Chapter 2—Financial Statement and Cash Flow Analysis

MULTIPLE CHOICE

1. Which of the following items can be found on an income statement?
   a. Accounts receivable
   b. Long-term debt
   c. Sales
   d. Inventory

   ANS: C        DIF:  E        REF:  2.1 Financial Statements

2. If you only knew a company’s total assets and total debt, which item could you easily calculate?
   a. Sales
   b. Depreciation
   c. Total equity
   d. Inventory

   ANS: C        DIF:  E        REF:  2.1 Financial Statements

3. How do we calculate a company’s operating cash flow?
   a. EBIT - taxes + depreciation
   b. EBIT - taxes - depreciation
   c. EBIT + taxes + depreciation
   d. EBIT - Sales

   ANS: A        DIF:  E        REF:  2.2 Cash Flow Analysis

4. Holding all other things constant, which of the following represents a cash outflow?
   a. The company sells a machine.
   b. The company acquires inventory.
   c. The company receives a bank loan.
   d. The company increases accounts payable.

   ANS: B        DIF:  E        REF:  2.2 Cash Flow Analysis

5. Which of the following is a liquidity ratio?
   a. Quick ratio
   b. P/E- ratio
   c. Inventory turnover
   d. Equity multiplier

   ANS: A        DIF:  E        REF:  2.3 Analyzing Financial Performance Using Ratio Analysis

NARRBEGIN: Bavarian Sausage, Inc.

**Bavarian Sausage, Inc.**

Bavarian Sausage, Inc. posted the following balance sheet and income statement.

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th></th>
<th>Accounts Payable</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$50,000</td>
<td>Accounts Payable</td>
<td>$185,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>125,000</td>
<td>Notes Payable</td>
<td>125,000</td>
</tr>
<tr>
<td>Inventories</td>
<td>225,000</td>
<td>Long-term debt</td>
<td>115,000</td>
</tr>
<tr>
<td>Net Plant and</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Income Statement

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$525,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>215,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>65,000</td>
</tr>
<tr>
<td>Earnings before interest and taxes</td>
<td>245,000</td>
</tr>
<tr>
<td>Interest expense</td>
<td>35,000</td>
</tr>
<tr>
<td>Net profit before taxes</td>
<td>210,000</td>
</tr>
<tr>
<td>Taxes (@ 40%)</td>
<td>84,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$126,000</td>
</tr>
</tbody>
</table>

6. What is Bavarian Sausage, Inc.’s operating cash flow?
   a. $394,000
   b. $191,000
   c. $226,000
   d. $359,000

   ANS: C   DIF: E   REF: 2.2 Cash Flow Analysis

7. What is the Bavarian Sausage, Inc.’s quick ratio?
   a. 0.5645
   b. 1.2903
   c. 1.9565
   d. 0.8871

   ANS: A   DIF: E

8. What is the Bavarian Sausage, Inc.’s average collection period?
   a. 14.39 days
   b. 4.20 days
   c. 122.56 days
   d. 86.90 days

   ANS: D   DIF: E

9. Bavarian Sausage, Inc. has 100,000 shares of common stock outstanding, but no preferred stock. The current price of Bavarian’s common stock is $15. What is the company’s P/E-ratio?
   a. 119.00

   ANS: A   DIF: E

REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
 NAR: Bavarian Sausage, Inc.
b. 1.26
c. 11.90
d. 12.60

ANS: C DIF: M
REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
NAR: Bavarian Sausage, Inc.

10. What is Bavarian sausage, Inc.’s net profit margin?
   a. 40%
   b. 47%
   c. 15%
   d. 24%

ANS: D DIF: E
REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
NAR: Bavarian Sausage, Inc.

11. What is Bavarian Sausage, Inc.’s debt-equity ratio?
   a. 0.23
   b. 0.52
   c. 1.25
   d. 0.85

ANS: A DIF: E
REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
NAR: Bavarian Sausage, Inc.

12. Calculate the Bavarian Sausage, Inc.’s return on assets.
   a. 25.20%
   b. 16.35%
   c. 13.62%
   d. 8.47%

ANS: C DIF: E
REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
NAR: Bavarian Sausage, Inc.

13. If Bavarian Sausage, Inc. has 100,000 shares outstanding, what is the book value per share?
   a. $5.00
   b. $9.25
   c. $3.50
   d. $1.50

ANS: A DIF: E
REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
NAR: Bavarian Sausage, Inc.

14. Calculate the Bavarian Sausage, Inc.’s inventory turnover.
   a. 1.05
   b. 0.96
   c. 0.76
   d. 1.51

ANS: B DIF: E
REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
15. Calculate the Bavarian Sausage, Inc.’s return on equity.
   a. 24.00%
   b. 13.62%
   c. 15.74%
   d. 25.20%

   ANS: D
   DIF: E
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

16. What is the Bavarian Sausage, Inc.’s times interest earned ratio?
   a. 3.60
   b. 7.00
   c. 15.00
   d. 6.00

   ANS: B
   DIF: E
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

17. If a company’s net profit margin is 5% and its total asset turnover is 3.5, what is its ROA?
   a. 17.50%
   b. 1.43%
   c. 70.00%
   d. 12.53%

   ANS: A
   DIF: E
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

18. You have the following information about a firm: total asset = $350,000; common stock equity = $175,000; ROE = 12.5%. What is the firm’s earnings available for common stockholders?
   a. $43,750
   b. $21,875
   c. $50,000
   d. $47,632

   ANS: B
   DIF: M
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

NARRBEGIN: Tax table

<table>
<thead>
<tr>
<th>Taxable income over</th>
<th>Not over</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 0</td>
<td>$ 50,000</td>
<td>15%</td>
</tr>
<tr>
<td>50,000</td>
<td>75,000</td>
<td>25%</td>
</tr>
<tr>
<td>75,000</td>
<td>100,000</td>
<td>34%</td>
</tr>
<tr>
<td>100,000</td>
<td>335,000</td>
<td>39%</td>
</tr>
<tr>
<td>335,000</td>
<td>10,000,000</td>
<td>34%</td>
</tr>
<tr>
<td>10,000,000</td>
<td>15,000,000</td>
<td>35%</td>
</tr>
<tr>
<td>15,000,000</td>
<td>18,333,333</td>
<td>38%</td>
</tr>
<tr>
<td>18,333,333</td>
<td>..........</td>
<td>35%</td>
</tr>
</tbody>
</table>

NARREND
19. Refer to Tax Table. First Watch, Inc. has a pretax income of $3,755,250. What is the company’s average tax rate?
   a. 25%
   b. 15%
   c. 39%
   d. 34%

   ANS: D  DIF: E  REF: 2.4 Corporate Taxes
   NAR: Tax table

20. Refer to Tax Table. First Watch, Inc. has a pretax income of $3,755,250. What is the company’s tax liability?
   a. $1,276,785
   b. $1,390,571
   c. $1,464,548
   d. $563,288

   ANS: A  DIF: E  REF: 2.4 Corporate Taxes
   NAR: Tax table

21. Refer to Tax Table. Bavarian Sausage, Inc. has a pretax income of $325,000. What is the company’s tax liability?
   a. $126,750
   b. $110,000
   c. $81,250
   d. $325,000

   ANS: B  DIF: E  REF: 2.4 Corporate Taxes
   NAR: Tax table

22. Refer to Tax Table. Bavarian Sausage, Inc. has a pretax income of $325,000. What is the company’s marginal tax rate?
   a. 34%
   b. 39%
   c. 35%
   d. 25%

   ANS: B  DIF: E  REF: 2.4 Corporate Taxes
   NAR: Tax table

23. Refer to Tax Table. Bavarian Sausage, Inc. has a pretax income of $325,000. What is the company’s average tax rate?
   a. 39.00%
   b. 29.55%
   c. 26.75%
   d. 33.85%

   ANS: D  DIF: E  REF: 2.4 Corporate Taxes
   NAR: Tax table

24. A company has an average collection period of 52 days and accounts receivables of $250,000. What are the company’s annual sales?
   a. $2,234,756
   b. $1,754,808
25. A company has a total asset turnover of 2 and sales of $500,000. What is the company’s total assets?
   a. $1,000,000
   b. $250,000
   c. $750,000
   d. $500,000

   ANS: B  DIF: E
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

26. You have the following information about a company: quick ratio = 0.85, inventory = $125,000 and current assets = $375,000. What is the company’s current ratio?
   a. 0.85
   b. 1.05
   c. 2.56
   d. 1.28

   ANS: D  DIF: M
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

27. A company has sales of $1,250,000, cost of goods sold of $750,000, depreciation expenses of $250,000 and interest expenses of $55,000. If the company’s tax rate is 34% and the income statement is complete, what is this firm’s operating cash flow?
   a. $183,700
   b. $433,700
   c. $165,000
   d. $415,000

   ANS: B  DIF: M  REF: 2.2 Cash Flow Analysis

28. In a given year a company decreased its inventory by $250,000, purchased $350,000 worth of fixed assets and took on a new $500,000 loan. What is the net change of the company’s cash as a result of these transactions?
   a. $100,000
   b. -$100,000
   c. $400,000
   d. -$400,000

   ANS: C  DIF: M  REF: 2.2 Cash Flow Analysis

29. Given the following information, calculate the company’s long-term debt.

   Current assets: $125,000
   Current liabilities: $85,000
   Net fixed assets: $250,000
   Total equity: $200,000

   a. $375,000
   b. $50,000
   c. $285,000
d. $90,000

ANS: D  DIF: E  REF: 2.2 Cash Flow Analysis

30. Last National, Inc. has a net profit margin of 12%, an equity multiplier of 2, sales of $575,000 and a ROE of 14.5%. What is Last National’s total asset turnover?
   a. 1.6042
   b. 0.6042
   c. 2
   d. Not enough information.

ANS: B  DIF: M  REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

31. Financial professionals prefer to focus on an accounting approach that focuses on
   a. governmental accounting methods.
   b. current and prospective cash flows.
   c. economically based accruals.
   d. international accrual accounting standards.

ANS: B  DIF: E  REF: Introduction

32. Generally accepted accounting principles are developed by
   a. the Securities and Exchange Commission.
   b. the Financial Accounting Standards Board.
   c. Congress.
   d. the New York Stock Exchange.

ANS: B  DIF: E  REF: 2.1 Financial Statements

33. Which of the following statements is not required by the SEC for publicly traded firms?
   a. the statement of cost of goods sold
   b. the statement of retained earnings
   c. the statement of cash flows
   d. the balance sheet

ANS: A  DIF: E  REF: 2.1 Financial Statements

34. The balance sheet entry that represents the cumulative total of the earnings that a firm has reinvested since its inception is
   a. common stock.
   b. paid-in-capital.
   c. par value.
   d. retained earnings.

ANS: D  DIF: M  REF: 2.1 Financial Statements

35. Company X had sales of $120 with a cost of goods sold equal to 25% of sales. In addition, X had total other operating expenses of $50 with an interest expense of $20. If X pays a flat 40% of its pre-tax income in income taxes, what is X’s net income?
   a. $20
   b. $27
   c. $12
   d. none of the above

ANS: C  DIF: M  REF: 2.1 Financial Statements
36. If you are looking to review a firm’s sources and uses of cash flows over the year, the easiest place to find that information is
a. the Income Statement
b. the Statement of Retained Earnings
c. the Statement of Cash Flows
d. the Balance Sheet
ANS: C DIF: E REF: 2.1 Financial Statements

37. In order to identify the amount of funds that a firm borrowed during the preceding year, what section is the best source within the Statement of Cash Flows?
  a. operating flows
  b. investment flows
  c. financing flows
d. total net cash flows
ANS: C DIF: M REF: 2.2 Cash Flow Analysis

38. If you start with earnings before interest and taxes and then subtract a firm’s tax expense while adding back the amount of depreciation expense for the firm during the year, the resulting figure is called
a. free cash flow
b. operating cash flow
c. net cash flow
d. gross cash flow
ANS: B DIF: E REF: 2.2 Cash Flow Analysis

39. The Park Corp. had earnings before interest and taxes of $500,000 and had a depreciation expense of $200,000 this last year. If the firm was subject to an average tax rate of 30%, what was Park’s operating cash flow for the year? If you need to, assume that Park’s interest expense was zero for the year.
  a. $305,000
  b. $350,000
  c. $450,000
d. $550,000
ANS: D
500,000 - (.3 * 500,000) + 200,000 = 550,000
DIF: H REF: 2.2 Cash Flow Analysis

40. Edison Bagels had operating cash flow equal to $850 for 2004. If its earnings before interest and taxes was $1,000 while its tax bill was $300, what was Edison’s depreciation expense for the year?
  a. $150
  b. $550
  c. $1,550
d. not enough information to calculate
ANS: A
OCF = EBIT - Taxes + Depreciation
850 = 1,000 - 300 + Depreciation
150 = Depreciation
DIF: H REF: 2.2 Cash Flow Analysis
41. When calculating a firm’s free cash cash flow from earnings before interest and taxes we must add back depreciation, amortization and depletion expense and allowances because
   a. they are non-cash expenditures.
   b. the accounting method for reporting such expenses may be different from that reported to the taxing authority.
   c. they approximate the value of fixed asset purchases during the year.
   d. they are unrelated to the amount of taxes paid during the year.

ANS: A    DIF: M    REF: 2.2 Cash Flow Analysis

42. When calculating the dollar amount of fixed assets purchased during the year what information is required? Assume that no fixed assets were disposed of during the year.
   a. the current and prior year’s gross fixed assets
   b. the current and prior year’s net fixed assets
   c. the current and prior year’s net fixed assets plus the firm’s depreciation expense for the year.
   d. either a or c will suffice

ANS: D    DIF: H    REF: 2.2 Cash Flow Analysis

NARRBEGIN: Cold Weather Sports

Cold Weather Sports, Inc. (CWS)

Cold Weather Sports, Inc. (CWS) just completed its 2003 fiscal year. During the year, CWS had sales of $10,000 and total expenses (no interest expenses were incurred) of $6,000. Assume that CWS pays 30% of its EBIT in taxes and that depreciation expense of $1,200 is included in the total expense number listed above. A list of some balance sheet items for CWS for end of fiscal year 2002 and 2003 is as below.

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Assets</th>
<th>Net Long-Term Assets</th>
<th>Accounts Payable</th>
<th>Accrued Expenses</th>
<th>Short-Term Debt</th>
<th>Long-Term Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td></td>
<td>$1,000</td>
<td>5,000</td>
<td>600</td>
<td>500</td>
<td>2,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td>$1,200</td>
<td>5,600</td>
<td>800</td>
<td>600</td>
<td>2,100</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

No fixed assets were disposed of during the year.

NARREND

43. What is Cold Weather Sports’ operating cash flow for 2003?
   a. $2,400
   b. $2,800
   c. $4,000
   d. none of the above

ANS: C
10,000 sales - 6,000 expense = 4,000 EBIT

4,000 EBIT - 1,200 tax + 1,200 depreciation expense = 4,000

44. What was the dollar amount of fixed assets purchased during the year for Cold Weather Sports?
   a. $600
   b. $1,200
   c. $1,800
   d. none of the above

   ANS: C
   5,600 - 5,000 + 1,200 = 1,800

45. What is the amount of free cash flow generated by Cold Weather Sports in 2003?
   a. $100
   b. $2,100
   c. $2,300
   d. none of the above

   ANS: C
   Change in CA = 1,200 - 1,000 = 200
   Change in AP = 800 - 600 = 200
   Change in Accrued = 600 - 500 = 100

   OCF = 10,000 sales - 6,000 expense - 1,200 tax + 1,200 depreciation expense = 4,000

   Change in FA = 5,600 - 5,000 + 1,200

   FCF = OCF - Change FA - (Change in CA - Change in AP - Change in Accrued)
   = 4,000 - 1,800 - (200 - 200 - 100) = 2,300

46. The effect of an increase in a firm’s accounts payable during the year, assuming that the current asset portion of the balance sheet remains the same, is
   a. an outflow of cash.
   b. an inflow of cash.
   c. neither an inflow nor an outflow of cash.
   d. a decrease in the equity of the firm.

   ANS: B
   DIF: M

47. Granny’s Jug Herbal Shop has total current liabilities of $2,000 and an inventory of $1,000. If its current ratio is 2.5, then what is its quick ratio?
   a. 2.0
   b. 2.5
   c. 3.0
   d. 3.5

   ANS: A
   2.5 = CA/ 2,000 ===> CA = 5,000
quick ratio = (CA - Inv)/CL = (5,000 - 1,000)/2,000 = 2.0

DIF: M  REF:  2.3 Analyzing Financial Performance Using Ratio Analysis

48. Wunder Boy Bat Co. has an average age of inventory equal to 121.67 days. If its end of year inventory level is $4,000, then what does that imply for the cost of goods sold during the year? (round to the nearest dollar)
   a. $1,333
   b. $3,000
   c. $12,000
   d. $16,000

   ANS: C
   121.67 = (365 / inventory turnover) ===> inventory turnover = 2.9992
   2.9992 = (CGS/ inventory) ===> 2.992 = (CGS/4,000) ===> CGS = 11,999.67 ===> 12,000

   DIF: H  REF:  2.3 Analyzing Financial Performance Using Ratio Analysis

49. The firm that you work for had credit sales of $3,500,000 last year and on average had $33,000 in its accounts receivable during the year. What is its average collection period?
   a. 3 days
   b. 3.44 days
   c. 3.5 days
   d. none of the above

   ANS: A
   3,500,000 / 365 = 9,589.04 average sales per day ===> 
   average collection period = 33,000 / 9,589.04 = 3.44 days

   DIF: E  REF:  2.3 Analyzing Financial Performance Using Ratio Analysis

50. In general, the more debt a firm uses in relation to its total assets
   a. the less risk there is to the equity holders of the firm.
   b. the less financial leverage it uses.
   c. the greater the financial leverage it uses.
   d. the greater extent to which it uses equity.

   ANS: C  DIF: M
   REF:  2.3 Analyzing Financial Performance Using Ratio Analysis

51. Devil Inc. has total liabilities equal to $3,500 and total assets equal to $5,000. What is Devil’s asset-to-equity ratio?
   a. 1.43
   b. 2.33
   c. 3.33
   d. none of the above

   ANS: C
   TA = 5,000 ===> Equity = 5,000 - 3,500 = 1,500
   asset-to-equity = 5,000 / 1,500 = 3.33
52. Straw Corp has an operating profit of $1,200 produced from $9,800 in sales. If Straw has no interest expense and currently pays 35% of its operating profits in taxes and $200 per year in preferred dividends, then what is Straw’s net profit margin?
   a. 5.92%
   b. 7.96%
   c. 7.96%
   d. 10.20%

ANS: A
\[
\frac{1,200 - (0.35 \times 1,200) - 200}{9,800} = 5.92\%
\]

53. Straw Corp has an operating profit of $1,200 produced from $20,000 in total assets. If Straw has no interest expense and currently pays 35% of its operating profits in taxes and $200 per year in preferred dividends, then what is Straw’s net profit margin?
   a. 2.90%
   b. 3.90%
   c. 5.0%
   d. none of the above

ANS: A
\[
\frac{1,200 - (0.35 \times 1,200) - 200}{20,000} = 2.90\%
\]

54. What is Import Inc.’s return on assets?
   a. 14%
   b. 7%
   c. 3.5%
   d. none of the above

ANS: C
\[
\text{ROA} = \frac{\text{earnings avail for common}}{\text{sales}} \times \frac{\text{sales}}{\text{TA}} = \frac{700}{10,000} \times \frac{10,000}{20,000} = 0.035
\]

55. What is Import Inc.’s return on common equity?
   a. 7.0%
   b. 8.75%
   c. 17.5%
   d. none of the above

ANS: A
\[
\text{ROE} = \frac{\text{earnings avail for common}}{\text{sales}} \times \frac{\text{sales}}{\text{TA}} \times \frac{\text{TA}}{\text{equity}}
\]
FactorMax is currently selling for $75 per share. If it is selling at a P/E ratio of 50, calculate FactorMax’s recent earnings per share.

a. $0.15  
b. $0.67  
c. $1.50  
d. none of the above

ANS: C

P/E = market price per share / earnings per share

\[ 50 = \frac{75}{\text{EPS}} \Rightarrow \text{EPS} = 1.50 \]

What is the financial ratio that measures the price per share of stock divided by earnings per share?

a. Return on assets  
b. Return on equity  
c. Debt-equity ratio  
d. Price-earnings ratio

ANS: D  

NARRBEGIN: Stone Cold

Stone Cold Incorporated

Balance Sheet: 12/31/04

<table>
<thead>
<tr>
<th>Assets</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Marketable Securities</td>
<td>10</td>
<td>80</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>375</td>
<td>315</td>
</tr>
<tr>
<td>Inventories</td>
<td>615</td>
<td>415</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td>1,000</td>
<td>810</td>
</tr>
<tr>
<td>Net plant and equipment</td>
<td>1,000</td>
<td>870</td>
</tr>
<tr>
<td>TOTAL ASSETS</td>
<td>2,000</td>
<td>1,680</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and Equity</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>Notes Payable</td>
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<td>60</td>
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<tr>
<td>Accruals</td>
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<td>130</td>
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<tr>
<td>Total Current Liabilities</td>
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</tr>
<tr>
<td>Common Stock</td>
<td>130</td>
<td>130</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>766</td>
<td>700</td>
</tr>
<tr>
<td>TOTAL COMMON EQUITY</td>
<td>896</td>
<td>830</td>
</tr>
<tr>
<td>TOTAL LIABILITIES AND EQUITY</td>
<td>2,000</td>
<td>1,680</td>
</tr>
</tbody>
</table>

Income Statement: 12/31/04
<table>
<thead>
<tr>
<th>Financial Item</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>3,200</td>
<td>2,850</td>
</tr>
<tr>
<td>Operating Costs (excludes Dep/Amortization)</td>
<td>2,700</td>
<td>2,497</td>
</tr>
<tr>
<td>EBITDA</td>
<td>500</td>
<td>353</td>
</tr>
<tr>
<td>Depreciation</td>
<td>100</td>
<td>90</td>
</tr>
<tr>
<td>Amortization</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Depreciation and Amortization</td>
<td>100</td>
<td>90</td>
</tr>
<tr>
<td>EBIT</td>
<td>400</td>
<td>263</td>
</tr>
<tr>
<td>Less Interest</td>
<td>88</td>
<td>60</td>
</tr>
<tr>
<td>EBT</td>
<td>312</td>
<td>203</td>
</tr>
<tr>
<td>Taxes (40%)</td>
<td>124.8</td>
<td>81.2</td>
</tr>
<tr>
<td>NET INCOME (before Preferred Dividends)</td>
<td>187.2</td>
<td>121.8</td>
</tr>
<tr>
<td>Preferred Dividends</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>NET INCOME</td>
<td>183.2</td>
<td>117.8</td>
</tr>
<tr>
<td>Common Dividends</td>
<td>117</td>
<td>53</td>
</tr>
<tr>
<td>Addition to Retained Earnings</td>
<td>66.2</td>
<td>64.8</td>
</tr>
</tbody>
</table>

NARREND

58. Refer to Stone Cold. For 2004, what was the return on assets?
   a. 9.16%
   b. 12.40%
   c. 15.60%
   d. 20.00%

   ANS: A
   \[ \frac{183.2}{2000} = 9.16\% \]

   DIF: E  
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
   NAR: Stone Cold

59. Refer to Stone Cold. For 2004, what was the return on common equity?
   a. 9.36%
   b. 12.40%
   c. 20.44%
   d. 20.90%

   ANS: C
   \[ \frac{183.2}{896} = 20.44\% \]

   DIF: E  
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
   NAR: Stone Cold

60. Refer to Stone Cold. For 2004, what was the debt-to-equity ratio?
   a. 0.81
   b. 0.84
   c. 0.98
   d. 1.19

   ANS: A
   \[ \frac{754}{(896+40)} = .81 \]

   DIF: H  
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
   NAR: Stone Cold
61. Refer to Stone Cold. For 2004, what was the average collection period for the firm in 2004?
   a. 6.84 days
   b. 8.77 days
   c. 42.77 days
   d. 51.22 days

   ANS: C
   =3200/365 = 8.767
   =375/8.767 = 42.77

   DIF: M
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
   NAR: Stone Cold

62. Refer to Stone Cold. For 2004, what was the total asset turnover for 2004?
   a. 0.80
   b. 1.20
   c. 1.40
   d. 1.60

   ANS: D
   =3200/2000 = 1.60

   DIF: M
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
   NAR: Stone Cold

63. Refer to Stone Cold. For 2004, what was the times interest earned ratio for 2004?
   a. 2.13
   b. 2.77
   c. 3.55
   d. 4.55

   ANS: D
   =400/88 = 4.55

   DIF: E
   REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
   NAR: Stone Cold

64. What was the free cash flow in 2004 for Stone Cold Incorporated?
   a. -$55.20
   b. -$44.80
   c. $145.20
   d. $215.00

   ANS: A
   \[ FCF = OCF - \text{chFA} - (\text{chCA} - \text{chA/P} - \text{chAccruals}) \]

   OCF = EBIT - Taxes + Depreciation
   OCF = $400 - $124.8 + $100 = $375.2

   chFA = Change in Gross Fixed Assets = Change in Net Fixed Assets + Depreciation
   chFA =($1,000 - $870) + $100 = $230

   chCA = Change in Current Assets
   chCA =$1,000 - $810 = $190
chA/P = Change in A/P  
chA/P = $60 - $40 - $20  

chAccruals = Change in Accruals.  
chAccruals = $110 - $130 = -$20  

FCF = OCF - chFA - (chCA - chA/P - chAccruals)  
FCF = $375.2 - $230 - (190 - $20 - $20)  
FCF = $375.2 - $230 - $190  
FCF = -$44.8  

65. Consider the following financial information for Classic City Ice Cream Corporation:

<table>
<thead>
<tr>
<th>2004 Financial Data</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income</td>
<td>$ 50,000</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$300,000</td>
</tr>
<tr>
<td>Total Shareholder Equity</td>
<td>$200,000</td>
</tr>
<tr>
<td>Net Sales</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

What is the total asset turnover for the firm in 2004?  
a. 16.67%  
b. 25.00%  
c. 33.33%  
d. 40.00%  

ANS: C  
=100000/300000=33.33%  

66. Consider the following financial information for Classic City Ice Cream Corporation:

<table>
<thead>
<tr>
<th>2004 Financial Data</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income</td>
<td>$ ???,??</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$250,000</td>
</tr>
<tr>
<td>Total Shareholder Equity</td>
<td>$200,000</td>
</tr>
<tr>
<td>Net Sales</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

If the return on equity is 20%, what was Net Income for 2004?  
a. $25,000  
b. $40,000  
c. $50,000  
d. $65,000  

ANS: B  
.20 = X / $200,000  
X= $40,000  

NARRBEGIN: Titans Electronics  
**Titans Electronics**
Titans Electronics reports the following data for the past year:

<table>
<thead>
<tr>
<th>EBIT</th>
<th>$1,000,000</th>
<th># of Common shares</th>
<th>400,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income</td>
<td>$480,000</td>
<td>Total Dividends Paid</td>
<td>$120,000</td>
</tr>
<tr>
<td>Interest Paid</td>
<td>$200,000</td>
<td>Current Assets</td>
<td>$80,000</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$6,000,000</td>
<td>Current Liabilities</td>
<td>$60,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Market Price of</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Common equity</td>
<td>$20</td>
</tr>
</tbody>
</table>

NARREND

67. What is the current P/E ratio for the Titans?
   a. 8.00
   b. 10.00
   c. 15.50
   d. 16.67

ANS: D
= $20/($480,000/400,000)=16.67

DIF: M REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
NAR: Titans Electronics

68. Titans Electronics is applying for a new line of credit from their banking partner. To issue the credit, the bank requires the following cutoffs for certain financial ratios:

TIE ratio of 4.25   Current Ratio of 1.50   ROA of 5%.

What is a likely response from the bank to the application?
   a. The bank will have reservations, as the TIE ratio does not meet requirements.
   b. The bank will have concerns, as the current ratio does not meet requirements.
   c. The bank will have concerns, as the ROA is not high enough.
   d. The bank will have concerns, as two or more of the requirements are not met.

ANS: B DIF: M
REF: 2.3 Analyzing Financial Performance Using Ratio Analysis
NAR: Titans Electronics

NARRBEGIN: Exhibit 2-1

**Exhibit 2-1**
The tax schedule for corporate income is shown in the table below:

<table>
<thead>
<tr>
<th>Taxable Income Over</th>
<th>Not Over</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$50,000</td>
<td>15.00%</td>
</tr>
<tr>
<td>0</td>
<td>75,000</td>
<td>25.00%</td>
</tr>
<tr>
<td>50,000</td>
<td>100,000</td>
<td>34.00%</td>
</tr>
<tr>
<td>75,000</td>
<td>335,000</td>
<td>39.00%</td>
</tr>
<tr>
<td>100,000</td>
<td>500,000</td>
<td>34.00%</td>
</tr>
<tr>
<td>335,000</td>
<td>15,000,000</td>
<td>35.00%</td>
</tr>
<tr>
<td>10,000,000</td>
<td>18,333,333</td>
<td>38.00%</td>
</tr>
<tr>
<td>15,000,000</td>
<td>...............</td>
<td>35.00%</td>
</tr>
<tr>
<td>18,333,333</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

NARREND
69. Refer to Exhibit 2-1. Pale Rider Corporation reports taxable income of $500,000 in 2004. What was their tax liability for the year?
   a. $56,100
   b. $91,650
   c. $170,000
   d. $200,000

   ANS: C
   =50000*.15+25000*.25+25000*.34+235000*.39+165000*.34=170000

   DIF: E  REF:  2.4 Corporate Taxes  NAR: Exhibit 2-1

70. Refer to Exhibit 2-1. Pale Rider Corporation reports taxable income of $500,000 in 2004. What was the average tax rate they paid for the year?
   a. 23.25%
   b. 25.00%
   c. 29.40%
   d. 34.00%

   ANS: D
   170000/500000=.34

   DIF: E  REF:  2.4 Corporate Taxes  NAR: Exhibit 2-1

71. Refer to Exhibit 2-1. Big Diesel Incorporated reports taxable income of $200,000 in 2004. What was the average tax rate they paid for the year?
   a. 25.00%
   b. 29.40%
   c. 30.63%
   d. 34.00%

   ANS: C
   61250/200000=.3063

   DIF: E  REF:  2.4 Corporate Taxes  NAR: Exhibit 2-1

72. Refer to Exhibit 2-1. Big Diesel Incorporated currently predicts taxable income of $200,000 for the next year. If this is their actual income, what will be the tax liability for Big Diesel?
   a. $45,250
   b. $56,500
   c. $61,250
   d. $91,650

   ANS: C

   DIF: E  REF:  2.4 Corporate Taxes  NAR: Exhibit 2-1

73. What ratio measures the ability of the firm to satisfy its short term obligations as they come due?
   a. Activity ratio
   b. Times interest earned ratio
   c. Current ratio
   d. Inventory turnover ratio
74. The asset to equity ratio for a firm is 1.5, and the firm has total assets of $6,000,000. Last year, net income for the firm was $250,000, and the earnings per share for the firm was reported as $0.50. If the current price-to-earnings ratio is 20, what is the current market-to-book ratio for the firm?
   a. 0.60
   b. 0.80
   c. 1.00
   d. 1.25

ANS: D  DIF: H  REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

75. The asset to equity ratio for a firm is 1.5, and the firm has total assets of $3,000,000. Last year, net income for the firm was $250,000, and the earnings per share for the firm was reported as $0.50. What is the current book value per share for the firm?
   a. $2
   b. $4
   c. $6
   d. $8

ANS: B  DIF: M  REF: 2.3 Analyzing Financial Performance Using Ratio Analysis

1.5=3,000,000/x; X=shareholder equity=$2,000,000
EPS=$0.50=$250,000/Y; Y= # of shares = 500,000
Book value per share = $2,000,000/500,000 = $4

76. Which financial ratio measures the effectiveness of management in generating returns to common stockholders with its available assets?
   a. Gross profit margin
   b. Return on equity
   c. Return on assets
   d. Current ratio

ANS: C  DIF: M  REF: 2.1 Financial Statements

77. When is the return on assets equal to the return on equity?
   a. When the current ratio of the firm equals 1.
   b. When the firm issues equal amounts of long term debt and common stock.
   c. When the firm issues no dividends for a given time period.
   d. When the firm only issues equity to finance its borrowing.

ANS: D  DIF: M  REF: 2.1 Financial Statements

78. Consider the following working capital information for Full House Corporation:

<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>$0</td>
<td>$100</td>
</tr>
<tr>
<td>Inventory</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$0</td>
<td>$50</td>
</tr>
</tbody>
</table>
What was the effect on free cash flow for the firm this past year?

a. Increase of $100
b. Increase of $150
c. Decrease of $50
d. Decrease of $100

ANS: C

c\text{change in NWC} = \text{change in CA} - \text{change in CL}
\text{change in CA} = ($200-$100)= $100
\text{change in CL} = ($50-$0) = $50
\text{change in NWC} = +$50
Effect on free cash flow = -$50

DIF: H

79. A firm reports net income of $500,000 for 2004. The most recent balance sheet for the reports retained earnings of $2,000,000. The firm will pay out 25% of net income as dividends. What will the new balance be for retained earnings?

a. $1,875,000
b. $2,125,000
c. $2,375,000
d. $2,500,000

ANS: C

\text{Addition to RE} = $500,000*(1-.25)=$375,000
\text{New RE} = $2,000,000 + $375,000

DIF: M

80. A firm reports a current ratio of 2 and a quick ratio of 1.2. The firm has total current assets of $4,000. If the firm reports cost of goods sold at $25,000 for the given year, what is the average age of their inventory?

a. 12.35 days
b. 15.63 days
c. 18.24 days
d. 23.36 days

ANS: D

\text{Current} = 2 = \text{CA/CL} = $4000/\text{CL}, \text{CL}=$2000
\text{Quick} = 1.2 = ($4000-\text{INV})/$2000
\text{INV} = $1,600

\text{Inventory turn} = $25000/$1600=15.625
\text{Average age} = 365/15.625=23.36

DIF: H

81. The average age of the inventory for a firm is 10 days old. If the current dollar amount of inventory is $1,000, what is a good estimate for the cost of goods sold over the last year?

a. $16,500
b. $26,500
c. $32,500
d. $36,500

ANS: D
10 = 365/Inv turn, Inventory turn = 36.5
36.5 = COGS/INV = COGS / $1000

COGS = $36500

DIF: H  REF: 2.3 Analyzing Financial Performance Using Ratio Analysis