a company must be equal to the liabilities of that company.
D) In a properly run business, the value of liabilities will not exceed the assets held by the company.

Answer: B

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

46) Refer to the balance sheet above. What is Luther's net working capital in 2011? 46) _______

A) $27 million B) $63.6 million C) $39 million D) $12 million

Answer: D
Explanation: A)
B)
C)
D) NWC = Current assets - Current liabilities = 144 - 132 = $12 million

47) Refer to the balance sheet above. When using the book value of equity, the debt-equity ratio for Luther in 2012 is closest to: 47) _______

A) 2.21 B) 2.98 C) 3.03 D) 2.29

Answer: D
Explanation: A)
B)
C)
D) D/E = Total debt / Total equity
Total debt = Notes payable (10.5) + Current maturities of long-term debt (39.9) + Long-term debt (239.7) = 290.1 million
Total equity = 126.6, so D/E = 290.1 / 126.6 = 2.29

48) What is a firm's net income? 48) ______

A) the difference between the sales and other income generated by the firm, and all costs, taxes, and expenses incurred by the firm in a given period

B) a measure of the firm's profitability over a given period

C) the last or "bottom" line of the income statement

D) all of the above

Answer: D

Explanation: A)

B)

C)

D)

49) Which of the following is NOT a reason that the income statement does not accurately indicate how much cash a firm has earned? 49) ______

A) It does not include entries for collection of money from account receivables.

B) It includes cash inflows from services rendered.

C) It does not include entries for expenditures on inventory.

D) It includes entries for the depreciation of assets.

Answer: B

Explanation: A)

B)

C)

D)

50) GenCorp has a total debt of $140 million and shareholders' equity of $50 million. It also has 25 million shares outstanding, with a market price of $3.50 per share. What is GenCorp's market debt-equity ratio? 50) ______

A) 0.63 B) 0.36 C) 1.02 D) 1.60

Answer: D

Explanation: A)

B)

C)

D) $140 / (3.5 \times 25) = 1.60$

51) Which of the following balance sheet equations is INCORRECT? 51) ______

A) Assets = Liabilities + Shareholders' Equity

B) Assets - Current Liabilities = Long-Term Liabilities

C) Assets - Current Liabilities = Long-Term Liabilities + Shareholders' Equity

D) Assets - Liabilities = Shareholders' Equity

Answer: B

Explanation: A)

B)

C)

D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

52) Refer to the balance sheet above. The change in Luther's quick ratio from 2011 to 2012 is closest to: 52) ______

A) an increase of 0.15
B) an increase of 0.10
C) a decrease of 0.15
D) a decrease of 0.10

Answer: B

Explanation:
A)
B) quick ratio in 2006 = (171.0 - 45.9) / 144 = 0.87
quick ratio 2005 = (144.0 - 42.9) / 132 = 0.77
So, the quick ratio increased by 0.87 - 0.77 = 0.10.
C)
D)

53) Why must care be taken when comparing a firm's share price to its operating income? 53) _______

A) Share price is a quantity related to equity holders, while operating income is an amount that is related to the whole firm.
B) Share price is a quantity related to the entire firm, while operating income is an amount that is related solely to equity holders.
C) Both share price and operating income are related solely to equity holders.
D) Both share price and operating income are related to the whole firm.

Answer: A
Explanation: A)
B)
C)
D)

54) Balance Sheet 54) _______

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	50	Accounts payable	42
Accounts receivable	22	Notes payable/short-term debt	7
Inventories	17		
Total current assets	89	Total current liabilities	49
Long-Term Assets		Long-Term Liabilities	
Net property, plant, and equipment	121	Long-term debt	128
Total long-term assets	121	Total long-term liabilities	128
		Total Liabilities	177
		Shareholders' Equity	33
Total Assets	210	Total Liabilities and Shareholders' Equity	210

Income Statement	
Total sales	312
Cost of sales	-210
Gross Profit	102
Selling, general, and administrative expenses	-34
Research and development	-10
Depreciation and amortisation	-5
Operating Income	53
Other income	-
Earnings before interest and taxes (EBIT)	53
Interest income (expense)	-20
Pretax income	33
Taxes	-8
Net Income	25

The balance sheet and income statement of a particular firm are shown above. What does the account receivable days ratio tell you about this company?

A) It takes on average about 7 weeks to collect payment from its customers.
B) It takes on average about 11 weeks to collect payment from its customers.
C) It takes on average about 4 weeks to collect payment from its customers.
D) It takes on average about 6 weeks to collect payment from its customers.

Answer: C
Explanation: A)
B)
C)
D)

55) Which of the following amounts would be included on the right side of a balance sheet? 55) _______
A) the amount of money owed to the company by customers who have not yet paid for goods and services they have received
B) the cash held by the company
C) the amount of deferred tax liability held by the company
D) the value of government bonds held by the company

Answer: C
Explanation: A)
B)
C)
D)

56) Accounts payable is a 56) _______
A) Current Liability.
B) Long-Term Asset.
C) Current Asset.
D) Long-Term Liability.

Answer: A
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Income Statement
Year ended June 30 (in $ millions)

	2012	2011
Total sales	610.1	578.3
Cost of sales	(500.2)	(481.9)
Gross profit	109.9	96.4
Selling, general, and administrative expenses	(40.5)	(39.0)
Research and development	(24.6)	(22.8)
Depreciation and amortisation	(3.6)	(3.3)
Operating income	41.2	31.3
Other income	---	---
Earnings before interest and taxes (EBIT)	41.2	31.3
Interest income (expense)	(25.1)	(15.8)
Pretax income	16.1	15.5
Taxes	(5.5)	(5.3)
Net income	10.6	10.2
Price per share	$16	$15
Shares outstanding (millions)	10.2	8.0
Share options outstanding (millions)	0.3	0.2
Shareholders' Equity	126.6	63.6
Total Liabilities and Shareholders' Equity	533.1	386.7

57) Refer to the income statement above. Luther's return on equity (ROE) for the year ending 30 June 2012 is closest to: 57) ______

A) 6.5% B) 8.4% C) 2.0% D) 12.7%

Answer: B

Explanation: A)
B) ROE = Net income / Shareholders' equity = 10.6 / 126.6 = 0.084 or 8.4%
C)
D)

Use the table for the question(s) below.

Balance Sheet

Assets	20011	2012	Liabilities	2011	2012
Current Assets			Current Liabilities		
Cash	50	46	Accounts payable	42	48
Accounts receivable	22	12	Notes payable/short-term debt	7	5
Inventories	17	38			
Total current assets	89	96	Total current liabilities	49	53
Long-Term Assets			Long-Term Liabilities		
Net property, plant, and equipment	121	116	Long-term debt	128	136
Total long-term assets	121	116	Total long-term liabilities	128	136
			Total Liabilities	177	189
			Shareholders' Equity	33	23
Total Assets	210	212	Total Liabilities and Shareholders' Equity	210	212

58) If the above balance sheet is for a retail company, what indications about this company would best be drawn from the changes in the balance sheet between 2011 and 2012? 58) _______

A) The company has experienced a significant rise in its market value.
B) The company has added a major new asset in terms of plant and equipment.
C) The company has reduced its debt.
D) The company is having difficulties selling its product.

Answer: D

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

AOS Industries Statement of Cash Flows for 2012

Operating activities	
Net Income	3.2
Depreciation and amortisation	1.4
Cash effect of changes in	
Accounts receivable	2.1
Accounts payable	1.1
Inventory	0.8
Cash from operating activities	2.8
Investment activities	
Capital expenditures	2.2
Acquisitions and other investing activity	-0.4
Cash from investing activities	2.6
Financing activities	
Dividends paid	-1.5
Sale or purchase of stock	2.1
Increase in short-term borrowing	1.4
Increase in long-term borrowing	3.2
Cash from financing activities	5.2
Change in Cash and Cash Equivalents	5.4

59) Consider the above statement of cash flows. In 2012, AOS Industries had contemplated buying a new warehouse for $2 million, the cost of which would be depreciated over 10 years. If AOS Industries has a tax rate of 25%, what would be the impact for the amount of cash held by AOS at the end of 2012? 59) ______

A) It would have $1,950,000 less cash at the end of 2012.
B) It would have $150,000 less cash at the end of 2012.
C) It would have an additional $50,000 in cash at the end of 2012.
D) It would have $2,000,000 less cash at the end of 2012.

Answer: A

Explanation: A) -$2,000,000 +200,000 × 0.25 = -$1,950,000
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

60) Refer to the balance sheet above. If in 2012 Luther has 10.2 million shares outstanding and these shares are trading at $16 per share, then using the market value of equity, the debt-equity ratio for Luther in 2011 is closest to: 60) ______

A) 2.35 B) 1.78 C) 1.71 D) 2.31

Answer: B

Explanation:
A)
B) D/E = Total debt / Total equity
Total Debt = Notes payable (10.5) + Current maturities of long-term debt (39.9) + Long-term debt (239.7) = 290.1 million
Total equity = 10.2 × $16 = 163.2, so D/E = 290.1 / 163.2 = 1.78
C)
D)

61) Manufacturer A has a profit margin of 2.0%, an asset turnover of 1.7 and an equity multiplier of 4.9. Manufacturer B has a profit margin of 2.3%, an asset turnover of 1.1 and an equity multiplier of 4.7. How much asset turnover should manufacturer B have to match manufacturer A's ROE? 61) ______

A) 1.54% B) 4.77% C) 3.00% D) 3.09%

Answer: A

Explanation: A) ROEa = 2 × 1.7 × 4.9 = 16.66; ROEb = 2.3 × 1.1 × 4.7 = 11.891; 16.66 / (2.3 × 4.7) = 1.54
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Income Statement
Year ended June 30 (in $ millions)

	2012	2011
Total sales	610.1	578.3
Cost of sales	(500.2)	(481.9)
Gross profit	109.9	96.4
Selling, general, and administrative expenses	(40.5)	(39.0)
Research and development	(24.6)	(22.8)
Depreciation and amortisation	(3.6)	(3.3)
Operating income	41.2	31.3
Other income	---	---
Earnings before interest and taxes (EBIT)	41.2	31.3
Interest income (expense)	(25.1)	(15.8)
Pretax income	16.1	15.5
Taxes	(5.5)	(5.3)
Net income	10.6	10.2
Price per share	$16	$15
Shares outstanding (millions)	10.2	8.0
Share options outstanding (millions)	0.3	0.2
Shareholders' Equity	126.6	63.6
Total Liabilities and Shareholders' Equity	533.1	386.7

62) Refer to the income statement above. Luther's operating margin for the year ending 30 June 2011 is closest to: 62) ______

A) 1.8% B) 2.7% C) 16.7% D) 5.4%

Answer: D

Explanation: A)
B)
C)
D) Operating margin = Operating income / Sales
OM = 31.3 / 578.3 = 0.054 or 5.4%

63) Convex Industries has inventories of $200 million, current assets of $1.4 billion, and current liabilities of $530 million. What is its quick ratio? 63) ______

A) 0.44 B) 0.38 C) 2.12 D) 2.26

Answer: D

Explanation: A)
B)
C)
D) (1.4 - 0.2) / 0.53 = 2.26

Use the table for the question(s) below.

Luther Corporation
Consolidated Income Statement
Year ended June 30 (in $ millions)

	2012	2011
Total sales	610.1	578.3
Cost of sales	(500.2)	(481.9)
Gross profit	109.9	96.4
Selling, general, and administrative expenses	(40.5)	(39.0)
Research and development	(24.6)	(22.8)
Depreciation and amortisation	(3.6)	(3.3)
Operating income	41.2	31.3
Other income	---	---
Earnings before interest and taxes (EBIT)	41.2	31.3
Interest income (expense)	(25.1)	(15.8)
Pretax income	16.1	15.5
Taxes	(5.5)	(5.3)
Net income	10.6	10.2
Price per share	$16	$15
Shares outstanding (millions)	10.2	8.0
Share options outstanding (millions)	0.3	0.2
Shareholders' Equity	126.6	63.6
Total Liabilities and Shareholders' Equity	533.1	386.7

64) Refer to the income statement above. Luther's net profit margin for the year ending 30 June 2011 is closest to: 64) ______

A) 5.4% B) 16.7% C) 2.7% D) 1.8%

Answer: D

Explanation: A)
B)
C)
D) Net profit margin = Net income / Total sales = 10.2 / 578.3 = 0.018 or 1.8%

Use the table for the question(s) below.

Balance Sheet

Assets	20011	2012	Liabilities	2011	2012
Current Assets			Current Liabilities		
Cash	50	46	Accounts payable	42	48
Accounts receivable	22	12	Notes payable/short-term debt	7	5
Inventories	17	38			
Total current assets	89	96	Total current liabilities	49	53
Long-Term Assets			Long-Term Liabilities		
Net property, plant, and equipment	121	116	Long-term debt	128	136
Total long-term assets	121	116	Total long-term liabilities	128	136
			Total Liabilities	177	189
			Shareholders' Equity	33	23
Total Assets	210	212	Total Liabilities and Shareholders' Equity	210	212

65) If the above balance sheet is for a retail company, what indications about this company would best be drawn from the changes in quick ratio between 2011 and 2012? 65) _______

A) The company has reduced the risk that it will experience a cash shortfall in the near future.
B) The company has eliminated the risk that it will experience a cash shortfall in the near future.
C) The risk that the company will experience a cash shortfall in the near future is unchanged.
D) The company has increased the risk that it will experience a cash shortfall in the near future.

Answer: D

Explanation: A)
B)
C)
D)

66) Which of the following is NOT an operating expense? 66) _______

A) selling, general, and administrative expenses
B) interest expense
C) research and development
D) depreciation and amortisation

Answer: B

Explanation: A)
B)
C)
D)

67) Which of the following best describes why firms produce financial statements? 67) ______

A) to show what activities the company has undertaken in the previous financial year, and what activities are planned for the near future
B) to use as a tool when planning future investments within the firm
C) to provide a means of enticing new investors to a firm
D) to provide interested parties, both inside and outside the company, with an overview of the short- and long-term financial condition of a business

Answer: D
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

AOS Industries Statement of Cash Flows for 2012

Operating activities	
Net Income	3.2
Depreciation and amortisation	1.4
Cash effect of changes in	
Accounts receivable	2.1
Accounts payable	1.1
Inventory	0.8
Cash from operating activities	2.8
Investment activities	
Capital expenditures	2.2
Acquisitions and other investing activity	-0.4
Cash from investing activities	2.6
Financing activities	
Dividends paid	-1.5
Sale or purchase of stock	2.1
Increase in short-term borrowing	1.4
Increase in long-term borrowing	3.2
Cash from financing activities	5.2
Change in Cash and Cash Equivalents	5.4

68) Consider the above statement of cash flows. Which of the following is true of AOS Industries' operating cash flows? 68) ______

A) It sold more inventory than it bought.
B) It collected more cash from its customers than they charged.
C) It charged more on its accounts payable than it paid back.
D) All of the above are true.

Answer: D
Explanation: A)
B)
C)
D)

69) What is the main problem in using a balance sheet to provide an accurate assessment of the value of a company's equity? 69) ______

A) Knowing at a single point in time what assets a firm possesses and the liabilities a firm owes does not give any indication of what those assets can produce in the future.
B) Valuable assets such as the company's reputation, the quality of its work force, and the strength of its management are not captured on the balance sheet.
C) The equity shown on the balance sheet does not reflect the market capitalisation of the company.
D) The balance sheet does not accurately represent the book value of assets held by the company.

Answer: B

Explanation: A)
B)
C)
D)

70) Together, CLERP 9 and the ASX Good Governance Principles have clarified 70) ______

A) risk disclosure, insider trading, and board composition.
B) board composition, director remuneration, and auditor remuneration.
C) the role of auditor, auditor rotation, and auditor remuneration.
D) directors' share trading, auditor rotation, and board composition.

Answer: D

Explanation: A)
B)
C)
D)

71) 71) ______

Firm A:		Firm B:	
Assets		Assets	
Current assets	4	Current assets	7
Fixed assets	10	Fixed assets	7
Total assets	14	Total assets	14

Firm A:		Firm B:	
Total sales	12	Total sales	12
Cost of sales	-5	Cost of sales	-7
Gross Profit	7	Gross Profit	5

Above are portions of the balance sheet and income statement for two companies in 2008. Based upon this information, which of the following statements is most likely to be true?

A) Asset turnover ratios indicate that firm A is generating greater revenue per dollar of assets than firm B.
B) Both asset turnover ratios and fixed asset turnover ratios indicate that firm A is generating greater revenue per dollar of assets than firm B.
C) Fixed asset turnover ratios indicate that firm A is generating fewer sales for the assets they employ than firm B.
D) Fixed asset turnover ratios indicate that firm A is generating more sales for the assets they employ than firm B.

Answer: C

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

72) Refer to the balance sheet above. If in 2012 Luther has 10.2 million shares outstanding and these shares are trading at $16 per share, then what is Luther's enterprise value? 72) ______

A) $516.9 million B) -$63.3 million C) $353.1 million D) $389.7 million

Answer: D

Explanation: A)

B)

C)

D) Enterprise value = MVE + Debt - Cash = 10.2 × $16 + 290.1 - 63.6 = 389.7

Use the table for the question(s) below.

Balance Sheet

Assets	20011	2012	Liabilities	2011	2012
Current Assets			Current Liabilities		
Cash	50	46	Accounts payable	42	48
Accounts receivable	22	12	Notes payable/short-term debt	7	5
Inventories	17	38			
Total current assets	89	96	Total current liabilities	49	53
Long-Term Assets			Long-Term Liabilities		
Net property, plant, and equipment	121	116	Long-term debt	128	136
Total long-term assets	121	116	Total long-term liabilities	128	136
			Total Liabilities	177	189
			Shareholders' Equity	33	23
Total Assets	210	212	Total Liabilities and Shareholders' Equity	210	212

73) If the above balance sheet is for a retail company, what indications about this company would best be drawn from the changes in shareholders' equity between 2011 and 2012? 73) _______

A) The company's net income in 2012 was negative.
B) The company is very profitable because it is obviously collecting receivables faster.
C) The company is selling its property, plant and equipment, which may result in a long-term deficiency in production capacity.
D) No conclusions can be drawn regarding shareholders' equity without additional information.

Answer: A

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Income Statement for Xenon Manufacturing:

	2011	2012
Total sales	202	212
Cost of sales	-148	-172
Gross Profit	54	40
Selling, general, and administrative expenses	-22	-20
Research and development	-8	-7
Depreciation and amortisation	-4	-3
Other income	4	6
Earnings before interest and taxes (EBIT)	24	16
Interest income (expense)	-7	-4
Pretax income	14	12
Taxes	-4	-3
Net Income	10	9

74) Consider the above Income Statement for Xenon Manufacturing. All values are in millions of dollars. If Xenon Manufacturing has 25 million shares outstanding, what is its EPS in 2012? 74) ______

A) $0.84 B) $0.36 C) $0.40 D) $0.63

Answer: B

Explanation: A)
B)
C)
D)

75) A printing company prints a brochure for a client, and then bills them for this service. At the time the printing company's financial disclosure statements are prepared, the client has not yet paid the bill for this service. How will this transaction be recorded? 75) ______

A) The sale will neither be added to Net Income on the income statement nor used to adjust Net Income on the statement of cash flows.
B) The sale will be added to Net Income on the income statement but deducted from Net Income on the statement of cash flows.
C) The sale will not be added to Net Income on the income statement but added to Net Income on the statement of cash flows.
D) The sale will be added to Net Income on the income statement and retained in Net Income on the statement of cash flows.

Answer: B

Explanation: A)
B)
C)
D)

76) What is a firm's gross profit? 76) _______

A) the difference between sales revenues and cash expenditures associated with those sales.
B) the difference between the sales and other income generated by the firm, and all costs, taxes, and expenses incurred by the firm in a given period
C) the difference between sales revenues and the costs associated with those sales.
D) all of the above

Answer: C
Explanation: A)
B)
C)
D)

77) Gross profit is calculated as 77) _______

A) Total sales - Cost of sales - Selling, general, and administrative expenses.
B) Total sales - Cost of sales - Selling, general, and administrative expenses - Depreciation and amortisation.
C) Total sales - Cost of sales.
D) none of the above

Answer: C
Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Income Statement
Year ended June 30 (in $ millions)

	2012	2011
Total sales	610.1	578.3
Cost of sales	(500.2)	(481.9)
Gross profit	109.9	96.4
Selling, general, and administrative expenses	(40.5)	(39.0)
Research and development	(24.6)	(22.8)
Depreciation and amortisation	(3.6)	(3.3)
Operating income	41.2	31.3
Other income	---	---
Earnings before interest and taxes (EBIT)	41.2	31.3
Interest income (expense)	(25.1)	(15.8)
Pretax income	16.1	15.5
Taxes	(5.5)	(5.3)
Net income	10.6	10.2
Price per share	$16	$15
Shares outstanding (millions)	10.2	8.0
Share options outstanding (millions)	0.3	0.2
Shareholders' Equity	126.6	63.6
Total Liabilities and Shareholders' Equity	533.1	386.7

78) Refer to the income statement above. Luther's return on assets (ROA) for the year ending 30 June 2012 is closest to: 78) ______

A) 8.4% B) 12.7% C) 6.5% D) 2.0%

Answer: D

Explanation: A)
B)
C)
D) ROA = Net income / Total assets.
This is a little tricky in that Total Assets are not given in the problem. The student must remember the basic balance sheet equation A = L + SE. Total Liabilities and Shareholders' Equity is given and this is the same as Total Assets. So, ROA = 10.6 / 533.1 = 0.020 or 2.0%.

Use the table for the question(s) below.

Balance Sheet

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	50	Accounts payable	42
Accounts receivable	22	Notes payable/short-term debt	7
Inventories	17		
Total current assets	89	Total current liabilities	49
Long-Term Assets		Long-Term Liabilities	
Net property, plant, and equipment	121	Long-term debt	128
Total long-term assets	121	Total long-term liabilities	128
		Total Liabilities	177
		Shareholders' Equity	33
Total Assets	210	Total Liabilities and Shareholders' Equity	210

79) The above diagram shows a balance sheet for a certain company. If the company buys new property, plant and equipment today using its entire cash balance, what will its net working capital be? 79) ______

A) -$3 million B) -$10 million C) $40 million D) $10 million

Answer: B

Explanation: A)
B) Current assets would fall by $50, with no change in current liabilities.
$39-$49=-$10
C)
D)

80) Which of the following is the LEAST likely explanation for a firm's high ROE? 80) ______

A) The firm is growing.
B) The firm enjoys high sales margins.
C) The firm has very efficient use of its assets.
D) The firm is able to find investment opportunities that are very profitable.

Answer: A

Explanation: A)
B)
C)
D)

Use the table for the question(s) below.

Luther Corporation
Consolidated Income Statement
Year ended June 30 (in $ millions)

	2012	2011
Total sales	610.1	578.3
Cost of sales	(500.2)	(481.9)
Gross profit	109.9	96.4
Selling, general, and administrative expenses	(40.5)	(39.0)
Research and development	(24.6)	(22.8)
Depreciation and amortisation	(3.6)	(3.3)
Operating income	41.2	31.3
Other income	---	---
Earnings before interest and taxes (EBIT)	41.2	31.3
Interest income (expense)	(25.1)	(15.8)
Pretax income	16.1	15.5
Taxes	(5.5)	(5.3)
Net income	10.6	10.2
Price per share	$16	$15
Shares outstanding (millions)	10.2	8.0
Share options outstanding (millions)	0.3	0.2
Shareholders' Equity	126.6	63.6
Total Liabilities and Shareholders' Equity	533.1	386.7

81) Refer to the income statement above. Luther's earnings before interest, taxes, depreciation, and amortisation (EBITDA) for the year ending 30 June 2012 is closest to: 81) ______

A) $37.6 million B) $44.8 million C) $19.7 million D) $41.2 million

Answer: B

Explanation: A)

B) EBITDA = EBIT + Depreciation and amortisation = 41.2 + 3.6 = $44.8 million

C)

D)

82) The third party who checks annual financial statements to ensure that they are prepared according to Generally Accepted Accounting Principles (GAAP) and verifies that the information reported is reliable is the 82) ______

A) auditor.
B) Australian Securities and Investments Commission (ASIC).
C) Australian Accounting Standards Board.
D) Australian Securities Exchange.

Answer: A

Explanation: A)

B)

C)

D)

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

83) How does a firm select the dates for preparation of its income statement? 83) ______________

Answer: The income statement is prepared on the fiscal closing date for the accounts of a firm that may or may not coincide with the fiscal year-end of 30 June. Typically the income statement spans the flow between two adjacent balance sheets.

Explanation:

84) Discuss the intention of the ASX Principles of Good Corporate Governance. 84) ______________

Answer: The Corporate Governance Principles and Recommendations articulate the core principles underlying effective corporate governance that should be adopted by all listed firms. They were developed with the intention of promoting investor confidence.

Explanation:

85) Is it possible to learn the true financial health of a corporation like HIH where the financial statements are deceptive? 85) ______________

Answer: Generally speaking, if an informed reader makes a detailed study of the entire contents of a financial statement, it is possible to identify warning signs that the health of the business may not be good.

Explanation:

86) How can we cross-check the statement of cash flows? 86) ______________

Answer: The last item in the statement of cash flows should equal the difference in cash balances between two adjacent balance sheets.

Explanation:

87) How does a firm select the date for preparation of its balance sheet? 87) ______________

Answer: The balance sheet is prepared on the fiscal closing date for the accounts of a firm. In Australia, the balance date is generally 30 June each year, however some companies - particularly companies that have overseas parents - may select a different balance date.

Explanation:

88) What role do external auditors play in the firm's financial reporting process? 88) ______________

Answer: As the name implies, external auditors act as third party monitors to the firms' financial reporting process.

Explanation:

89) What is the need for the notes to the financial statements when the firm's operations are already documented in the financial statements? 89) ______________

Answer: Not all actions of the firm can be directly converted to an entry on the financial statements. For example, the firm may be involved in off balance sheet transactions, which have to be reported through notes to the financial statements.

Explanation:

90) What will be the effect on the balance sheet if a firm buys a new processing plant through a new loan? 90) ______________

Answer: The Assets side will increase under Net property, plant, and equipment with the net effect of the new processing plant while the Liabilities side will correspondingly show the new debt that was incurred in paying for the plant.
Explanation:

91) State the names of some of the firms discussed in the chapter that had inaccurate reporting in their financial statements. 91) ______________

Answer: Examples of some firms that had practiced inaccurate reporting are Enron and HIH.
Explanation:

92) What will be the effect on the statement of cash flows if a firm buys a new processing plant through a new loan? 92) ______________

Answer: The new loan entry should show as a cash inflow for the firm, while the payment for the new processing plant will be entered as a cash outflow.
Explanation:

93) What will be the effect on the income statement if a firm buys a new processing plant through a new loan? 93) ______________

Answer: The effect on the income statement will be in the form of a depreciation expense for the first year on the new processing plant.
Explanation:

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

94) The balance sheet shows the assets, liabilities, and shareholders' equity of a firm over a given length of time. 94) ______

Answer: True ✓ False
Explanation:

95) In Australia, publicly traded companies can choose whether or not they wish to release periodic financial statements. 95) ______

Answer: True ✓ False
Explanation:

96) The income statement reports the firm's revenues and expenses, and it computes the firm's bottom line of net income, or earnings. 96) ______

Answer: ✓ True False
Explanation:

97) The firm's statement of cash flows uses the balance sheet and the income statement to determine the amount of cash a firm has generated and how it has used that cash during a given period. 97) ______

Answer: ✓ True False
Explanation:

98) Use of the A-IFRS and auditors has eliminated the danger of inadvertent or deliberate fraud in financial statements. 98) ______

Answer: True ✓ False
Explanation:

99) The managements of public companies are not legally required to disclose any off balance sheet transactions. 99) ______

Answer: True ✓ False
Explanation:

100) Price-earnings ratios tend to be high for fast-growing firms. 100) ______

Answer: ✓ True False
Explanation:

101) Shareholders' equity is the difference between a firm's assets and liabilities, as shown on the balance sheet. 101) ______

Answer: ✓ True False
Explanation:

102) In general, a successful firm will have a market-to-book ratio that is substantially greater than 1. 102) ______

Answer: ✓ True False
Explanation:

103) Financial statements are accounting reports issued periodically by a firm which present information on the past performance of the firm, a summary of the firm's assets and the financing of those assets, and a prediction of the firm's future performance. 103) ______

Answer: True ✓ False
Explanation:

104) International Financial Reporting Standards are taking root throughout the world. However, it is unlikely that Australia will report according to IFRS before the second half of the twenty-first century. 104) ______

Answer: True ✓ False
Explanation:

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

Use the table for the question(s) below.

Luther Corporation
Consolidated Balance Sheet
June 30, 2011 and 2012 (in $ millions)

Assets	2012	2011	Liabilities and Shareholders' Equity	2012	2011
Current Assets			*Current Liabilities*		
Cash	63.6	58.5	Accounts payable	87.6	73.5
Accounts receivable	55.5	39.6	Notes payable / short-term debt	10.5	9.6
Inventories	45.9	42.9	Current maturities of long-term debt	39.9	36.9
Other current assets	6.0	3.0	Other current liabilities	6.0	12.0
Total current assets	171.0	144.0	Total current liabilities	144.0	132.0
Long-Term Assets			*Long-Term Liabilities*		
Land	66.6	62.1	Long-term debt	239.7	168.9
Buildings	109.5	91.5	Capital lease obligations	---	---
Equipment	119.1	99.6	Total Debt	239.7	168.9
Less accumulated depreciation	(56.1)	(52.5)	Deferred taxes	22.8	22.2
Net property, plant, and equipment	239.1	200.7	Other long-term liabilities	---	---
Goodwill	60.0	--	Total long-term liabilities	262.5	191.1
Other long-term assets	63.0	42.0	Total liabilities	406.5	323.1
Total long-term assets	362.1	242.7	Shareholders' Equity	126.6	63.6
Total Assets	533.1	386.7	Total liabilities and Shareholders' Equity	533.1	386.7

105) Refer to the balance sheet above. If on 30 June 2011 Luther has 8 million shares outstanding trading at $15 per share, then what is Luther's market-to-book ratio?

Answer: market-to-book = market value of equity / book value of equity
market-to-book = 8 million × $15 / $63.6 = 1.89

106) Refer to the balance sheet above. If on 30 June 2011 Luther has 8 million shares outstanding trading at $15 per share, then what is Luther's enterprise value?

Answer: Enterprise value = Market value of equity + Debt - Cash
Market value of equity = 8 million × $15 = $120 million
Debt = Notes payable + Current maturities of long-term debt + Long-term debt
Debt = 9.6 + 36.9 + 168.9 = 215.4
Cash = 58.5
So, enterprise value = $120 + 215.4 - 58.5 = $276.90.

107) What is the role of an auditor in financial statement analysis?

Answer: Key points:

1. to ensure that the annual financial statements are prepared accurately
2. to ensure that the annual financial statements are prepared according to the Australian equivalent of International Financial Reporting Standards (A-IFRS)
3. to provide evidence to support the reliability of the information

108) What are the four financial statements that all public companies must produce?

Answer:
1. balance sheet
2. income statement
3. statement of cash flows
4. statement of changes in equity

Answer Key
Testname: C2

1) C
2) D
3) D
4) A
5) D
6) B
7) C
8) D
9) C
10) A
11) C
12) C
13) C
14) A
15) D
16) B
17) D
18) C
19) C
20) D
21) A
22) D
23) C
24) C
25) D
26) D
27) C
28) D
29) C
30) A
31) C
32) C
33) C
34) A
35) B
36) B
37) C
38) C
39) D
40) A
41) A
42) D
43) A
44) D
45) B
46) D
47) D
48) D
49) B
50) D

51) B
52) B
53) A
54) C
55) C
56) A
57) B
58) D
59) A
60) B
61) A
62) D
63) D
64) D
65) D
66) B
67) D
68) D
69) B
70) D
71) C
72) D
73) A
74) B
75) B
76) C
77) C
78) D
79) B
80) A
81) B
82) A
83) The income statement is prepared on the fiscal closing date for the accounts of a firm that may or may not coincide with the fiscal year-end of 30 June. Typically the income statement spans the flow between two adjacent balance sheets.
84) The Corporate Governance Principles and Recommendations articulate the core principles underlying effective corporate governance that should be adopted by all listed firms. They were developed with the intention of promoting investor confidence.
85) Generally speaking, if an informed reader makes a detailed study of the entire contents of a financial statement, it is possible to identify warning signs that the health of the business may not be good.
86) The last item in the statement of cash flows should equal the difference in cash balances between two adjacent balance sheets.
87) The balance sheet is prepared on the fiscal closing date for the accounts of a firm. In Australia, the balance date is generally 30 June each year, however some companies - particularly companies that have overseas parents - may select a different balance date.
88) As the name implies, external auditors act as third party monitors to the firms' financial reporting process.
89) Not all actions of the firm can be directly converted to an entry on the financial statements. For example, the firm may be involved in off balance sheet transactions, which have to be reported through notes to the financial statements.
90) The Assets side will increase under Net property, plant, and equipment with the net effect of the new processing plant while the Liabilities side will correspondingly show the new debt that was incurred in paying for the plant.

Answer Key
Testname: C2

91) Examples of some firms that had practiced inaccurate reporting are Enron and HIH.
92) The new loan entry should show as a cash inflow for the firm, while the payment for the new processing plant will be entered as a cash outflow.
93) The effect on the income statement will be in the form of a depreciation expense for the first year on the new processing plant.
94) FALSE
95) FALSE
96) TRUE
97) TRUE
98) FALSE
99) FALSE
100) TRUE
101) TRUE
102) TRUE
103) FALSE
104) FALSE
105) market-to-book = market value of equity / book value of equity
market-to-book = 8 million × \$15 / \$63.6 = 1.89
106) Enterprise value = Market value of equity + Debt - Cash
Market value of equity = 8 million × \$15 = \$120 million
Debt = Notes payable + Current maturities of long-term debt + Long-term debt
Debt = 9.6 + 36.9 + 168.9 = 215.4
Cash = 58.5
So, enterprise value = \$120 + 215.4 - 58.5 = \$276.90.
107) Key points:
1. to ensure that the annual financial statements are prepared accurately
2. to ensure that the annual financial statements are prepared according to the Australian equivalent of International Financial Reporting Standards (A-IFRS)
3. to provide evidence to support the reliability of the information
108) 1. balance sheet
2. income statement
3. statement of cash flows
4. statement of changes in equity