5.02 Analyzing Income Statements

Question 1
A company reports net income of CNY 250 million and weighted average shares outstanding of 100 million for its fiscal year. The company also has convertible bonds outstanding with a par value of CNY 120 million. The bonds pay a 10% coupon and are convertible into a total of 10 million shares of common stock. If the company's tax rate is 25%, then its diluted earnings per share (in CNY) are *closest* to:
A. 2.27
B. 2.30
C. 2.35

Question 2
An air services company entered into a contract with a city to build a new runway at an airport. The contract price is €100 million, and the company estimated its total project costs to be €80 million. The contract calls for construction to take place over four years, and the company does not anticipate any material changes to its costs nor any uncertainty about receiving payment. Each year's costs are listed in the following table:

Year	1	2	3	4	Total
Costs (€ millions)	35	15	13	17	80

The company reports under IFRS standards. The amount of revenue that this company will recognize cumulatively at the end of Year 2 is *closest* to:
A. €0
B. €50.0 million
C. €62.5 million

Question 3
.An analyst gathers information about a company's outstanding common shares (in millions) for fiscal year 20X7.

Shares outstanding on Jan 1	2,000
Shares issued on April 1	400
Shares repurchased on Oct 1	(500)
Shares outstanding on Dec 31	1,900

The company reported annual net income of CHF 500 million, paid CHF 40 million in preferred dividends, and paid CHF 30 million in common dividends. For 20X7, the company's basic earnings per share is *closest* to:
A. 0.21
B. 0.23
C. 0.24

Question 4
A company reported earnings per share (EPS) of £1.35 on net income of £2,200,000 for the most recent year. It had issued new common shares during the year, and its weighted average number of shares for the year was 1 million. At the end of the year, there were 1.5 million common shares outstanding. The company has no dilutive securities in its capital structure. The amount of preferred dividends paid last year, if any, is *closest* to:
A. £0
B. £180,000
C. £850,000

Question 5
A construction company is hired to construct a building for a total contracted value of €10 million. The estimated cost of the building is €8 million. At the end of Year 1, the company has spent €3 million. At this time, the contract is modified to include an extension. The total contracted price is changed to €12 million and the new expected cost is €9 million. The amount of catch-up revenue that the company should immediately recognize (in € millions) is *closest* to:
A. 0.25
B. 0.67
C. 1.00

Question 6
On January 1, a company has 50 million ordinary shares outstanding. During the year, the company pays INR 20 million in preferred dividends. On October 1, the company issues 30 million new ordinary shares. If the company reports INR 100 million of net income, then the company's basic earnings per share for the year is *closest* to:
A. INR 1.00
B. INR 1.39
C. INR 1.74

Question 7
An analyst collects the following year-end data on a company:

Selected Items from Financial Statement

(USD *millions*)	
Net revenues	100,000
Cost of goods sold	75,000
Administrative expenses	9,000
Depreciation	4,500
Interest	2,500
Income taxes	3,300

The company's operating profit margin is *closest* to:
A. 9.0%
B. 11.5%
C. 16.0%

Question 8
An analyst reviews a company's fiscal year-end common-size income statement:

Common-Sized Income Statement

Cost of goods sold	36.84%
Selling, general, and administrative	9.21%
Research and development	3.95%
Depreciation	1.84%

There are no other operating costs. If the annual research and development expense is ¥150 billion, then the company's operating profit is *closest* to:
A. ¥1,829 billion
B. ¥1,899 billion
C. ¥1,979 billion

Question 9
A company has the following capital structure, which has been in effect for the entire year:

Common shares outstanding, January 1	3,000,000
Convertible debt, 6% coupon, presently convertible into 1,000,000 common shares (at par value)	$5,000,000
Preferred stock, 8% dividend, $50 par value	$5,000,000
Net income	$5,000,000
Corporate tax rate	30%

The diluted earnings per share (EPS) that the company will report for the year is *closest* to:
A. $1.20
B. $1.23
C. $1.53

Question 10
An analyst gathers the following information about a company's most recent fiscal year:
- Net income: $50 million
- Weighted average common shares outstanding: 100 million
- Preferred shares outstanding: 2 million (each share paid an annual dividend of $1 and is convertible into 5 common shares)

The company's diluted earnings per share (in $) is *closest* to:
A. 0.45
B. 0.48
C. 0.49

Question 11
When analyzing income statements using common-size analysis, an analyst should *most appropriately* show:
A. tax expense as a percentage of pre-tax income.
B. bad-debt expense as a percentage of net income.
C. interest expense as a percentage of operating income.

Question 12
An analyst gathers the following data on a company at year end:

Net income	€12.25 million
Preferred dividends	€0.25 million
Exercise price	€20
Weighted average common shares outstanding	15 million
Employee stock options outstanding	2 million

If the number of stock options outstanding remained constant throughout the year and the average stock price was 25, then the company's diluted EPS (in €) is *closest* to:
A. 0.71
B. 0.78
C. 0.80

Question 13
A company receives CHF 500 today from a customer for a product that it will deliver two weeks from now. The company should *most appropriately* recognize CHF 500 of:
A. revenue today.
B. unearned revenue today.
C. cash two weeks from today.

Question 14
An analyst gathers the following information about a company for its fiscal year:

Selected Financial Statement Data (CAD *millions*)	
Common dividends paid	4
Preferred dividends paid	15
Net income	75

The weighted average number of common shares outstanding is 20 million, with 750,000 options outstanding at the beginning of the year. There are no other dilutive securities. If the options' exercise price is CAD 15 per share and the average market price of the stock is CAD 20 per share, then the company's diluted earnings per share is *closest* to:
A. CAD 2.77
B. CAD 2.89
C. CAD 2.97

Question 15
A company has agreed to build a multistory residential building for a contract sales price of $10 million, with delivery in four years. To complete the project, the company has contracted with a real estate developer, who estimates the total costs will be $5 million, although changes in construction methods may result in higher total costs. The company prepares its financial statements under US GAAP. If the company spends $1 million in costs on this project in Year 1, its reported revenue for Year 1 is *closest* to:
A. $0
B. $1 million
C. $2 million

Question 16
A company has 500,000 preferred shares that pay a dividend of $4 per share and 1 million common shares that pay a dividend of $1 per share. All shares are outstanding over the current year . If net income is $10 million, then the company's basic earnings per share for the current year is *closest* to:
A. $7
B. $8
C. $9

Question 17
A manufacturer operates two production plants: Plant 1 and Plant 2. After ten years, management restructures the company by closing Plant 2 and shifting its entire operations to Plant 1. All expenses, as well as any gains or losses, from the closure of Plant 2 are *most appropriately* be reported under:
A. extraordinary items.
B. discontinued operations.
C. unusual or infrequent items.

Question 18
A company has 10 million shares of common stock outstanding and has not issued or repurchased common stock this year. It issued 300,000 employee stock options several years ago, which are presently exercisable at $40 per share. The average market price per share for the company's stock this year is $30. It also paid dividends of $1 million on its nonconvertible preferred stock. If the company has a net income of $11 million this year, the company's reported EPS will be *closest* to:
A. $1.00
B. $1.01
C. $1.10

Question 19
At the end of its fiscal year, a company has net income of $8,750,000 and 1,000,000 weighted average common shares outstanding. It also has 200,000 shares of convertible preferred shares. Each preferred share pays a dividend of $15 per share and is convertible into two

shares of the company's common stock. There are no other potentially dilutive securities. The company would *most appropriately* report diluted earnings per share of:
A. $4.11
B. $5.75
C. $6.25

Question 20
Under IFRS, a company reporting bad debt expense should *most appropriately*:
A. write off the receivable when the customer fails to pay and recognize the write-off as a bad debt expense.
B. multiply the company's credit sales by its historical percentage of uncollectible receivables, and report that result as an operating expense.
C. multiply the company's average accounts receivable by the historical percentage of delinquent receivables, and deduct that amount from revenues to calculate gross profit.

Question 21
XYZ Corporation has 10 million shares of common stock outstanding and has not issued or repurchased common stock this year. Several years ago, it issued $10 million in bonds with 1,000,000 warrants attached. Each warrant allows the holder to purchase one share of XYZ common stock for $30. The average market price per share for XYZ stock this year is $40. It also paid dividends of $1 million on its nonconvertible preferred stock. If XYZ has a net income of $16 million this year, the diluted earnings per share that XYZ will report is *closest* to:
A. $1.36
B. $1.46
C. $1.56

Question 22
In 20X9 a publicly traded corporation reported $10 million in net income. The information concerning its common shares outstanding is shown below:

Date (20X9)	Action	Change in Shares	Shares Outstanding
1/1	Beginning balance		3,000
3/1	Shares issued	9,000	12,000
6/1	Shares repurchased	(3,000)	9,000
11/1	Shares issued	6,000	15,000
12/31	Ending balance		15,000

All shares in thousands

The company also has 500,000 shares of nonconvertible preferred stock, which have been outstanding the entire year. The annual dividend for each share of preferred stock is $5.00,

which has been paid. The basic earnings per share (EPS) for this company in 20X9 is *closest* to:
A. $0.50
B. $0.77
C. $1.03

Question 23
A manufacturer will voluntarily increase the useful lives of several different types of equipment it uses in its manufacturing process. The change will be effective for the current year. To account for this change in its financial statements, the company is *most likely* required to:
A. restate net income reported in all prior financial statements.
B. explain the change in the footnotes but not restate prior earnings.
C. restate net income for prior periods if it determines that the change is material.

Question 24
A company sells cloud-based accounting software. A 12-month subscription costs $3,000 payable in advance. If this company reports under IFRS standards, how much revenue will it recognize for the 4th month of each subscription?
A. $0
B. $250
C. $1,000

Question 25
A company finalizes a contract to sell a product that will be delivered to the customer 2 months from today. The customer will pay the full amount of the contract next month. If the company expects no problems in delivering the product or receiving payments, then it will *most appropriately* recognize revenue:
A. immediately.
B. when cash is received.
C. when the product is delivered.

Question 26
An analyst compiles the following information on a company:

¥ millions	20X1	20X2
Revenue	1,500	2,000
COGS	500	650
Selling, general, and administrative expenses	450	550
Depreciation and amortization	100	150
Operating income	450	650
Interest expense	80	90
Pretax profit	370	560
Income tax expense	111	140
Net income	259	420

The analyst decides to use a common-size income statement to evaluate the company. After the necessary adjustments are made, which of the following was the *greatest* contributor to the company's net profit margin expansion in 20X2?
A. Greater gross margin percentage
B. Smaller proportion of interest expenses
C. Smaller proportion of selling, general, and administrative expenses

Question 27
An analyst collects the following information on two companies:3

Modified Income Statement

	Company	
(€ thousands)	A	B
Revenue	20,000	15,000
Cost of goods sold	5,000	4,000
Gross profit	15,000	11,000
General and administrative	5,100	2,500
Depreciation	5,000	2,520
Operating income	4,900	5,980
Interest	–	1,500
Earnings from continuing operations before tax	4,900	4,480
Income taxes	1,460	1,900
Net income	3,440	2,580

Companies A and B paid common dividends of €200,000 and €250,000, respectively. Company A's net profit margin is *most likely*:

A. less than Company B's.
B. equal to Company B's.
C. greater than Company B's.

Question 28
On January 1, 20X8, Company Z issued convertible preferred stock that pays a dividend. Other than common stock, Company Z has issued no other securities. When an analyst calculated its basic and diluted earnings per share (EPS) for the year, the analyst found that basic EPS was $0.50 and diluted EPS was $0.55. Company Z should treat the convertible stock as:
A. dilutive and report only diluted EPS.
B. antidilutive and report only basic EPS.
C. dilutive and report both diluted EPS and basic EPS.

Question 29
A company has issued convertible bonds and has no other dilutive securities outstanding. If the convertible bonds are antidilutive, the impact on reported basic and diluted earnings per share (EPS) is *most likely* that:
A. basic EPS increases.
B. neither earnings measure changes.
C. both basic and diluted EPS are impacted.

Question 30
A company will report net income of €30 million this fiscal year ending 31 December. It began the year with 40 million common shares and neither issued nor repurchased common shares during the year. On July 1, the firm sold 100,000 shares of convertible preferred stock for €50 per share. The shares carry a 5% dividend and are immediately convertible into 20 shares of common stock. The effective tax rate is 40%. The company's diluted EPS for the year is *closest* to:
A. €0.71
B. €0.73
C. €0.74

Question 31
A company just sold a warehouse that it no longer uses. The sale price was $4 million payable in equal installments over four years. The buyer has paid the first installment of $1 million and is expected to make the remaining payments on time. The company carried the warehouse on its balance sheet at its net book value of $6 million. This year, the company will *most appropriately* recognize a loss of:
A. $0
B. $500,000
C. $2,000,000

Question 32
An analyst gathers the following information about a company for the most recent fiscal year:

- annual net income: HKD 500 million
- weighted average common shares outstanding: 250 million
- convertible debt outstanding: HKD 100 million at 9% interest, convertible into 10 million common shares
- tax rate: 33.33%

If there are no other dilutive securities, then diluted EPS (in HKD) is *closest* to:
A. 1.95
B. 2.00
C. 2.11

Question 33
Which of the following *best describes* a conservative approach for managing expenses?
A. Using estimates that maximize periodic expenses
B. Expensing the cost of warranties when they occur
C. Decreasing receivables when an account is deemed uncollectible

Question 34
An analyst collects the following information on a company for the most recent reporting period:

Net income	€100 million
Preferred dividends	€5 million
Weighted average common shares outstanding	150 million
Stock options	20 million
Exercise price	€30
Average stock price	€40

Based on this information, if the number of stock options is constant during the period, then the company's diluted EPS (in €) is *closest* to:
A. 0.56
B. 0.61
C. 0.63

Question 35
A company's 20X6 income statement is:

(¥ *millions*)	20X6 Income Statement
Revenue	200,000
Cost of goods sold	100,000
Operating profit	100,000
Rent	10,000
Marketing	30,000
Interest	20,000
Pretax income	40,000
Taxes	10,000
Net income	30,000

On the company's 20X6 common-size income statement, rent expense is *closest* to:
A. 5%
B. 10%
C. 33%